



Subcontracting Is Not Illegal, But Is It Unethical?

Business Ethics, Forced Labor, and Economic Success

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DEEPENING CONCERN ABOUT FORCED LABOR and slavery has paralleled the rapid growth of the world's biggest retail and brand companies in the era of globalization. The risk of slavery and forced labor in global supply chains is now significant. The International Labour Organization estimates that at least 21 million people are victims of forced labor worldwide and the illegal profits derived from the extraction of forced labor by private business have been estimated to exceed \$44 billion.¹ At least 80 percent of forced labor occurs in the private economy and involves business in some way. From shrimp processed by debt-bonded workers in Bangladesh to cotton picked by children and forced workers in Uzbekistan, the worst forms of labor exploitation are increasingly linked to industry—particularly to transnational retail and manufacturing corporations.²

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Nongovernmental organizations (NGOs) and the social audit industry are currently working with corporations to “slavery-proof” supply chains against these illegal practices through voluntary, corporate social responsibility (CSR) initiatives. As NGOs have developed mechanisms to trace supplier labor practices back to corporations, retail firms have sought to manage risk and reputation by monitoring portions of their supply chains. They do so through social or ethical auditing as well as through collaboration with NGOs within multi-stakeholder initiatives like the Global Reporting Initiative, the Sustainable Apparel Coalition, and the Fair Labor Association.³ While these voluntary initiatives focus on a range

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of concerns—including environmental, health, and safety standards—measures to identify and prevent forced labor, trafficking, and slavery are an increasingly central component of these private governance initiatives.

Corporate involvement in antislavery efforts has also been driven by a recent wave of government legislation, which has raised awareness about the links between consumer products and slavery, human trafficking, and forced labor. California's Transparency in Supply Chains Act (2012), for instance, requires large companies to report on what they are doing to verify their supply chains against forced labor, trafficking and slavery. Canada, the United States, Mauritania, Brazil, and other countries have recently launched action plans to deal with the problems of trafficking and slavery, and as of March 2014 the United Kingdom has a Modern Slavery Bill before Parliament.

Given the flurry of voluntary and government initiatives, it would seem that in recent years there has been much positive change. After all, few corporations today would reject the notion that they have some responsibility for promoting labor standards in their supply chains. But the question of how far corporate liability and responsibility should extend within supply chains remains contentious. Corporate directors have argued that while they will not tolerate slavery, trafficking, or forced labor within their operations, it is ultimately the responsibility of their external suppliers to ensure compliance. After all, how could a mega-retailer like Walmart—which contracts over 100,000 suppliers—be responsible for labor practices within its continuously evolving, many-tiered production network? NGOs and international organizations have at least to some extent accepted this line of reasoning that corporate responsibility and liability for forced labor in their global operations must be limited given the complexity and length of their global supply chains. As the International Labour Organization has put it, “When modern supply chains are so complex there is the question of how far a company’s liability should extend.”⁴

Without diminishing the serious challenges that corporations face in governing complex supply chains, I argue in this article that framing the discussion in these terms overlooks the question of why supply chains have become so long and complex, and indeed the agency of corporations in restructuring production practices in this way. After all, corporations themselves have given rise to complexity and very high levels of subcontracting within both labor and product supply chains, as they have continually restructured production in recent decades to cut costs and reduce legal ownership to curtail liability. As corporations have moved toward arm’s-length contractual arrangements with suppliers, they have introduced the risk of highly exploitative labor relations



into their supply chains. After all, forced labor, slavery, and other forms of labor exploitation are not randomly occurring relations. Rather, they are a coherent management practice that suppliers use to balance contractual demands for low-priced production with quick turnaround times, short contracts, unstable demand, and quickening speed to market.⁵

Despite increasing evidence that subcontracting—and indeed, the very way that supply chains are organized—fuels exploitative labor practices, discussions of how to eradicate forced labor from supply chains have scarcely mentioned the political economy and ethics of the business models that promote subcontracting. Few academics, policy makers, or even NGOs have questioned the dynamics of subcontracting, perhaps because there is no law against it. Such practices are generally considered essential to economic success in competitive retail markets. Yet ethical matters remain at the center of efforts to confront the problem of slavery in supply chains. Moreover, if subcontracting is fueling practices such as forced labor and slavery, is it unethical? If so, how does this change our understanding of corporate responsibility for labor practices within global supply chains?

This article explores these unasked ethical questions. Section I documents the lengthening and growing complexity of supply chains, the result of corporate strategies to restructure production in order to cut costs and maximize flexibility. Section II argues that the dynamics of forced labor in supply chains are closely tied to the prevalence and complexity of subcontracting arrangements. The final section argues that subcontracting must therefore be understood not only as a technical or neutral business decision, but rather as an issue of business ethics. If prevailing models of economic success depend on subcontracting—which fuels illegal and unethical practices like forced labor—then this business model must be reconsidered as part of contemporary efforts to eradicate forced labor.

I. THE GROWING COMPLEXITY OF TRANSNATIONAL SUPPLY CHAINS

Walmart is now the world's largest retailer. In 2013 Walmart's net sales in the United States surpassed \$274 billion, while its international net sales surpassed \$135 billion.⁶ The *Financial Post* reported in 2012 that if Walmart were a country, it would be the twenty-sixth largest economy in the world and China's sixth largest export market.⁷ Walmart's economic success has been founded upon the low-cost, high-volume business model of production that currently reigns in the global economy. Retailers have pioneered and popularized this business model in recent decades as part of the retail revolution through which Walmart and



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similar corporations have dramatically remade global marketplaces.⁸

Like many other transnational retail and branded corporations, Walmart does not own any of the factories that produce goods sold in its stores.⁹ Rather, from its Arkansas headquarters and purchasing center based in Shenzhen,

Lead firms coordinate the production of goods through loose and arm's-length contractual relationships with thousands of independent suppliers.

China, Walmart designs, advertises, and buys products, which are then manufactured by suppliers. Since the 1970s and 1980s, when growing numbers of U.S.-based firms began sourcing from overseas to access lower-cost labor and increasingly sophisticated export manufacturing, many transnational corporations have transitioned from actual manufacturers into big brands. In 2014 firms like Gap, Apple, and Nike produce no actual goods themselves, but rather contract manufacturing and manage the logistics of delivery, shipment, and sale of goods produced under their brand through tightly coordinated supply chains.

At the heart of the big-brand retail business model, then, is the practice of subcontracting. Lead firms such as Nike and Apple issue purchase orders for goods, then coordinate the production of those goods through loose and arm's-length contractual relationships with thousands of independent suppliers. With their power, size, and markets, lead firms can dictate the price and speed to market associated with the manufacture and delivery of products.¹⁰ As Walmart describes in its 2013 annual report, "Our purchase orders are based on current inventory needs and are fulfilled by our suppliers within short time periods. We also enter into contracts for outsourced services; however, the obligations under these contracts are not significant and the contracts generally contain clauses allowing for cancellation without significant penalty."¹¹ Since lead firms operate in highly competitive markets, the growing discount global economy means that corporations are under constant pressure to cut the retail prices of their goods.

The big brand retail business model has developed to continuously cut the cost of production and maximize lead firms' flexibility in ordering and logistics. Retail and manufacturing companies' scale and market power allows them to impose slim profit margins and quick turnaround times onto their largely overseas suppliers. While exact contract lengths are difficult to calculate since governments do not collect systematic information about subcontracting and retailers consider this type of purchase order data proprietary, Walmart suppliers have reported that contract periods can be as short as 45 days.¹² In recent years speed to market has been picking up pace in many industries, and in some mar-



kets—such as fashion—contracts can even be under six weeks, giving suppliers very little time to complete orders.¹³ Profit margins vary hugely across the high and low ends of the retail market, but the high-volume, low-price retail model means that suppliers across many industries are “squeezed” by lean margins.¹⁴ It is generally the case that the further down the supply chain, the lower the supplier profit margins.

Significantly, as Peter Dauvergne and Jane Lister estimate, “one-third of global gross domestic product (GDP) and 70% of all employment and activity in developed countries is now tied to retail,” allowing lead firms to command significant power and control over their supply chains.¹⁵ Tight and tough production schedules, unsteady demand, cancellation of contracts, and slim profit margins imposed by lead firms fuel subcontracting along the product supply chain. The race to fulfill orders on time within shorter and shorter contract lengths has led the Tier 1 suppliers (who contract directly with retailers like Foxconn does with Apple) to source parts from and subcontract out activities—particularly labor-intensive activities—to additional firms.¹⁶ Today, the production processes associated with a single good can span many different countries and can involve dozens, if not hundreds, of suppliers. For instance, an Apple iPhone contains glass produced in Taiwan and Japan, metals from Asia and Africa, circuitry from Korea, microelectronics from Morocco, semiconductors from Germany and Malaysia, and is assembled in China across 18 final assembly facilities.¹⁷ Apple’s top 200 suppliers include factories located in Taiwan, Portugal, Thailand, Korea, Germany, Malaysia, Indonesia, Singapore, Japan, China, Vietnam, Mexico, Israel, the United States, the Czech Republic, Italy, Ireland, Netherlands, Brazil, and many other countries.¹⁸ Each of these suppliers subcontracts activities to other firms, who further subcontract or outsource activities. The result is a layered and dynamic multitier system of production.

Retail business models have fueled the growing length and complexity not only of product supply chains, but also of labor supply chains.¹⁹ In the face of tight turnaround times and unstable orders, supplier firms use labor market intermediaries—such as labor contractors or agents—to temporarily supplement their core workforces for periods of high-intensity production. Facilitating the increased flexibility of labor in competitive markets, intermediaries may either provide workers access to employment—creating a “triangular employment relationship”—or employ workers directly, supplying a certain number of workers in exchange for a fixed rate. Labor market intermediaries often recruit and come to deploy workers through long and informal supply chains. Apple described the labor contractors used in its supply chain by saying, “Some of our suppliers



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work with third-party labor agencies to source workers from other countries. These agencies, in turn, may work through multiple subagencies: in the hiring country, the workers' home country, and in some cases, all the way back in the worker's home village."²⁰

The use of contract workers is a strategy to avoid the costs and obligations associated with direct employment, or, as Nicola Phillips has put it, to "shed the costly necessity of retaining a permanent and stable workforce."²¹ Growing numbers of workers enter global production processes through these long and often informal labor supply chains as suppliers attempt to meet fluctuating

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orders, keep costs low, and promote labor flexibility amid unpredictable demand. Contract workers may work alongside core workforces in factories or fields, but suppliers' accountability for their working conditions is limited. Workers who are not

directly employed are often not on the books and can be very difficult to track by lead firms and social auditors. While the exact number of contract workers in global production is difficult to measure, contract workers are thought to be widespread and growing. A recent multi-industry study carried out across five countries (Costa Rica, India, South Africa, Vietnam, and the United Kingdom) found extensive use of labor contractors in four countries (all except Vietnam).²²

In short, complexity and increasingly high levels of subcontracting within both labor and product supply chains are rooted in core dimensions of the retail-driven transnational production model. As lead firms have forged a model of economic success grounded in low-cost, high-volume production, they have sought to cut production costs and reduce responsibility and liability for the risks associated with this business model through arm's-length contractual relationships with mostly overseas suppliers. This has fueled high levels of subcontracting and outsourcing along product and labor supply chains. Supply chain fragmentation is therefore not an automatic or spontaneous process, but rather a business strategy to facilitate economic success—at least in part by distancing lead firms from risk. These risks are then transferred onto suppliers, who in turn distance themselves and attempt to ensure economic success through further subcontracting. One of the most significant and growing liabilities from which firms are attempting to distance themselves is that of forced labor.

II. THE ETHICS OF SUBCONTRACTING

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It is no coincidence that concern about forced labor and slavery has emerged alongside these ever-more complex forms of subcontracting since mounting evidence suggests that supply chain fragmentation is fueling forced labor within global supply chains. While the causes of forced labor, trafficking, and slavery in the global economy are multifaceted and complex, a growing body of evidence suggests that forced labor and slavery are concentrated in the sectors and portions of supply chains where subcontracting and outsourcing are the highest.²³ In Brazil and India, slavery and forced labor are concentrated in subcontracted production activities like the manufacture of garments as well as in outsourced production of labor-intensive commodities, such as soybeans, coal, cotton, and sugar.²⁴ Within global manufacturing hubs such as Vietnam and China, forms of severe labor exploitation tend to be concentrated beyond first-tier suppliers although forced labor continues to occur within first tier suppliers as Apple's recent discovery of child labor confirms.²⁵ Forced labor and especially debt bondage are also linked to the presence of subcontracting within the labor supply chain in a wide range of industries and countries, including in South Africa, Malaysia, and Bolivia.²⁶

The links between forced labor and subcontracting are not coincidences, but rather are grounded in key facets of the retail business model. As supplier firms struggle not only to meet tight order deadlines and turn a profit, but also to minimize the risk of losing retail contracts over labor or environmental violations, they subcontract activities to other firms and factories that are usually smaller. In these firms exploitative practices generally evade retail monitoring systems like auditing. While retailers continuously state their expectation that supplier firms will adhere to retailers' labor and environmental standards as well as national laws, specific labor standards are rarely integrated directly into commercial agreements. As one retail CSR director put it, "There is no greater power than a purchase order. The power relation begins and ends with the buyer's signature. All the rest that floats around it is talk...until your buyer says you care [about the environment and workers] in the purchase order, you don't care."²⁷ In practice, this means that suppliers often prioritize the need to get high-quality goods produced and delivered on time over labor standards set by corporations.

While not all outsourcing and subcontracting necessarily involves forced labor, it has been persuasively demonstrated that subcontracting leads to lower labor standards and reduced rights for workers.²⁸ Much of this subcontracting is unauthorized and unregulated. For instance, in the garment sector, labor-intensive activities like sewing, dying, and beadwork are subcontracted to unregistered "shadow factories," in which exploitative labor practices are a core part



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of the business model.²⁹ As shadow factories generally evade retail-monitoring systems, there is often little incentive to promote labor standards. Indeed, the opposite can be true—since these facilities are designed to help larger suppliers meet tight turnaround times at a low cost, their competitive advantage can be high levels of overtime and severe forms of labor exploitation, including child and forced labor.³⁰ For instance, a study of Unilever’s Vietnam-based suppliers found that in spite of Unilever’s ambitious global CSR program, its factories were largely non-compliant with labor and human rights standards. As *The Guardian* reported, one factory found “offering excessive overtime gave it a competitive advantage.”³¹ An auditor with over ten years of experience monitoring factories in China estimates that “99 percent of factories have a ‘shadow’ to help them meet retailers’ demands.”³²

Recent disasters have brought these forms of unauthorized subcontracting have been brought to light. For instance, in the aftermath of the collapse of the Rana Plaza garment complex in Bangladesh in 2013, one retail CSR director remarked, “Many of the brands that found themselves in the factory were as surprised as the next person to find their brand in there. And the immediate defense was, ‘We never gave work to that factory and the people who gave them the work were in violation of the contract.’”³³ Similarly, many brands whose goods were found in the aftermath of a fire at Tazreen Factory, which killed 112 workers in Bangladesh, denied having authorized production in that factory. As Disney explains on their website, “Tazreen was not an authorized supplier for Disney-branded product... Disney did not authorize the movement of products to Tazreen. As described, the movement of this product and its storage at an unauthorized factory is a violation of our policies and requirements.”³⁴

In addition to being fueled by subcontracting along the product supply chain, forced labor is also fueled by subcontracting along the labor supply chain. Like producers, labor market intermediaries, such as labor contractors or “agents,” use forced labor as a cost-saving and revenue-generating strategy.³⁵ Of course, not every labor contractor is exploitative. The industry is geared toward supplying workers to meet peak demands in volatile industries. Consequently, many contractors engage in exploitative practices such as contract substitution, recruitment fees, passport retention, and restrictions on mobility and freedom of association—all practices associated with forced labor.³⁶ For instance, in one recent example, Apple acknowledged the presence of recruitment fee overcharges among labor contractors in their supply chain, and claimed to have required contractors to reimburse \$2.2 million in recruitment fees in 2011 alone.³⁷ The vast majority of retail corporations are far less vigilant about labor contractors



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in their supply chains, and indeed fuel their utility by tasking supplier firms with tight turnaround times and intermittent production volumes. Supplier firms frequently engage contract labor at or even below minimum wage. As one social auditor put it, if workers are not being “paid the minimum wage, it is very frequently because the [supplier] company itself is not paying sufficient to that [labor] agent.”³⁸

The key point is that in spite of its depiction as a relatively technical or neutral business practice designed to maximize efficiency and flexibility for firms, subcontracting is in fact also a business strategy to push unethical practices further down the supply chain. As retailers have stepped up monitoring efforts around labor standards at their Tier 1 factories, these factories have displaced the risk of liability for labor exploitation, and of auditors holding them responsible for such violations through practices including unauthorized subcontracting and the use of widely exploited agency and contract workers.

Significantly, while many retailers have recently stepped up efforts to identify and prevent forced labor and slavery in their supply chains through social and ethical audit systems, these systems focus on first tier suppliers and are not currently designed to detect abuse among the subcontracted portions of supply chains in which forced labor is most likely to take place. For instance, U.S.-based outdoor retailer REI audited “a percentage of the ‘tier one’ factories in [its] supply chain” in 2012, amounting to 27 percent of their total supply chain.³⁹ Apple, which claimed in 2012 to be “going deeper into the supply chain than any other company we know of” and “reporting at a level of detail unparalleled in our industry,” conducted 393 audits in 2012, representing a 72 percent increase over 2011—approximately two audits per year for each of their 200 top suppliers.⁴⁰ As a recent study by social audit firm Sedex summarized, “globally, only a third of companies are actively seeking transparency below tier 1 in their supply chain” yet “the greatest and most critical sustainability risks are found deeper down the supply chain.”⁴¹ Reflecting on this paradox, one social auditor argued that the vast majority of social or ethical retail audits are “not trying to find things out, they’re trying to prove that something is not there.”⁴²

III. ENDING FORCED LABOR REQUIRES US TO RECONSIDER PREVAILING MODELS OF ECONOMIC SUCCESS

Transnational retail corporations have experienced remarkable economic success through the competitive strategy of low-cost, high-turnover, outsourced production. Walmart, for instance, has grown exponentially in recent decades, taking



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in \$1 billion per day in 2012 compared with \$1 billion in revenues in 1979. Unethical labor practices facilitate lower costs, enabling these large profits. While Walmart may not own the factories responsible for such practices, their model of economic success is premised upon and indeed fuels the forms of supply chain fragmentation that allow practices such as forced labor to thrive. As previously stated, far from developing automatically, corporations have themselves driven the complexity of supply chains as they have continually restructured production in recent decades as a strategy to cut costs as well as reduce responsibility and liability for the production practices associated with the goods sold in their stores. As they have done so, corporations have introduced high levels of risk into their supply chains. In the context of cutthroat competition, coordinating production through arm's-length and short-term contracts allows lead firms to push the risks associated with low-cost, high-volume production on to suppliers, thus reducing their responsibility and liability for the unethical practices associated with this model of economic success.

Walmart, like other corporations, claims that because they do not own their factories, they cannot be held responsible for unethical labor practices within their supply chains. This line of reasoning seeks to downplay the role of corporations in shaping the market conditions in which suppliers produce their goods. On the one hand, retailers demand supplier compliance to labor standards and regulations. On the other hand, their purchase orders demand suppliers to deliver low-cost and high-quality goods on time. As consumer prices fall while costs of raw materials rise across many sectors, the growing reality is that external suppliers simply cannot meet the retail price and speed the market demands without resorting to labor exploitation. As Martin Cooke, then-Membership Director at the Ethical Trade Initiative explained, retailers' "relentless drive to push down prices of their products means the money has to come from somewhere."⁴³ Not wanting to lose retail business, suppliers push exploitation further down the supply chain or temporarily subcontract agency workers through long and complex labor supply chains.

Given that subcontracting is fueling exploitative labor practices, including forced labor and slavery, corporations' assertions of limited liability must be reconsidered on an ethical basis. While it may be true that they are not legally liable for such practices, the fundamental ethical point is that they have avoided legal responsibility for a reason: to distance themselves from the unethical practices that are at best fueled, and at worst required, by their business model. As this article has shown, forced labor in global supply chains is not a random occurrence, but rather is rooted in key features of the ways in which retail sales



and supply chains are currently organized. For instance, retailers' profits are founded on high in-store turnover, which leads them to impose short production timelines onto suppliers, which tend to have a negative impact on labor standards. As one social auditor noted, "You need all of your workers, but you only need them for two weeks. You need to flog them to death for those two weeks, but then afterwards, there's no work for them."⁴⁴ Thus, while subcontracting is not against the law, some of the practices that it fuels are against the law. Given that forced labor appears to be a growing problem in global production networks, there is an urgent need for debate about how best to tackle slavery and forced labor in supply chains to confront these underlying dynamics.

Significantly, contemporary efforts to slavery-proof supply chains leave the dynamics of outsourcing and subcontracting, as well as the business practices and pressures that give rise to these practices, fully intact. Voluntary CSR initiatives like social or ethical auditing attempt to mediate the contradiction between retailers' demands for compliance with labor standards and for quick, cheap production by verifying supplier practices around overtime, wages, and freedom of association. They do not tackle, however, the compulsions that lead suppliers to use the worst forms of exploitation, including forced labor and slavery. Additionally, voluntary self-regulation through audits and other compliance programs have shifted further costs associated with compliance onto suppliers themselves.⁴⁵ This fuels the problem of factories cheating on audits to conceal unethical practices. For instance, China Labor Watch reportedly "obtained documents from a Walmart packaging supplier on how to hide or adjust safety and environmental records; how workers should lie to auditors about wages, benefits, and working hours; and how to conceal a shadow factory. Another investigation by the group found forced overtime, phony pay stubs, poor living conditions, and the use of hazardous chemicals at a Walmart shoe factory. Walmart-hired auditors had previously raised no concerns with either plant."⁴⁶ In short, voluntary initiatives do not fundamentally alter the firm-to-firm dynamics that fuel forced labor. Furthermore, as noted in the previous section, audits tend to ignore the portions of the supply chains in which unethical practices are most likely to occur.

Governments have also largely refrained from questioning the dynamics of subcontracting. Efforts such as California's Transparency in Supply Chains Act (SB-657) require large companies to report on the voluntary measures that they

Efforts to slavery-proof supply chains leave the dynamics of outsourcing and subcontracting fully intact.



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are taking to identify and prevent forced labor, slavery, and trafficking in their supply chains. Companies are now disclosing their efforts with, for instance, clothing retailer Abercrombie & Fitch claiming in 2010 to “have taken proactive steps to mitigate the risk of human trafficking and forced labor in our supply chain” and Nike recently claiming to “take seriously the federal and international efforts to end all kinds of forced labor—whether in the form of prison labor, indentured labor, human trafficking or otherwise.”⁴⁷ Yet among the hundreds of SB-657 statements posted on corporate websites, not a single retailer claimed to be paying higher margins or adjusting contract lengths or speed to markets.

Ultimately, we need to stop imagining that subcontracting is somehow an iron law of doing business that must remain off the table to change. Recognizing that subcontracting is a strategy to cut costs and reduce liability should prompt policy makers, nongovernmental organizations, and social audit firms to change their understanding of corporate responsibility for labor practices within global supply chains. The growing evidence that subcontracting and outsourcing fuels forced labor compels us to consider whether eradicating forced labor will require more profound change to contemporary business models than is generally considered in debates about slavery and supply chains. 

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