UNCTAD/DITC/TED/9

Making FDI Work for Sustainable Development

United Nations Conference on Trade and Development
and
Sustainable Business Institute at the European Business School

UNITED NATIONS
New York and Geneva, 2004

NOTE

- Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

- The views expressed in this volume are those of the authors and do not necessarily reflect the views of the United Nations Secretariat. The designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the United Nations Secretariat concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its function or boundaries.

- Material in this publication may be freely quoted or reprinted, but acknowledgement is requested together with a reference to the document number. A copy of the publication containing the quotation or reprint should be sent to the UNCTAD secretariat at: Palais des Nations, 1211 Geneva 10, Switzerland.

UNCTAD/DITC/TED/9

PREFACE

The subject matter of this study is at the heart of two key policy objectives of our times: promoting foreign direct investment (FDI) in developing countries, and achieving sustainable development.

Cross-border environmental management by transnational corporations (TNCs) plays a decisive role in pursuing these objectives. However, this role is perceived in different, and sometimes opposite, ways. Pessimists keep testing the "pollution haven" hypothesis; optimists tend to put a premium on TNCs as a vehicle for promoting environmentally sound technologies and management systems. The truth lies somewhere in between. Various private and public interests in economic development and environmental protection are far from converging. At the same time, there is no doubt that TNCs have great – and largely unexplored – potential to contribute to sustainable development in "host countries".

It is important to realize that environmental management is not just about traditional concerns over pollution. It is also about scale. A lot of environmental problems, actual and potential, have to do with the sheer size of TNCs' operations rather than merely the way they conduct their business. For the developing countries, the issue of environmental protection is also about time, or rather the lack thereof. The pressure of delivering high growth rates and securing FDI means that policy decisions often have to be taken in response to immediate output and employment objectives. The lack of resources and expertise in monitoring and enforcement, and sometimes the inability to work collaboratively with TNCs, adds to the problem.

Cross-border environmental management tends to be seen as a difficult balancing act for TNCs and host countries, an act that requires the right mix of policies and goals in terms of investment, output, job creation and environmental protection. It is nonetheless important not to lose sight of the fact that home countries, too, have an important role to play through their laws, regulations, policies and guidelines.

Regulatory and ethical considerations are, and always will be, important. However, they are no longer the only major determinants of the interface between FDI and the environment. The focus of attention – and action – has shifted to market-based approaches and measures. The simple strategies of compliance are giving way to eco-performance considerations, the lifecycle approach to products and production processes, and the internalization of environmental costs.

Managing environmental risks has become a standard feature of corporate behaviour as TNCs seek to improve their competitiveness and environmental performance. How responsible – and how successful – are TNCs in cross-border environmental management and the transfer of environmentally sound technologies? What lessons can we learn from their success stories and failures? Does ownership matter? What can policy makers do to accentuate the positive contribution of TNCs and reduce their negative effects? Finding answers to these questions is important if we are to make an assessment, or reassessment, of the approaches that Governments and TNCs take to the links between environment and development.

Since this study focuses on TNCs with a high level of environmental sophistication, the answers are, predictably, optimistic. One can argue that the success stories are too few to allow for generalized conclusions. Be that as it may, taken together with a survey of transborder environmental management practices of TNCs conducted under a parallel project by UNCTAD and the Copenhagen Business

School, with financial support from the Danish International Development Agency (DANIDA), the stories do provide useful insights leading to some positive conclusions.

The "greening" of consumption and production is changing the way of life and the way of doing business not just in the industrialized countries, but increasingly in developing countries as well. Consumers are becoming more environmentally conscious. TNCs find considerable competitive advantages in being "green" and are increasingly concerned about their environmental image. Environmental policies and regulations of the command and control type give way to economically adjusted measures, such as "green" procurement.

There is an enormous potential for improving environmental performance along the supply chain, making full use of the purchasing power of consumers, businesses and the public sector – the latter often being the biggest, and sometimes the only, customer of TNCs. "Supply chain management" makes suppliers part of what can be called the "environmental footprint" of firms. In this case, it is not the ownership that matters, but the creation of "green" business and consumer networks across national borders.

"Greening" the supply chain is a matter of shared responsibility and cooperation. There are encouraging signs of TNCs offering their suppliers in developing countries training courses and supporting them in the implementation of environmental management systems. Expanding this practice could greatly improve the environmental impact of FDI. Cooperation between TNCs and their suppliers in the developing countries is also necessary, if only to ensure that introducing environment-related conditions for suppliers does not erect new barriers to trade or detract from the objectives of setting up environmental management systems.

The efficiency of markets depends on transparency, which is also crucial for environmental performance. Environmental reporting by TNCs – internal and external, voluntary and mandatory – can go a long way towards improving management practices and, in turn, environmental performance. In fact, reporting back to stakeholders creates a strong incentive to improve environmental performance. It also makes it easier for civil society to maintain a spotlight on environmental performance, for instance through awards and publicity, as opposed to more conventional regulatory approaches.

"Best practices" bring life to binding legal and administrative regimes. The examples provided in the study show that while there is a general trend towards managing corporate environmental responsibilities, including reporting, on an international scale, there is no single "best practice" describing how to do that. What constitutes "best practice" in one company or country is not necessarily the best, or even good, for another company with a different organizational make-up, or in a country with a different environmental profile and priorities.

Although most "best practices" tend to be rather specific, they do provide a point of reference for companies operating in a particular industry and country. They also constitute a good starting point for a dialogue between government, industry associations, companies, and civic and professional organizations, a dialogue that can do a lot for clarifying and sharing expectations concerning environmental performance in terms of guidelines, codes of conduct and standards. Such voluntary measures can be instrumental in ensuring that the operations of TNCs are in harmony with policies in the "home country", as well as in building mutual confidence between TNCs and "host countries".

Whether and under what conditions a particular measure or policy is justified depends on circumstances. The challenge is to find an appropriate policy mix capable of reducing environmental tensions without diminishing the opportunities FDI provides to countries to exploit their competitive advantage. Context-specific analysis is therefore required in each and every case to determine whether a response to environmental concerns will be welfare-enhancing or welfare-reducing. This study deals with the issues that need to be taken into account in this type of analysis.

Since some environmental issues defy economic and political geography, it is only natural that measures at the company level and policy action at the national level are accompanied or driven by international initiatives. The concept of cross-border environmental management has already found its way into international commitments. The best example is the 1992 United Nations Conference on Environment and Development (UNCED) in Rio de Janeiro. There is a vast and growing number of multilateral environmental agreements. Environmental chapters are becoming more and more common in bilateral investment agreements. On top of that, there are environmental guidelines adopted by international business associations.

Some of these initiatives may lead to partnerships that could give a practical meaning to the deliverables of the World Summit on Sustainable Development (WSSD) in Johannesburg. It is very encouraging that the study – and the project that made it possible – have prompted the "EcoChain Initiative", launched by the Sustainable Business Institute at the European Business School with the support of the German Federal Environmental Agency and the German Industry Association.

"Promoting sustainable development through investment" was one of the priorities for the Summit. Joint action by corporations, private sector associations, Governments, international organizations and other stakeholders are expected in the following five areas:

- Exploring ways to ensure that a larger number of developing countries and countries with economies in transition benefit from investment, in particular FDI;
- Promoting the use of environmental management systems in developing countries as well as the transfer of environmentally sound technologies to these countries;
- Encouraging companies to take responsibility for promoting sustainable development by applying best practices and promoting environmentally responsible corporate behaviour and information policies, especially those related to public disclosure procedures;
- Improving environmental performance along the supply chain and in waste management; and
- Exploring the potential role of voluntary guidelines for making investment more broadly supportive of sustainable development.

These recommendations provide a good framework for the EcoChain Initiative, which offers companies an opportunity to "showcase" their best practices and encourage others to take greater responsibility for sustainable development. With enough support from Governments, businesses, and civic and professional organizations, such an initiative could become a useful extension of the World Summit on Sustainable Development. I would welcome further cooperation with the SBI, other partners in Germany and other countries with a view to advancing this initiative and giving it a truly international character.

In one of his statements, the Secretary-General of the United Nations spoke of the “environment millennium”, stressing that environmental issues must be fundamentally repositioned in the policy-making and business arenas, that corporations need to recognize that their choices can have significant consequences, and that Governments must not only create environmental agreements but enforce them. I find this study a practical and timely contribution to the ongoing debate on a new era of conservation and stewardship and am grateful to the Government of Germany, in particular the German Federal Environmental Agency, for supporting a project that has made this study possible.

The quality of the study is very much the result of the dedicated work of the SBI and its partners: the Center for Environmentally Sound Technology Transfer in China, the Administrative Staff College in India, the Indo-German Chamber of Commerc ironmental Technologies in Malaysia. I view this partnership as a good foun search institutions promoting new and innovative approaches to technological and organizational solutions for the environment, corporate social responsibility and stakeholder relations.

Rubens Ricupero

Secretary-General of UNCTAD

Foreword

At the World Summit on Sustainable Development in Johannesburg in 2002 politicians, business representatives and delegates from civil society will be asked which of the objectives of the Agenda 21 have been achieved. Has there been any progress since the 1992 conference in Rio ?

For many people, globalization is a key to reaching a high level of development and welfare for all the countries of the world. Yes, there are great opportunities connected with globalization, but there are also quite significant risks. Globalization supports the ability of investors and traders to locate their capital and to exchange goods and services wherever they choose. But there is a risk of environmental standards being lowered, e.g. to attract foreign investors. To avoid this, we have to strengthen our efforts to ensure a coherent global and ecologically responsive framework of environmental agreements and institutions, in order to guarantee that globalization will support sustainable development. The German Government believes that in framing the process of globalization we have to integrate ecological and social concerns.

In the field of investment**,** Governments are very active in creating attractive framework conditions for business activities. Reducing tariffs and signing trade and investment facilitating agreements are good examples. In turn, we also see companies taking on greater responsibility towards supporting sustainable development in their foreign direct investment (FDI). We should call on multinational enterprises to contribute to sustainable development by transferring environmentally sound technologies, using environmental management schemes in all the countries in which they operate and by generally committing themselves to international codes of conduct such as the OECD Guidelines for Multinational Enterprises.

This study was commissioned by the Federal Ministry for the Environment and the Federal Environmental Agency in cooperation with UNCTAD in 1998. The Sustainable Business Institute at the European Business School was commissioned to undertake empirical research on the practice of environmental management in FDI. The study is based on four company level case studies which were carried out in cooperation with the companies *Adtranz*, *Bosch Siemens Hausgeräte*, *Aventis Pharma* and *Burgmann* regarding their FDI in China, Malaysia and India.

One of the main results of the study, and a very evident one, is that environmental requirements are no obstacle to FDI. On the contrary, environmental management can help develop advantages for frontrunners, to improve the transfer of environmentally sound technology, to 'green' the supply chain, to avoid environmental risks and to raise environmental awareness of consumers and business partners.

Building on this successful study, we initiated a national dialogue process for elaborating guidelines for the integration of environmental aspects into FDI. A working group of representatives from politics, business associations, enterprises, unions and civil society was established to develop operational and voluntary guidance for multinational enterprises in co-operation with UNCTAD and UNEP. The task is to make existing guidelines – such as the OECD Guidelines and the UN-initiatives Global Compact and Global Reporting Initiative - more specific by working out guidelines for applying best practice measures when carrying out foreign direct investment. These guidelines will be underpinned by best practice examples. The results will be presented at the World Summit in Johannesburg in September 2002.

Jürgen Trittin Minister for Environment, Natural Resources and Nuclear Safety	Prof. Dr. Andreas Troge President, Federal Environmental Agency

Acknowledgements

This study is a collaborative effort of the Sustainable Business Institute at the European Business School, Centre for Environmentally Sound Technology Transfer (CESTT) in China, Administrative Staff College India (ASCI) in India, and Centre for Environmental Technologies (CETEC) in Malaysia.. It was commissioned by *Andreas Burger*, German Federal Environmental Agency (UBA), *Kilian Delbrück*, *Peter Franz* and *Ulf Jaeckel*, German Federal Ministry for the Environment (BMU) and carried out under the aegis of the United Nations Conference on Trade and Development (UNCTAD).

The following people and institutions have made a major contribution to this project:

Uwe *Bergmann*, *Christine Koch*, *Johannes Schmidt*, *Bettina Schwarzhaupt*, *Achim Seitz* and *Cornelia Temme*, Sustainable Business Institute at the European Business School.

Shi Han, Centre for Environmentally Sound Technology Transfer, China.

P.D. Jose, Administrative Staff College, India.

Goh Kiam Seng, Centre for Environmental Technologies, Malaysia

Dieter Jochen Bärmann and *Herbert Mrotzek*, BSH Bosch und Siemens Hausgeräte GmbH, and *Jan-Grigor Schubert*, Anhui BSY Cooling Appliances Co., Ltd., Germany.

Hans Feess, *Jean Pedelaborde* and *Martin Siewert*, Aventis Pharma AG and *R.G. Naik*, Hoechst Marion Roussel Ltd., India

Michael Schemmer, Adtranz-DaimlerChrysler Rail Systems GmbH, and *Krishnaswami Ganapathy*, Adtranz, India.

Peter Waidner, Burgmann Dichtungswerke GmbH & Co. KG, Germany.

Wolf-Eberhard Schiegl, Siemens AG, Germany.

Jan Strömblad, Asea Brown Boveri AG, Germany.