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The Impact of Due Diligence Legislation on International Trade and Business: An Analysis of Potential Trade-Offs

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Summary

As countries increasingly adopt due diligence legislation to promote human rights, labor standards, and environmental sustainability in global value chains, a complex dilemma arises. While these laws commendably aim to address moral and political issues in international trade, they may also impose significant costs on companies, potentially disincentivizing investment and trade. This study examines the impact of due diligence laws on international trade and business, analyzing some 60 cases. We explore their unintended consequences, including the potential withdrawal of investors from partner countries, reduced trade, including of strategic commodities, and increased costs of compliance leading to competitiveness concerns. Our research categorizes different forms of legislation, investigating whether current due diligence laws are well-designed to achieve their goals without producing unwanted side effects. We end with a brief set of suggestions for a future research agenda.

Keywords

due diligence legislation, global value chain, international trade, international business, human rights

JEL Classifications

F13, F16, K33

Abbreviations

ADCs	Developing countries
DRC	Democratic Republic of the Congo
EMEs	Emerging economies
EU	European Union
FTAs	Free Trade Agreements
GVCSs	Global Value Chains
ILO	International Labour Organization
NTIs	Non-trade Issues
OECD	Organization for Economic Cooperation and Development
TSD	Trade and Sustainable Development
UDHR	Universal Declaration of Human Rights
USA	United States of America

1. Introduction

The majority of the world's nation-states have committed themselves to adhere to universal human rights and labour standards, as documented for instance in their signature of the Universal Declaration of Human Rights (UDHR) and a number of declarations of the International Labour Organization (ILO).

Nonetheless, when it comes to the implementation, 'the human rights embedded in the UDHR are far from realized today', as declared in a 2016 report by the Global Citizenship Commission (Brown, 2016). As a result, the issues of human rights and labour standards, alongside environmental standards in global value chains, have becoming increasingly important in trade policy formulation and trade negotiations between developed and developing countries (Borchert et al., 2021; Meissner & McKenzie, 2019; Richer, 2023). A related but distinct issue is the evolution of due diligence laws created in the home country jurisdiction of multinationals that create legal obligations in third countries to monitor and enforce human rights and labour standards (Bonnitcha & McCorquodale, 2017; Ramasastry, 2015).

These developments have coincided with intense political and societal discussions in developed countries over the roles of international trade and international business relations in addressing moral and political issues that stretch across national borders (Allendoerfer et al., 2020; Peterson et al., 2018; Wettstein et al., 2019). Key actors in this debate include consumer groups, non-governmental organizations, and political parties responding to increased social and political awareness of these issues in recent years. An important aspect of this debate concerns the degree to which developed country multinationals should implement home country human rights and labour standard directives across their supply chains when operating in third countries. While multinationals are expected to implement and monitor the 2011 United Nations Guiding Principles on Business and Human Rights within their direct operations,[5] these are not hard legal obligations, but rather constitute 'soft' international law that lack enforcement mechanisms (Van Tulder et al., 2021). National due diligence legislation involves both enforcement mechanisms and hard legal obligations, but also typically entails far-reaching obligations that impose large costs and operational challenges concerning the implementation of domestic law in foreign jurisdictions. Furthermore, such actions may not only affect developing countries' living standards, but also reduce the economic welfare of developed countries by imposing additional costs on the production and delivery of goods and services thereby disincentivising investment to begin with. The situation is extremely complex against the background that action in liberal democracies who are primarily driving such legislation is politically sensitive.

In this paper, we focus on the implications of developed countries' due diligence laws for international business and trade. This legislation is directed at environmental sustainability, human rights adherence, and social issues in the global value chains (GVCs)[6] of their companies. Companies' obligations range from controlling and reporting their supply chains to enforcing environmental sustainability and human rights within the supply chain. There are also differences in the consequences for neglecting the obligations. The legislation across countries also differs with respect to the range of targeted countries and areas of business. All in all, we have analysed some 60 examples of due diligence legislation.

The legislation affects a range of social and political interactions and, therefore, needs a thorough analysis to be fully understood. While universal human and labour rights have been formally accepted

5. Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework, UN Doc. HR/PUB/11/04 (2011), available at http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

6. We use the terms supply chain and value chain synonymously and abbreviate with the international standard GVCSs.

by most countries, in practice there are ongoing serious and systematic breaches in many authoritarian and undeveloped countries that have become increasingly visible in liberal democracies (Murphy, 2021; Zenz, 2023). This creates a major dilemma for liberal democracies importing goods produced under conditions in breach of core domestic values and laws, or for businesses from liberal democracies investing in economies where such abuses are occurring, or at risk of occurring, within the supply chain. At the same time, taking China as example, much trade and business investment occurs under acceptable conditions, hence it is a policy challenge to address the portion of trade that is problematic.

Therefore, developed countries legislating ever more stringent due diligence laws face a trade-off. On the one hand, most citizens are increasingly unwilling to consume goods and services produced under inhumane or environmentally unfriendly conditions, as political pressure for due diligence legislation and values-based trade indicates. They want to see agreements and legislation that address these issues. On the other hand, the same consumers wish to maintain their living standard and may accept enforcing adherence to Western standards that requires imposing further costs on doing business. With the implementation of sustainable-supply-chain-legislation, costs of production increase for Western companies, while other producers – notably from China, Russia, or other autocratic countries – do not face these costs and appear as more flexible and less paternalistic to many governments and citizens in developing and emerging economies.

We address this trade-off by looking at unintended consequences of due diligence legislation. Especially, we ask the question of what the potential effects of due diligence legislation on domestic companies and international relations are. With this analysis, we can then start to explore whether current due diligence legislation approaches are well-designed to achieve their goals without producing unwanted side effects. Such unwanted side effects could be the withdrawal of developed country investors from partner countries, or reduced trade between developed and partner countries as consequences of increased costs of compliance.

To explore this fundamental question, in section 2 we categorize different forms of legislation depending on the obligations laid down in the respective law. In section 3 we provide an overview of the literature, addressing the theoretical understanding of the effects of due diligence on economic costs and behaviour. In section 4 we derive a number of propositions to guide future research and further empirical work. Hence this paper is aimed at building insights and testable propositions for an emerging research agenda on due diligence legislation. Section 5 summarises our main findings regarding a future research agenda.

2. Due diligence legislation: A categorization

Before we can analyse consequences of due diligence legislation, we must be able to understand the differences between these laws. Depending on the intensity of compliance obligations, the costs of conducting business in, or with, target countries also differ.

At the margin, we can expect cost impacts due to newly introduced compliance rules. The number of laws enacted in the last thirty years is sufficiently large to observe systematic differences.

Based on our examination of some 60 due diligence laws adopted in the Oceania, North American, and European contexts, we identify three principle approaches to due diligence laws: (1) pure reporting obligations (Reporting Mechanism); (2) the prohibition of certain practices (Import Control Mechanism); and (3) detailed prescriptions (Prescribed Conduct Mechanism). Another dimension is the regional focus — does the law relate to all countries, in other words is it non-discriminatory, or does it target one or more named countries or regions within a country or countries? Finally, special sectors may be targeted instead of a general application.

Under the **Reporting Mechanism,** targeted firms are obligated to produce reports in accordance with prescribed regulations. In North America, this is seen in the *California Transparency in Supply Chains Act* in the United States (USA) and the *Fighting Against Forced Labour and Child Labour in Supply Chains Act* in Canada. In the Oceania context, this approach, and due diligence regulation of supply chains more generally, is only to be found in Australia's *Modern Slavery Act 2018* (Commonwealth) and *Modern Slavery Act 2018* (New South Wales). In Europe, the reporting mechanism exists within the United Kingdom's *Modern Slavery Act (2015)* and France's *Duty of Vigilance Law (2017)*.

Generally, these laws require certain — not all — entities to report. Coverage criteria include employment and turnover thresholds, sectors, types of entities (public versus private and different kinds of private entities). A key consideration in making these choices is whether one wishes to target a certain industry or all industries. By targeting all industries, one may be more effective at combatting modern slavery everywhere, at the expense of burdening some entities that have a near zero chance of modern slavery risks. Alternatively, by targeting a specific industry, one may be effective in combatting modern slavery in troublesome industries and avoiding burdening non-troublesome industries, at the risk of allowing some degree of modern slavery to persist.

There is also the matter of what covered entities should report. Generally, these obligations are set out in the governing legislation and cover basic data on the entity and its supply chains, its due diligence policies, and risks identified in its supply chains, remedial measures taken to alleviate forced labour when found in the supply chain (although this is not present in the Australian legislation), and training measures instituted to elevate employee as well as supplier awareness of the company's due diligence policies. However, there are some important differences in these countries governing legislation. The Californian approach creates an enticement for entities to conduct due diligence in accordance with what they are expected to report about, namely, conduct audits and require certifications of suppliers.

The more general nature of the Australian and Canadian approaches leaves it to the entity to decide what constitutes best practice for due diligence by asking it to report on what it is actually doing, not on certain things it may or may not be doing. The French reporting obligations are different again, where they are to produce a plan to combat human rights risks and report on that plan's effectiveness, rather than the broad approach taken in the other jurisdictions.

The next issue is to determine what should happen if an entity fails to meet these reporting obligations. Each jurisdiction takes a different approach to this question with punishments varying in degree of severity. On the lesser end of the spectrum, in which severity is seen through the lens of tangible punishment, lays the Australian "name and shame" approach in which the relevant Minister can publish defined information on the Modern Slavery Register should an entity not comply with their reporting obligations. On the other end, in which punishment is the most severe, lays the French civil liability, with redress through the courts, and Canadian defined offences and corresponding punishments approaches. The Canadian approach defines two levels of offence, being the failure to report and/or disclose the report to shareholders, and provision of misleading information in the report itself with penalties for successful convictions being restricted to fines. The Californian/United Kingdom injunctive relief approaches lay somewhere in between, in both cases empowering the relevant public official to impose sanctions to compel compliance, pursuant to pursuing such sanctions via the appropriate court.

The **Import Control Mechanism** uses customs law to prohibit the importation of products that have been produced using prescribed prohibited processes. In the North American context, this approach is seen within the United States *Uyghur Forced Labor Prevention Act* and the Tariffs Act of 1930. It is also seen within the Canadian *Fighting Against Forced Labour and Child Labour in Supply Chains Act.* In the Oceania context, such mechanisms do not exist but could theoretically exist pursuant to the *Customs Act 1901* (Commonwealth).

The import control mechanism uses often long-standing customs legislation that was never explicitly designed to regulate supply chain due diligence. While it does not require due diligence in theory, it requires it in practice if an entity wishes to consistently import its product without interference from customs officials. It applies only to those entities that import products.

The precise design depends on how two key questions are answered: 1) what type of processes should be prohibited, and 2) should the controls be global or specific to a geographic target? Both the US and Canadian approaches proscribe forced and child labour, but differ in their approaches to defining what child labour means with the Canadian legislation adopting a wider definition. Taking a too narrow approach is likely to lead to legal importation of products, despite their ethically dubious production methods. On the other hand, taking a wide approach can result in the prohibition of a significant number of imports, which has its own associated challenges. Within the Australian context, section 50 of the *Customs Act 1901* (Commonwealth) permits the Governor-General, by way of regulation, to prohibit the importation of goods in specified circumstances. This provision would allow the Governor-General to prohibit the importation of goods produced through forced or child labour, however defined. However, current regulations, as codified in the *Customs (Prohibited Imports) Regulations 1956* do not prohibit imports based on child/forced labour, or otherwise like grounds.

Generally, an import control mechanism will apply globally, as is the case with the US *Tariffs Act of 1930* and the Canadian *Fighting Against Forced Labour and Child Labour in Supply Chains Act*. The rationale being that forced/child labour occurs globally, therefore it makes most sense to regulate globally. However, the *Uyghur Forced Labour Prevention Act,* pursuant to section 3, creates a rebuttable presumption that imports are to be prohibited with respect to "... goods, wares, articles and merchandise mined, produced, or manufactured wholly or in part in the Xinjiang Uyghur Autonomous Region in the People's Republic of China...". The potential for this approach also exists in the Australian context. Pursuant to section 50(2)(b) of the *Customs Act 1901* (Commonwealth), the Governor-General is permitted to prohibit the importation of goods from a specified place. In fact, pursuant to the *Customs (Prohibited Imports) Regulations 1956,* imports of certain goods from the Democratic People's Republic of Korea, Iran, Eritrea, and Libyan Arab Jamahiriya are prohibited. While these geographic provisions targeted the trade of arms and paramilitary equipment, and other associated equipment, there is no reason to suspect that such measures could not be used to target products produced using forced/child labour.

The **Prescribed Conduct Mechanism** is predominantly found in Europe, and operates in tandem with the "reporting" and "import control" mechanisms. It manifests in two ways. First, through legislation, such as the Norwegian *Transparency Act,* prescribing how a company undertakes due diligence. It prescribes both the scope of due diligence conduct, through its understanding of what due diligence means for the purposes of the act, and the method in which it is to be undertaken through its reference to the *OECD Guidelines for Multinational Enterprises.* This naturally differs from the Oceanic approach where due diligence practice is left largely for firms to decide, guided only by broad reporting criteria and a consumer expectation of thorough investigation to merit legitimacy.

Second, Section 7 of Germany's *Corporate Due Diligence Act* prescribes the remedial action that an enterprise is to undertake when faced with a human rights related issue in their supply chains. This is a unique approach to due diligence in which the law prescribes what action a corporation is to take both in anticipation of identified risks and if those risks are realised. Spelling out what a corporation is expected to do to be seen as conforming to the law makes it easier to comply. Its prescriptive nature can reduce costs and, more importantly, the efforts of adhering to due diligence legislation. Naturally, the time and cost implications additionally turn on how burdensome such expectations may be. It further prevents variance in approaches that a less prescriptive approach would yield, that would see differing levels of success depending on how seriously a corporation took its obligations. Conversely, prescribing what measures are to be taken runs the risk of being ineffective should the standards so prescribed prove unproductive. It inherently prevents innovation and doesn't allow for corporations to tailor their due diligence response in accordance with their size and industry; a one size fits all approach may lose the nuance required for success.

This concept is entirely foreign to the Oceanic experience, which prescribes no such obligations.

3. Literature review

A (formal) theoretical analysis of the effects of due diligence legislation on trade, investment, income, the adherence to human rights and social entitlements as well as environmental quality does not exist.

The causal relationships and channels of causality are too complex to be captured in one model. Having this in mind, we initially conduct a literature review in the fields of political science, economics, and business administration to then develop our theoretical framework.[7]

Debates in the **political science and international relations literature** focus normatively on respect for human rights and environmental concerns in GVCs. Among many themes, the effects of legalized human rights and environmental due diligence rules, and their effectiveness, are relevant. This literature rarely discusses unintended consequences of mandatory due diligence laws as they are widely interpreted as steps in the right direction (e.g., Gustafsson et al., 2023; Schilling-Vacaflor, 2021).

That said, the increasing use of due diligence legislation across Organization for Economic Cooperation and Development (OECD) countries is seen as being positive for the enhancement of human rights and environmental sustainability. Therefore, if there is a critical perspective, the literature analyses remaining shortcomings in the realization of human rights and environmental due diligence and the conditions under which governments can enforce it effectively. These shortcomings include the perceived lack of stringency (Moser & Leipold, 2021; Partzsch, 2020), challenges in the harmonization of policies among European Union (EU) member states (Zeitlin & Overdevest, 2021), allegations of symbolic compliance with due diligence obligations (Monciardini et al., 2021), and weak enforcement by states (LeBaron & Rühmkorf, 2019).

The **economic literature** in the field of due diligence legislation is mostly of a positive nature. It does not give much

7. There is also a large legal literature, which does not focus on the effects of this legislation.

emphasis on judging due diligence legislation normatively.[8] Thus, the literature can be distinguished into three sub-fields: (1) descriptions and interpretations of the laws; (2) consequences of due diligence legislation including effects on trade flows and jobs in both the law-imposing and the target countries respectively, as well as unintended side-effects such as withdrawals of Western companies' foreign direct investment from developing countries thus leaving room for investors from autocracies without any interest in human rights adherence; and (3) political economy analyses of the causes of different forms of due diligence legislation.

As regards the first group, the European Commission (2020) has published a comprehensive study on due diligence legislation of OECD countries, observing the market practices of companies, reviewing regulations, and discussing policy options including their impact on economic welfare and sustainability. In a similar vein, Loch et al. (2023) do this for conflict minerals related legislation. Garnizova (2018) discusses the nature and cause of changes in the use of non-tariff measures in the EU's trade policy, thereby touching upon non-trade issues (NTI). Velut et al. (2022) introduce the reader to trade and sustainable development (TSD) clauses in EU free trade agreements (FTA) with mostly developing countries and emerging economies. These contributions to the literature are mostly positive in nature, refraining from value judgements. Draper et al. (2023) map the challenges of due diligence legislation and argue that human rights adherence follows a historical trajectory, as it can be interpreted as a frontier along which societies change and place an increasing weight on human rights and environmental standards.

In the second group, one can distinguish theoretical and empirical analyses of applying or even imposing industrialised countries' standards and values on trade, investment, and political developments. Applying industrial economic theory, Beaulieu and Gaisford (2002) analyse the effects of labour and environmental standards on international trade and discuss appropriate policy measures against 'social dumping'. Zhao (2009) theoretically analyses the effects of labour standards in international trade on investment relations, welfare, and jobs in developing countries. Under the assumption that higher standards benefit workers, a higher standard imposed on developing countries by an industrialised country through trade policy may indeed increase welfare and standards in the latter. Otherwise, the results change. Freytag (2020) as well as Felbermayr et al. (2021) assess the *Act on Corporate Due Diligence Obligations in Supply Chains (Lieferkettensorgfaltspflichtengesetz)* before it came into force on the 1st of January 2023, and conclude that it bears more economic risks than opportunities and may be ineffective with respect to its main objectives.

These mixed theoretical results beg empirical assessments, which in general are rather critical and do not support the claim that due diligence legislation fulfils its objectives of human rights adherence and the improvement of workers' situation in developing countries. The evidence collected so far concentrates on case studies and surveys. There are a few econometric analyses, but the data base is generally too small to run meaningful regressions, since the laws are mostly too young.

The third group of contributions does not address the welfare implications of due diligence legislation, but is interested in the drivers behind such legislation, thereby taking an explicit political economy perspective. This perspective assumes that governments are not necessarily benevolent in the sense that they only focus on economic welfare, but also consider their own utility such as re-election, increase of budgets, or ideological positions.[9] This literature is important to understand the consequences and effects of the legislation better. If governments are using it as instruments to get re-elected, they might not be interested in the effects, even if they are detrimental.

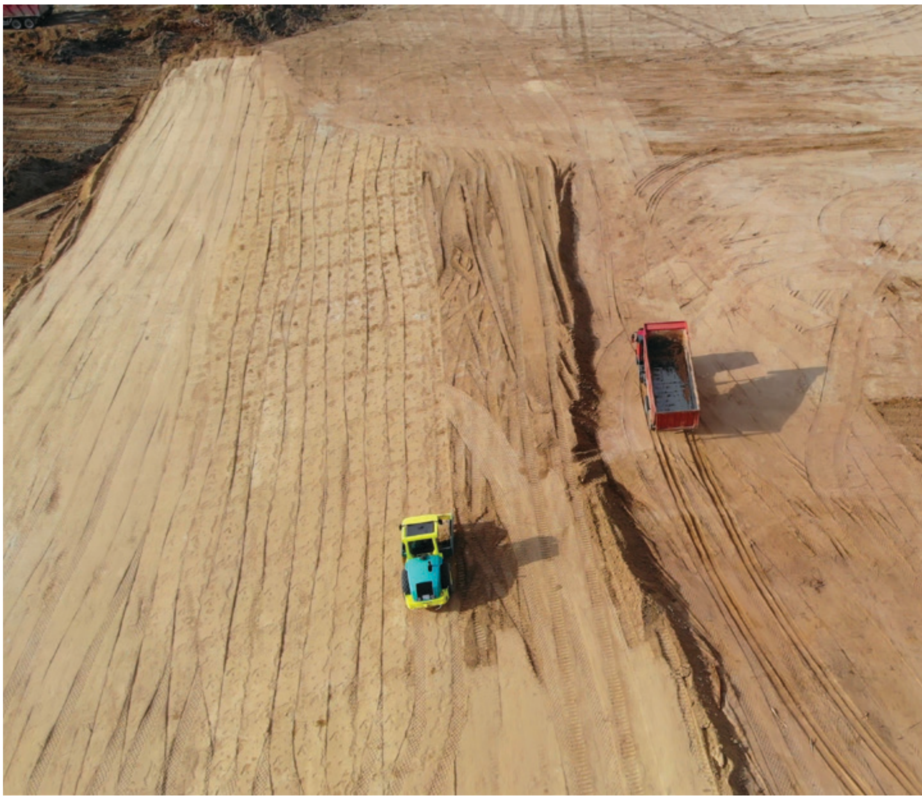
In her paper, di Floristella (2021) shows that the EU is responding strategically to human rights violations: whereas Cambodia is treated rather harshly, the violations in Vietnam are mostly accepted. Similarly, Lechner (2016) shows that NTIs' treatment through TSD clauses in EU free trade agreements (FTAs) is dependent on strategic interests the EU may have. Analysing the shipping costs in China and Europe, Gunter (2021) sees a justification for higher European standards imposed on competitors to level the playing field, which suggests multiple reasons for due diligence legislation; it is driven by humanitarian, political, and economic reasons.

The **business administration literature** is more focused on firms' competitiveness than the economics literature and addresses the impact of human rights and environmental due diligence legislation on competitiveness and innovation. In today's globalized economy, the competitiveness of firms hinges not only on traditional factors like cost-efficiency and quality but also on their ability to innovate and adapt to rapidly evolving business landscapes and changing regulations (Isaksen, 2001). Concurrently, legislative frameworks and public policies have increasingly emphasized corporate responsibility, particularly in the realm of global supply chains, to respect human rights and protect the environment (Lund-Thomsen & Lindgreen, 2014).

8. Exceptions are Fridell (2010) or Dommen (2022), who take a critical stance towards mainstream economics and claim that it does not help the poor and should be replaced by so-called heterodox approaches.

9. An interesting contribution by Woodberry (2012), a political scientist who does not look at due-diligence legislation, argues that democratisation efforts by Western countries can be understood by looking at the missionary history of protestant countries. Indeed, many of the countries imposing due-diligence legislation have a protestant background.

Whereas the traditional understanding of competitiveness revolved around the efficiency of production processes, cost management, and market share, contemporary approaches are more comprehensive, encompassing among others responsible business practices and ethical considerations (Bhawsar & Chattopadhyay, 2015). Firms that align themselves with human rights and environmental due diligence laws can enhance their competitiveness by meeting evolving consumer preferences for ethically sourced and sustainable products. Compliance with such laws not only ensures a company's legal standing but also bolsters its reputation and appeal to socially-conscious consumers. These laws might further encourage firms to develop novel approaches to supply chain management, traceability, and ethical sourcing. Firms that proactively embrace these challenges can not only comply with the law but also gain a competitive edge by being at the forefront of responsible and sustainable business practices. Hence, compliance with responsible business practices not only upholds legal standards but also enhances competitiveness and might contribute to market leadership (Lise et al., 2020). Adhering to human rights and environmental due diligence legislation would thus increase transparency, support risk mitigation, enhance resource efficiency, broaden market opportunities, strengthen brand reputation, and attract talent. In essence, legislation related to human rights and environmental due diligence can act as catalysts for firms to become more innovative. It pushes them to find creative solutions to address legal requirements, while simultaneously fostering responsible and sustainable business practices. These innovations not only ensure compliance but also position firms favourably in a market where consumers increasingly value ethics and sustainability. These positive impacts yet would only fully occur if (national) legislation could be equally applied to all firms operating on the (global) market – which is often not the case (Rühmkorf, 2018).



However, due to the different application of human rights and environmental due diligence legislation across countries, there might occur multiple downsides in terms of competitiveness and innovativeness for domestic firms that need to be considered and that might even outweigh potential positive effects (Gustafsson et al., 2022). First, meeting the rigorous standards set by such legislation can be expensive. Firms may need to allocate significant resources to ensure they are complying. This can strain their budgets and affect their competitiveness, particularly for smaller businesses as the administrative burden of due diligence can be substantial. Firms must allocate time and manpower to gather, analyse, and report on various aspects of their operations. These bureaucratic processes can divert energy and focus away from innovation. Second, in an effort to minimize legal and reputational risks, firms may become risk-averse. They might be less inclined to invest in novel technologies, products, or services that carry uncertainty, thereby hindering their ability to innovate. Companies could also refrain from becoming active in certain markets. Legal interpretations and requirements may change over time, making it even more difficult for firms to plan for the future and invest in innovation with confidence. Third, to meet immediate compliance requirements, firms might prioritize short-term solutions over long-term innovative strategies. This can limit their ability to stay ahead in rapidly evolving industries. Fourth, strict compliance with due diligence legislation can put firms at a competitive disadvantage if their competitors prioritize innovation over compliance or are not required to follow certain (national) restrictions.

In conclusion, the relationship between competitiveness, innovativeness, and due diligence legislation is dynamic and complex. Compliance necessitates innovative approaches to supply chain management and risk mitigation. Firms that excel at integrating these innovations within their operations often reap benefits not only through compliance but also by differentiating themselves as responsible market leaders. Moreover, as consumers increasingly prioritize ethically sourced products, the alignment of innovation with legislative requirements becomes a source of competitive advantage and market leadership. However, there is also a downside of due diligence legislation leading to potentially decreasing innovation activities and reduced competitiveness. Hence, while due diligence legislation serves important societal goals, its impact on firm competitiveness and innovativeness requires careful consideration, as there are trade-offs (McCorquodale et al., 2017)

4. A theoretical framework to guide future research

Our review of different disciplinary perspectives dealing with the subject of due diligence legislation raises questions which take into account the obligations for domestic businesses dealing with delicate partners with respect to human rights enforcement and environmental sustainability: What are the potential effects of due diligence legislation and pressure on international relations? Are current due diligence legislation models well-designed to achieve their goals without producing unwanted side effects?

The answers to these two questions differ between imposing and target countries respectively. As for the imposing countries, it is necessary to understand how competitiveness of Western companies is affected. It could be subject to opposing trends: as costs rise, competitiveness may diminish; as consumers wish to consume "clean" or "ethical'" products, it may rise. Hence, additional questions arise: Do compliance costs for companies rise in linear, regressive, or progressive form? How do these economic effects affect innovative capacity of an ageing society and, therefore, productivity? Which economic consequences are induced, e.g., which jobs might be endangered through reduced competitiveness? Which social implications are triggered, e.g., the opposition to due diligence legislation in democracies?

In developing countries (DCs) and emerging economies (EMEs) other questions become relevant. Will production factors be reallocated owing to increased labour rights? Would adherence to human rights and labour standards decline if Western companies feel forced to withdraw from certain DCs and EMEs as companies from less strict countries might fill the gap and engage? Will official relations between DCs and EMEs improve or deteriorate? Does this depend on the willingness of DC and EME governments to adhere to standards?

Finally, it is interesting to understand what the effect on the global order in an increased systems competition will be. Does due diligence legislation maintain an advantage in standards setting? The "Brussels effect" (Bradford, 2020) is a key phrase here, indicating that actors in large export markets can set de facto global standards when many others want to serve this market.

It is impossible to answer all these questions in detail and conclusively without a complex model. In addition, most legislation is relatively young, implying that we do not have the data to feed such a model. Therefore, we focused on the empirical literature to derive some empirical patterns that allow us to draw preliminary conclusions. For this purpose, in the next three sub-sections we state three propositions derived from the theoretical literature and our categorization of legislation according to the obligations. These propositions do not flow from each other, and can be diametrically opposed given that they are sourced from a literature that draws varying conclusions from investigating similar matters. Since we have not conducted detailed investigations ourselves, we do not attempt to draw conclusions. Rather, we provide brief commentary on each, drawing on the literature reviewed.

4.1 Compliance

Proposition 1 is: Due diligence laws affect compliance with human rights and labour standards.

1a) Due diligence laws increase companies' compliance with human rights and labour standards.

1b) Due diligence laws enhance human rights and environmental sustainability in target countries.

1c) Effective due diligence laws consider the institutional background of target countries.

The literature suggests that due diligence legislation affects compliance. Empirical analyses of France's *Duty of Vigilance* Law lend support to the assumption that due diligence obligations have a positive impact on company compliance, especially among the most notorious "laggards" (Lafarre & Rombouts, 2022; Schilling-Vacaflor & Gustafsson, 2024). This is in line with a study by the European Commission (2020), analysing the need to impose due diligence standards. Companies asked about their motives to practise due diligence gave as motives reputational risks, the fact that investors demand high standards, and consumers' demand for them. Nevertheless, only a third of the questioned (some 300 companies) conducted due diligence at all. Rogerson et al. (2024) assess the reporting behaviour of the largest 100 EU-listed firms and show that they choose between three strategies: dismissal, concealment, and compliance, with dismissal being the dominant strategy in the disclosure policy of these firms. Obviously due diligence legislation encourages compliance.

This leads to the question of whether due diligence legislation affects human right adherence in target countries. Looking at one single case, Smith et al. (2018) show that imposing EU standards on the Moldavian economy does not fully take the institutional setting into account and misses its objectives. In addition, there has been a long discussion about the question of whether trade is adding to social problems in developing countries – often the discussion is led by lawyers and sociologists under the heading "social dumping". The empirical literature does not really support this claim, see e.g. Felbermayr et al. (2021) who argue that due diligence legislation may inhibit the integration developing countries into global value chains, potentially exacerbating human rights and social problems. Similarly, Maffei et al. (2006) explore the causes of child labour in developing countries and conclude that rather than trade, political repression drives it. Although not directed at due diligence legislation, this paper indicates that due diligence legislation is not a panacea for social problems in developing countries.

4.2 Trade-offs in trade and investment relations

Proposition 2 is: Due diligence laws affect trade and investment relations with DCs and EMEs.

2a) Compliance costs of companies with human rights and labour standards decrease trade and investment flows.

2b) Compliance of companies with human rights and labour standards improves the situation in DCs and EMEs and increases trade and investment flows.

2c) A change of trade and investment partners away from those that do not comply with human rights and labour standards (e.g., companies from other countries) will further decrease the adherence to human rights and environmental sustainability in the target countries.

The political discussion preceding the implementation of due-diligence legislation, as well as the empirical literature, suggest the potential for relevant trade-offs resulting from the legislation. Using a survey, Kolev and Neligan (2022) demonstrate that strict and biting due diligence legislation may deter investment from European firms in developing countries, leading to damage there. This would be the opposite of the intention of the legislation. In a first attempt to measure the effects empirically, Kolev and Neligan (2024) show that trade flows between Germany and apparel producers from risky sources have declined sharply already one year after the *German Act on Corporate Due Diligence Obligations in Supply Chains* entered into force. The authors conclude that this is at least partly due to the law. They also report the results of a survey among 737 German companies. Since the law raises the costs of German companies, some of whom had to hire personnel or employ consultancies to deal with the legal requirements, trade and investment flows are negatively affected. Some companies withdrew from countries perceived as too risky and relocate business. They also note that although the law officially only affects large companies, also small and medium enterprises are affected, as large companies want to make sure that they fulfil the law and demand according standards from all suppliers. That said, and as noted in section 4.1, only two thirds of companies surveyed by the European Commission (2020) actually complied with the legislation.

In an econometric analysis, Higashida et al. (2022) assess the effects of the USA *Dodd-Frank-Act* on the USA's trade with the Democratic Republic of Congo (DRC) and show a reduction of bilateral conflict minerals trade flows, which seems to be compensated for by trade diversion to other countries. To the extent those other countries are conflict countries, the purpose of the US legislation was not fully met. However, as shown below (Levin Sources 2021), the *Dodd-Frank-Act* contributed to better regulation in the DRC.

The disappointing result of Higashida et al. (2022) is emphasized by Murphy (2021), using the example of cotton from Xinjiang, which is hidden in global supply chains and seems to be exported via other places. This evidence is further supported by Pelkmans (2021) who does not see any positive effects of linking trade policy to NTIs such as human rights adherence or environmental standards. Sandkamp (2022) asks the question of the consequences of reshoring within the EU, i.e., the redirection of trade flows from all countries only to countries with the same set of values. He finds welfare losses for the EU. This can be interpreted as an indirect assessment of the effects of due diligence legislation, should it lead to decoupling of trade flows.

4.3 Different obligations and focus

Proposition 3 is: The implementation mechanisms of due diligence laws affect trade and investment relations

3a) Legislation focused on one or a few countries or sectors respectively, leads to less trade distortions than a globally applied rule. It may also be more effective with respect to the objective.

3b) The Reporting Mechanism is less distortive than the Import Control Mechanism and the Prescribed Conduct Mechanism respectively.

3c) The Reporting Mechanism is more investment friendly than the Import Control Mechanism and the Prescribed Conduct Mechanism respectively.

The International Labour Organization analyses experiences of due diligence legislation from developing countries' perspectives (Delautre et al., 2021) in a rather anecdotal way. An interesting result of its literature review is the claim that the reporting mechanism is leading to less compliance than the other two mechanisms; this is supported by Bédard et al. (2019). However, no evidence on the effects on trade and investment is given.

As Levin Sources (2021) show, a sectoral focus of due diligence legislation, in this case the US *Dodd-Frank-Act,* can trigger domestic activities to increase sustainable developments and according regulations in target countries. They study the mining sector in the DRC, which became subject to closer regulation after 2010, although there is much scope for further regulation left.

Although far from being conclusive, the empirical literature confirms that due diligence legislation is generating trade-offs for Western companies. Costs of doing business rise, contributing to reduced trade and investment flows as well as relocations and withdrawals from countries with a high perceived risk.

Such reaction may not be conducive to human rights adherence and sustainability in target countries. Nonetheless, the positive news is that due diligence legislation may contribute to better regulation in targeted countries, in particular if there is a sectoral or regional focus of the legislation.

5. Summary of potential research directions

Our analysis highlights the complexities and trade-offs associated with due diligence laws. While aiming to promote human rights and environmental sustainability, such laws may have unintended consequences for trade and investment relations.

Empirical evidence suggests that due diligence laws can increase compliance costs, leading to reduced trade and investment flows, relocations, and withdrawals from high-risk countries. However, sectoral or regional focus of the laws can contribute to better regulation in targeted countries.

Given the scant empirical analyses in this field, future research should investigate the long-term effects of due diligence laws, analyse country-specific impacts, and conduct comparative analysis of implementation mechanisms. Our propositions may serve as guidelines and suggestions for how to address these effects. The role of institutional factors, such as regulatory bodies and judicial systems, also warrants further exploration. Additionally, studies should examine the implications of due diligence laws on global value chains, including production relocation, trade pattern changes, and SME impacts.

By pursuing these research avenues, scholars can provide valuable insights into the complex dynamics surrounding due diligence laws. This knowledge can inform more effective policy interventions that balance human rights, environmental sustainability, and economic development. Ultimately, a deeper understanding of due diligence laws can help policymakers create more effective and sustainable solutions for promoting human rights and environmental sustainability in global supply chains.

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