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BIAC DISCUSSION PAPER

I. Introduction

Trade and investment liberalisation, market-oriented reforms, and privatisation have combined to create a period of sustained economic growth in many countries. The resulting expansion in international economic activity has created global markets in capital and investment products, world-wide manufacturing and customer bases, and brought a broad array of new products and services. Globalisation, with its increased economic interactions, serves to reinforce and consolidate the political, market and economic reforms already well under way. A successful policy for sustainable development aims to make environmental protection and economic growth and integration mutually supportive.

Moreover, globalisation, accompanied by open trade and investment, provides the conditions not just for improved economic prosperity but also for environmental protection. An overwhelming part of the research on environmental effects of foreign direct investment (FDI) shows that: 1) the environmental effects of foreign direct investment are largely positive and 2) foreign investors contribute significantly to ensuring that the positive effects are realised.¹ FDI flows are increasingly important in providing the resources and capacity necessary to address environmental and infrastructure challenges, particularly in non-OECD countries.²

Indeed, the development impact of FDI is not only its monetary value but also its positive side-effect on production, including:

- the transfer of modern environmentally-friendly technology and know how,
- the spread of efficient management practices.

Foreign investors more often meet the environmental standards of the countries in which they operate than domestic companies do. Many investors have introduced state of the art environmental technologies and management practices in their host country production facilities. Increased international investment flows result in increases in the rate at which environmentally sound technologies are introduced into markets world-wide.

¹ See for example: Open Markets Matter: The Benefits of Trade and Investment Liberalisation, OECD 1998, p. 96.

² "FDI is an increasingly important 'engine' for sustainable development in many countries." Foreign Direct Investment and the Environment: An Overview of the Literature, OECD December 1997, p. 9.

II. FDI Improves environmental performance in host countries

Foreign investors, particularly global companies, generally standardise technologies and management systems across countries in which their facilities are located. When they maintain a single standard for environmental practices, they nevertheless must meet legal requirements in the most stringent jurisdiction; therefore their single standard is set at a high level, and carried as a practice to the less strict countries.

As foreign investors, they are often subject to greater scrutiny than local industries. For this reason, they are important potential partners for those who wish to give real effect to environmental standards. They tend to prefer a transparent, consistent, and predictable environmental policy over a weak policy.

The arrival of foreign investors can also have a beneficial impact on the environmental operations of domestic companies. Local firms try to match the product characteristics and quality standards of foreign-owned operations, and suppliers working to cater to foreign operations will increase process and product quality to meet high standards. Also, employees that move from foreign-owned to local facilities bring with them the training and expertise gained in high quality, well-managed operations.

Currently, the privatisation of state-owned enterprises is a major cause of foreign direct investment entering some OECD and most non-OECD countries. Privatised companies generally install management teams that focus on reducing costs, increasing employee productivity, and improving the efficiency of the facility. The accompanying new investment frequently brings better technologies which reduce the amount of waste generated and lower the pollution levels of the facility.

III. Open investment policies are fully compatible with high environmental standards

In most cases the driving forces behind an investor's decision to direct FDI to a particular country are market opportunities, local and regional, and the availability of raw materials or other major production factors. Because environmental costs are a small part of the total costs of establishing production facilities, they are not decisive criterion for foreign direct investors, in contradiction to the common notion of "environmental dumping."

Recent market and investment liberalisation has provided many examples of how open investment and improved environmental performance can work in tandem. In Mexico, in a period during which the FDI increased subject to the investment rules of NAFTA, the environmental regulatory system has continued to expand and enforcement activities have increased. An ongoing study by Charles Oman of the OECD's Development Centre (October 1998 draft) finds that the evidence "provides scant support for the race to the bottom hypothesis." Governments that attempt to attract companies with low environmental standards have not proven successful. Instead, the study suggests that foreign investors do not cause downward pressure on environmental standards, but instead cause standards to rise.

At worst, the study indicates that it is a governments' fear of not attracting new foreign investment that may somewhat limit upward pressures on local environmental standards. Given that policy choices must balance environmental with social, political and economic goods (such as justice, education, non-discrimination, incentives for work and wealth creation), the limits on upward pressures may be essential to a process of democratically setting the right balance for environmental policy.

IV. Sound regulatory policies help promote both FDI and environmental protection

FDI has already made a considerable contribution to sustaining economic growth and achieving environmental improvement in developing countries. Market factors are the primary determinants of investment decisions but the investment climate is also a major factor. Specifically, investors seek long-term stability of rules and procedures, guarantees for entry and establishment, equal competitive opportunities and protection of existing investment.

Liberal rules for FDI and the attraction of FDI are a necessary precondition for environmental improvement. Appropriate incentives to encourage private investment are:

- stable economic, financial and tax systems;
- a transparent legal structure, with sound rules about foreign ownership, and reliable protection of confidential information and property;
- free capital flows and stable rules for foreign currency exchange;
- a stable regulatory framework fostering innovation in a cost-effective manner, implemented by well-functioning administrative structures (with few bureaucratic rules and delays);
- sound environmental laws and standards, based on scientific assessment, and (again) permitting innovation;
- a long-term commitment and dedication of resources by all partners; and
- regular and open communication between government and industry.

V. Governmental efforts to attract FDI also helps local citizens

Aside from the benefits that new investment brings--cash to the local economy, job creation (often of high quality), and improvements in protection of the environment--there is also a benefit that arises from the effort of government to attract foreign investors: better government, subject to competitive pressures. Competition between governments to attract foreign investment results in:

- better planning to regulate efficiently (to reach the same policy goals with lower compliance costs), and
- better planning to run government efficiently (to reach the same policy goals with lowest possible taxes).

This discipline can reduce waste and inefficiency caused by misapplied or poorly designed regulation, helping to promote wealth-creation in the economy while still promoting environmental protection.

VI. International Frameworks for FDI and Environment are Mutually Supportive

International rules for environmental protection have been developed in MEAs between some countries (e.g. on climate change, bio-diversity, trans-boundary movements of hazardous waste). In some other cases, MEAs will not be developed because the appropriate environmental standards should be set on a local, national or bilateral basis.

Meanwhile, efforts to develop a Multilateral Agreement on Investment (to promote cross-border investment), have been obstructed by groups asserting that a multilateral investment agreement should include *precise* environmental standards. Business continues to believe that a multilateral investment framework is not the appropriate vehicle for setting precise environmental standards. MEAs are more effective: they can include graduation for developing countries, adjustments for unforeseen improvements to technologies, dispute settlement procedures and other specific features to make them better at addressing environmental protection.

Business supports international rules for investment as well as for environmental protection. Business agrees that clauses in international investment agreements should prevent negative effects on local or national environmental standards (for example, the “not lowering standards to attract an investment” clause as discussed for the MAI). On the other hand, governments should prevent multilateral environmental agreements being used to restrict foreign direct investment on the basis of environmental considerations.

Multilateral investment rules can help countries attract FDI and other economic activity (including lending), and avoid distortions which might inhibit economic development—a vehicle for improving environmental protection.

VII. Conclusion

Economic development itself has proven to be a vehicle for real improvements in the environment, and foreign investment the means by which cleaner technologies and better environmental practices are introduced in countries where they are most needed.

Globalisation, accompanied by open trade and investment, provides the conditions for improved economic prosperity as well as environmental protection. Business continues to be an important and engaged actor in the pursuit of sustainable development, and in partnership with others, can make its contribution most effectively in the framework of economic growth, more open trade and investment and a conducive regulatory framework.

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Annex

EXAMPLES OF INVESTMENTS BRINGING ENVIRONMENTAL IMPROVEMENTS:

Many environmental improvements foreign investors bring are integral to the introduction of a production process; therefore, in many cases the effects of such environmental improvements may be difficult to measure and describe outside of their context. Some contributions foreign investors are making to environmental improvement are described below:

Power Generation Industry: An example of a partnership between government and business involves the Ministry of Electric Power in China and the Tokyo Electric Power Company. Since 1992 about 100 managers from the Ministry of Electric Power in China have participated in an exchange program with the Tokyo Electric Power Company, concentrating on proper and effective operation and management, including environmental consciousness raising.

Automotive Industry: General Electric provides an example of the importance of skills as part of technology cooperation. In parallel with the transfer of technological hardware to developing countries, General Electric has established many co-operative research and development projects with local businesses and universities. Electric-powered vehicles, battery research, oxygenated fuels, and fuel cells are some of the programs currently under way in Chinese laboratories. Technology is also being transferred to the Chinese automotive industries via university technology institutes and government/industry-sponsored technology seminars.

The Volkswagen Group products are developed in compliance with international standards and produced worldwide according to these standards to the largest possible extent. This means that Volkswagen Group cars produced in developing countries are usually technologically and environmentally more advanced than local products. Constraints may arise due to local conditions: in some countries, the latest engine technology could not be used because unleaded fuel was not available.

Volkswagen production processes are based on local legislation while usually going far beyond simple compliance. For example:

- Waste water treatment in Brazil, Mexico, Nigeria and China etc.: large investments were made in waste water treatment at local factories at a time when waste water treatment was still very rudimentary in the respective countries.
- Waste air treatment has been implemented at many sites without the legal obligation to do so. In consequence, emissions of paint shops etc. could be greatly reduced.
- Assessment of under-ground contamination has been made at many sites, especially at sites in Latin America. Remediation of contaminated soil is underway.
- Waste treatment: In South Africa, where non-hazardous waste is usually not separated and recycled, a project was started in 1996 to separate the waste produced in the factory. Metals, cardboard etc. are sold to contractors. Apart from the environmental benefits, there are also obvious social benefits: ten persons, mostly women, were newly hired for the waste management project. Economically, the income created through the sale of recyclable materials pays for most of the cleaning costs of the factory.

Finally, technology transfer by Volkswagen includes not only factories and their suppliers, but also a number of organisations and university institutes in host countries.

Agri-Food Industry: The development of new higher yielding plant varieties is an important factor which has contributed to sustainable agriculture and long term food security. Sustaining and improving crop performance requires continuous development of advanced technologies. The transfer of such technologies is a prerequisite for building sustainable and productive agriculture in developing regions. Activities of the International Service for the Acquisition of Agri-biotech Applications (ISAAA), for example, concentrate on building partnerships between the private and public sectors based on the donation of technology as an instrument to build mutual trust and confidence. ISAAA is working with the main agri-biotech companies in the world and has so far developed over a dozen projects in Africa, Asia and South America.

Chemical Industry: Upon the request from the Indonesian government, a member of the Japan Chemical Industry Association (JCIA) sent its experts in 1995 and 1996 to the industrial park in the suburb of Jakarta. Its mission was to provide small and medium-size local food factories with technical expertise for waste water treatment. With this technical cooperation, they significantly improved the operation of their activated sludge treatment facilities and thereby the environmental performance.

Oil and Gas Industry: Amoco in Western Siberia - Cooperation between US and Russian enterprises is helping identify means of revegetating areas of Siberia. This effort is part of a broader program to repair damage that occurred during past Soviet era development of oil and gas resources. BP in Colombia: A scheme to monitor tropical river systems, and assess the impacts of oil and gas exploration on them, has led simultaneously to scientific innovation and to local capacity building. Chevron in Papua New Guinea: Papua New Guinea's oil production is accompanied by innovative plans to protect the environment, improve the well-being of affected people and build up businesses that will thrive after oil stocks have been depleted. Exxon in Malaysia - Development of the petroleum industry in Malaysia is playing an important role in the nation's drive to become an industrialised nation and meet its «Vision 2020». Industry is working with the government at all levels to help assure that the environmental and economic benefits are fully realised by Malaysians, their communities and the nation. Mobil in Indonesia: Development of the Arun natural gas field in Indonesia has involved training, conservation capacity building and technical co-operation. Shell in the Czech Republic: investing in bringing privatised refining industry up to EU environmental standards.

Tanning Industry: Technology cooperation is not only a North-South affair. There are growing examples within the developing world and even between sectors of business within a single country. For example, the BCSD Colombia has been helping small companies involved in industries such as the leather business to cut pollution through ways that save money.