Identifying and measuring the sustainability characteristics of FDI

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In the face of major global challenges, such as climate change and achieving the sustainable development goals, policy makers have become increasingly interested in the notion of sustainable foreign direct investment (FDI). In some contexts, sustainable FDI has been defined as investments in environmentally-friendly industries, technologies, infrastructure, and practices that directly contribute to environmental progress, sometimes also referred to as "green FDI". While this type of FDI plays a critical role in supporting more sustainable societies, given the magnitude of the global challenges confronting governments today a broader approach that goes beyond climate issues and aims to leverage all FDI in support of a more sustainable future is called for.

Turning FDI into a powerful tool in support of sustainability can be done, if governments put in place the right policies and institutional frameworks. This informal note elaborates what governments need to do in support of more sustainable FDI as well as critical actions multinational enterprises (MNEs) need to take in order that FDI sustainability translates into global value chain sustainability.

Putting in place a policy framework for sustainable FDI

In additional to supporting environmental sustainability, a broader approach to sustainable FDI would need to consider the contribution of FDI to the societies in which it takes place. From this perspective, all FDI can play a role in supporting sustainability and we can identify multiple sustainability channels.

These channels could include the impact of FDI projects on employment and industrial relations, human rights, corruption and bribery, taxation, and competition, among others. Where clear and sound policy frameworks are in place dealing with these different dimensions of MNE activities, OECD work has shown that FDI tends to be more sustainable. Many countries do have such policy frameworks in place, but it remains that many do not.

This is one of the major challenges for promoting sustainable FDI. The sustainability of FDI is not independent of the policy framework in which it takes place. In order to address asymmetries and gaps in domestic policy frameworks for sustainable FDI, international approaches are often called for. This is the logic behind the OECD's Policy Framework for Investment, which helps governments put in place domestic policy frameworks that are conducive and supportive of sustainable FDI and the logic of instruments like the OECD Guidelines for Multinational Enterprises. These Guidelines support sustainable FDI by calling on firms to uphold standards of responsible business conduct, a key link between FDI and sustainability, wherever they operate, irrespective of the strength of local legal and governance frameworks. This is particularly important in countries where domestic policy frameworks remain weak. In essence, the Guidelines recognise the importance of domestic policy frameworks as a variable that influences sustainability outcomes and seeks to address this challenge through a multilateral approach.

The Guidelines address many of the issues, beyond environment and employment, that impact the sustainability of FDI. For example, corruption and bribery by MNEs contribute to the erosion of the integrity of public institutions and finances in the host country, and thereby act as a direct impediment to the achievement of sustainable development goals. Likewise, good corporate citizenship in the area of taxation implies that enterprises should comply with both the letter and the spirit of the tax laws and regulations in all countries in which they operate, co-operate with authorities and make information that is relevant or required by law available to them. Finally, competing fairly in host economies (as opposed to e.g. setting up international cartels) supports sustainability of FDI by ensuring that markets work efficiently, that domestic firms are able to compete fairly, and that rents are not extracted from local consumers and diverted to foreign producers.

Value chain sustainability

An important dimension of FDI sustainability that is often neglected concerns value chains. Any given FDI project is only as sustainable as its upstream suppliers of intermediate inputs and services. If an intermediate input has been manufactured in an environmentally unsustainable way, this unsustainability then comes to be embodied in the output of the FDI project. Thus value chain sustainability requires due diligence on the part of MNEs with a view to identifying and mitigating upstream sources of unsustainability.

This has been the approach, for example, in the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas which marks a shift away from traditional commercial risk management to a more holistic approach that addresses risks of business impacts on society and the environment, with a view to promoting inclusiveness and growth. The most advanced of those projects in terms of implementation and global uptake from business is the project on due diligence in responsible mineral supply chains from conflict-affected and high-risk areas.

The objective of the Due Diligence Guidance is to help companies respect human rights and avoid contributing to conflict through their mineral production and sourcing practices. Given the focus of the Due Diligence Guidance on Minerals on value chains, as opposed to individual firms, it covers business activities from mining to production of final products.

In very practical terms, the Due Diligence Guidance proposes a five-step due diligence framework for companies in those mineral supply chains.

The Due Diligence Guidance provides companies with detailed guidance for these five steps as well as a 'model supply chain policy' which companies throughout the supply chain are encouraged to incorporate into their existing policies on RBC. Finally, the Guidance provides users with measures for risk mitigation as well as indicators for measuring improvement.

Given the success of the due diligence approach for responsible mineral supply chains in tin, tantalum, tungsten and gold, work is now expanding to other minerals (such as cobalt, copper and coal, among others), new geographies (such as new producer regions in West Africa and Latin America but also refining countries like Dubai, Turkey and India and consuming countries such as China), and new sectors (such as apparel, footwear, agriculture, and finance).

Experience with the due diligence approach highlights the importance of taking a systemic approach to evaluating the sustainability characteristics of FDI. While developing indicators on value chain sustainability would be challenging since it implies covering often thousands of domestic producers that supply MNEs and FDI projects, it needs to be recognised as an important determinant of FDI sustainability.

The OECD Guidelines for Multinational Enterprises also request business to take care of their direct impact operations on environment, employment and other areas. In this context, some MNEs have been developing indicators of environmental sustainability focus on firm-level management practices. Sound environmental management is an important part of sustainable development, and is increasingly being seen as both a business responsibility and a business opportunity. Multinational enterprises have a role to play in both respects. Managers of these enterprises should therefore give appropriate attention to environmental issues within their business strategies. Improving environmental performance requires a commitment to a systematic approach and to continual improvement of the system. An environmental management system provides the internal framework necessary to control an enterprise's environmental impacts and to integrate environmental considerations into business operations.

Conclusion

A key challenge in measuring the sustainability characteristics of FDI is the firm-specific or even project-specific nature of this relationship. For example, a coal-fired power plant with carbon scrubbers will be much more sustainable than one without. Furthermore, as was explained at the beginning, sustainability is not uniquely determined by the investment itself but is conditioned by the characteristics of the environment in which it takes place. A subsidiary operating in a highly corrupt environment is much more likely to engage in corrupt practices than a subsidiary of the same company operating in a 'clean' environment. Finally, global value chains present perhaps the biggest challenge for the measurement and promotion of sustainable FDI. The Rana Plaza tragedy underscored how unsustainable upstream production at the domestic level can become embedded in products that move through global value chains and usually end up passing through the integrated FDI-based production networks of MNEs. In these cases, even if the MNE and its FDI projects are highly sustainable when viewed in isolation, the reality is that they are directly involved in promoting unsustainable business practices.

Notwithstanding these challenges, measuring some sustainability characteristics of FDI is possible and more systematic approaches combining different initiatives could help policy makers in this regard.

OECD Global Forum on International Investment

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