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#### **SUSTAINABLE FOREIGN DIRECT INVESTMENT— SUPPLY CHAIN MANAGEMENT AND LABOUR RIGHTS IN CHINA.**

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This paper is based on research undertaken by the Brotherhood of St Laurence, some of which has been presented at the OECD Roundtable on Corporate Responsibility in Paris, June 2002<sup>1</sup> and at the Academic Meeting on International Labour Standards and Workers' Rights, and Business and Human Rights in Wuhan, China, October 2002<sup>2</sup>.

In this paper I will explore the relationship between sustainable foreign direct investment and responsible supply chain management in China. First, I will give an overview of the realities of foreign direct investment in enterprises in China, drawing on the Brotherhood of St Laurence experiences in attempting to responsibly manage the supply chain of its optical business—Mod-Style. Second, I will identify the issues, opportunities and limitations facing both multinational and small to medium-sized enterprises that are committed to ensuring they have a positive impact on supply chain decisions. Finally, I will discuss the global integration of trade and investment, and the role of the OECD Guidelines for Multinational Enterprises and their contribution to supply chain management.

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<sup>1</sup> Lillywhite, S., 2002 (in press). *Pursuing corporate responsibility in China—experiences of a small enterprise in the optical industry.*

<sup>2</sup> Lillywhite, S., 2002 (unpublished) *Pursuing corporate responsibility in China—labour rights and supply chain management.* Paper presented to the Academic Meeting on International Labour Standards and Workers' Rights, and Business and Human Rights in Wuhan, China, October 2002

## **Introduction**

Foreign Direct Investment (FDI) is by no means a new concept, yet there is increased recognition that the benefits of FDI do not automatically and evenly flow on to all<sup>3</sup>. A further development is the growing global awareness that trade and investment are increasingly integrated and that FDI needs to be sustainable. Sustainable FDI necessitates consideration of the economic, social and environmental impacts of investment. It means that investment needs to be driven by more than cheap labour and raw materials, and requires investment in labour and the protection of labour rights, technology transfers, education and training and protection of the environment.

The idea of socially responsible investment (SRI) is also gaining momentum amongst portfolio investors and therefore needs to be considered as part of the global debate on international investment. This will require an increased willingness by enterprises to accept responsibility for labour and environmental standards and conditions within supply chains. Corporate governance, labour standards, corruption and the environment are likely to be the major issues for SRI investors<sup>4</sup>, and appropriate criteria are required for all offshore supply chains and trading relationships to determine if a company in China is eligible for SRI funds. With China's accession to the WTO and the forthcoming Olympic Games in 2008, many foreign enterprises are assessing the opportunities and risks associated with doing business in China. This is set against the backdrop of a business culture and regulatory framework that continues to offer FDI incentives—namely, cheap and compliant labour, a stable political environment and a relatively (compared to other developing countries) well developed infrastructure. In considering FDI, it is important to recognise that an economy based on exploitation and the erosion of workers rights cannot lead to sustainable development.

### **1. Foreign direct investment in China—the realities of corporate responsibility in supply chain management**

#### ***1.1 Case Study: Experiences of an Australian non-government organisation (NGO) managing a supply chain in China***

The Brotherhood of St Laurence (BSL) is an Australian welfare organisation with a vision of promoting social justice and a whole of society framework for a poverty-free Australia.

In 2000, the BSL gained ownership of a small business, Mod-Style. Mod-Style imports and wholesales optical frames to Australia's independent optical retailers. In 2001-02, the company imported 152,000 optical frames, with a turnover of AUD\$5 million. Most of the production occurs in China, where 90 per cent of the world's optical frames are currently manufactured, primarily for the US and European markets.

The BSL accepted ownership of the company on the basis that it would investigate the ethical implications of owning a company that sourced goods from China. Profits were quarantined for two years, and used to fund a thorough investigation of the supply chain, the conditions of the workers, and the barriers to improvements in these conditions and some creative responses to the issues. This has involved extensive discussions with factory owners in China and their representatives in Hong Kong, the Hong Kong Optical Manufacturers Association, brand name customers who use the same suppliers

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<sup>3</sup> OECD (2002). *Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs*, Paris

<sup>4</sup> Rosen, R December-January 2001-2002, 'Asia Beckons', *Ethical Investor*, Issue 7, p.13.

in China, NGOs based in Hong Kong and Australia such as the Asia Monitor Resource Centre (AMRC), Hong Kong Christian Industrial Committee (HKCIC) and Oxfam, academics, trade unions, industrial hygienists and representatives of organisations such as Business for Social Responsibility.

The experiences of the BSL in attempting to responsibly manage the supply chain of its commercial enterprise highlights the realities of FDI in China. It provides valuable insight into the complexity of the issue, and the opportunities and challenges facing those enterprises that are committed to sustainable business practices. The BSL has accepted responsibility for its investment via supply chains in China, and is looking beyond relying on codes of conduct and monitoring to demonstrate corporate responsibility and protection of workers rights. Its emphasis is on direct engagement with suppliers and the promotion of education and training as the most meaningful way to support labour rights and participation. The research confirms that no one organisation has all the answers to achieving sustainable FDI. The best results are achieved through innovative incremental progress and global collaboration amongst enterprises, trade unions, industry associations, NGOs and governments.

## ***1.2. Mapping the Mod-Style supply chain***

### *Identifying the factories*

This has involved identifying and regularly visiting factories that supply Mod-Style, developing an understanding of the customer profile and subcontracting relationships of the factories, and understanding the workforce. The BSL has invested considerable time and resources to understand the business and labour rights issues in China —an undertaking which, whilst difficult for many small or medium enterprises, needs to be done to contribute to sustainable FDI. Mod-Style's largest Chinese supplier (also one of the largest producers for the global market) has 4500 workers, 20 production lines, and a monthly production capacity of 1.1 million optical frames. It is listed on the Hong Kong stock exchange and has a market value of more than US\$ 50 million<sup>5</sup>. This company is setting standards that go beyond the requirements of many foreign enterprises, and helps demonstrate that not all production facilities in China are 'sweatshops'.

Mod-Style has approximately 10 suppliers in China, most of which are wholly Hong Kong owned family businesses, with the well-educated and business astute second generation significantly involved in managing the operations. Those factories with 1500 workers or more have clearly appropriated the benefits of FDI, adapted technologies and processes from Europe and Japan and created highly competitive operations in global markets. In other respects, however, it cannot be said that the Chinese workers have achieved 'decent work', in the sense understood by the ILO.

Companies pursuing sustainable FDI in China need to familiarise themselves with the different management practices of the countries that have established joint ventures or wholly owned production facilities in China. Regardless of the nationality or their particular management style, the emphasis should be on compliance with The Labour Law of the People's Republic of China (PRC), 1994. Cultural differences in management styles and business practices do not justify differences or erosion of basic labour rights.

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<sup>5</sup> Frost, S., South East Asian Research Centre (discussions), November, 2002, Hong Kong.

### *Customer profile and subcontracting relationships*

Prior to China joining the World Trade Organisation (WTO), the Hong Kong owned optical factories based in China were producing only for the export market. At that time and now, the final customers include some of the large global brands, however, many of these larger customers have no idea which factories are producing their products or the conditions under which they are being made. They rely on complex licensing arrangements with trading houses and agents that do not necessarily share the stated values and business practices of the brand name company. This lack of transparency is, in some cases, a calculated risk management strategy to assist in ensuring minimal damage to companies' reputation as result of potential labour rights and environmental concerns. It can also be interpreted as an enterprise not accepting their corporate responsibility for the global dimension of their business, or that considering China just too hard and the less they know about it the better.

The size of the factory in China influences not only conditions but also the complexity of subcontracting arrangements. The smaller factories often outsource production processes such as electroplating and injection moulding, and are not able to access the advantages of the larger vertically integrated operations. In addition, our research has shown that those factories that are able to produce cheaper products than their competitors, are doing so through compromising the labour standards and the necessary investment in capital equipment and facilities that would ensure higher occupational health and safety standards.

### *Understanding the workforce*

The workforce in the optical industry is representative of much of the manufacturing sector in southern China. The majority of workers are young women aged 17-25 years who have migrated from surrounding rural provinces to work in the burgeoning industrial districts. The primary aim is to earn as much money as possible. Generally speaking, they appear to have a relatively low level of education, and for the most part are not well informed of their labour rights. Most are employed in repetitive, low-skilled jobs. Staff turnover is high, with most workers staying with a factory for one to two years.

### ***1.3. Understanding the labour and environmental conditions***

The BSL experience has shown that not all factories are the 'sweatshops' often attributed to China. Factories and their processes vary in terms of conditions for workers, compliance with labour and environmental standards, and managerial style, as they do in Australia. For example, some factories meet their obligations and provide social security contributions on behalf of workers, but have a heavy security presence and an arbitrary system of fines and deductions. Other factories provide state-of-the-art facilities and architect-designed plants, yet expect excessive overtime without appropriate remuneration. In pursuing sustainable FDI, it is necessary to recognise that the physical conditions of a factory can be misleading and thereby divert attention from poor labour conditions. It is important to remember that currently all workers migrating from rural areas are in a vulnerable position because of their temporary residential and employment status resulting from the Chinese system of residential registration, or 'Hukou'. This system will need to be reformed if China is to continue to develop and meet the needs of its highly mobile labour market

### *Environmental standards and physical conditions*

Environmental standards and physical conditions vary significantly among the factories in China. With regard to the optical industry, the larger factories, which undertake electroplating on site, had sophisticated equipment, ventilation and waste management. Indeed, worse conditions have been witnessed in Australian electroplating facilities. All factories appeared to collect, and in some cases treat, wastewater before it was sent to an outside plant for further processing. Some factories had acetate dust collection bags, and in one case all acetate shavings are sold for recycling into personal goods such as combs and toothbrushes. Chemicals and paints are, for the most part, well labelled and stored, and most of the larger factories had a chemical inventory. The smaller optical factories, however, did not appear to invest as heavily in the capital equipment and processes necessary to ensure compliance with environmental standards.

The physical conditions of the factories also presented a complex picture. Generally, they were better than anticipated, particularly in terms of occupational health and safety (OH&S) standards. Most of the factories visited were clean and well lit with adequate heating and cooling. Dust masks are often provided (though rarely worn), and some factories have specialised ‘hands-free’ machines to reduce finger injuries. The overall impression, confirmed by Hong Kong based NGOs such as the Asia Monitor Resource Centre, is that these factories provide better facilities and working conditions than usually reported in the toy, footwear, textile and apparel industries, industries that are relatively well understood and accessible to independent monitors. The same cannot be said of the electronics and petrochemical industries in China which are very much off limits and where conditions are reported to be harsh <sup>6</sup>.

In other respects, however, it cannot be said that the Chinese workers have achieved ‘decent work’, in the sense understood by the International Labour Organisation (ILO). For example, worker accommodation is often spartan and dehumanising. In the worst cases limitations are placed on water usage and time allowed for toilet breaks. Large, clean new factories do not guarantee reasonable working conditions and can often mask serious human rights abuses.

### *Labour standards*

Significant human and labour rights issues exist, particularly with regard to wages, hours, and social security entitlements. In these key conditions there were evident breaches of The Labour Law of the PRC. Managerial regimes are strictly hierarchical and at times repressive. It is often difficult for workers to raise grievances and have disputes resolved without risking reprisal. Fines and disciplinary action are common, and in some factories workers appear despondent. The BSL experience has confirmed that overall workers are compliant and in reality do not participate in the co-determination of their workplaces in any meaningful way.

Freedom of association outside of the only legal trade union (All China Federation of Trade Unions—ACFTU) is not possible. Whilst some optical factories had trade union representatives, these positions are usually held by supervisors and managers. There was no evidence of collective bargaining, and conditions were set by unilateral management decisions.

Consideration will need to be given to the issue of freedom of association and collective bargaining if discussions and progress on the complex issue of human rights and business is to be progressed. In this regard, individual firms have little capacity to bring about change in China, as this is a matter of

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<sup>6</sup> Liu Kaiming, (unpublished) *Working Together to Build a Sustainable Improving Model*, China, 2002

national law. However, it should be noted that several of the major footwear companies have been involved in a significant capacity building project which is encouraging worker participation through occupational health and safety committees<sup>7</sup>. Furthermore, one of these companies has been involved in facilitating ACFTU elections within a factory, a significant first step in the process of ensuring workers participate in choosing their union representative. These examples help demonstrate that progress is taking place in China, often at astonishing speed and there is scope for enterprises to contribute.

## **2. Foreign direct investment in China—understanding the issues, opportunities and limitations**

### ***2.1 The regulatory, business and cultural environment***

#### *China's Labour Law and regulatory environment*

China has a complex regulatory environment that needs to be understood in the context of sustainable FDI. Chinese labour law sets standards and rules<sup>8</sup>, which are as high as those in most OECD countries, although the extent to which they are implemented and influence behaviour in the factories is another matter. There is a gap between practise stated by Department of Labour and ACFTU officials and some foreign enterprises and factory managers, and what actually occurs.

The Chinese legal system and culture do not provide strong institutional support for compliance with domestic law, and there are many inconsistencies within the laws and regulations. Chinese labour law is complex, made more so by provincial adaptations and exceptions in special economic zones. Some factory managers have expressed frustration about the complexity of the regulations (and also the foreign company imposed codes of conduct) and the inability of the local departments of labour to assist with interpretation of the law. Local labour departments may prefer not to insist on compliance with laws—it is reported that staff have friends and relatives who manage factories, and financial contributions and kickbacks are a reality.

Workers are not well informed of their rights, and the weakness of Chinese legal institutions means too that workers are reluctant to take steps to secure their legal entitlements, adding to a culture of avoidance of legislated standards. China is not a country with a strong civil society. The trade unions are not particularly effective in protecting workers rights, independent NGOs have very little space in which to operate and there are few consumer protection mechanisms. As such, factories are under no pressure from Chinese society to reform and comply with labour law, thereby adding to an environment that misses opportunities to maximise the benefits of FDI. This is most evident with regard to wages, hours of work, social security entitlements and overtime. The practices of not paying legal minimum wages, appropriate overtime and bonus payments, and of imposing arbitrary fines and deductions force many workers to choose a factory where they are able to work illegal amounts of overtime in order to survive. Interestingly, in the optical industry many factory managers are now openly saying they cannot comply with the legal hours of work. One view is that NGOs should accept this and campaign to ensure workers receive the appropriate wages for hours and overtime worked.

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<sup>7</sup> <http://www.igc.org/mhssn/China3.htm> electronic [accessed 22 July 2002]

<sup>8</sup> [www.acftu.org.cn/labourlaw.htm](http://www.acftu.org.cn/labourlaw.htm) electronic [accessed 27 November 2002]

However, this does not address the issue of industrial accidents and work-related deaths caused by excessive overtime<sup>9</sup>.

The key to reform in China is collective bargaining and an increase in employee autonomy. China has a variety of collective contracts but these do not touch on the subject of collective disputes. In this regard trade union reform is needed, to ensure that representatives are democratically elected, professional and represent the workers concerns<sup>10</sup>.

These are complex issues of national scope, and there is very little a small firm can do to ensure the guaranteed, full enforcement of all laws. There are however, opportunities to contribute to sustainable FDI and these are discussed later.

### *Codes of conduct, monitoring and compliance*

In addition to the national laws, there are various requirements of large customers, in the form of corporate codes of conduct or certification with reporting instruments such as SA 8000. Whilst important in contributing to the promotion of core labour standards (particularly where national laws are inadequate or poorly regulated), in our experience, codes too often represent a shallow attempt to understand the real difficulties in transnational supply chain management. They do not provide an accurate representation of conditions. They are often developed at distance with a lack of involvement and commitment from both workers and managers. They are frequently poorly promoted and understood within factories, and workers are usually not consulted or given an opportunity to comment freely and without reprisal on their operation. Monitoring, compliance and enforcement is complex and problematic, and inspections are ad hoc and not necessarily undertaken by skilled personnel able to accurately identify falsified information. In addition, some codes are insensitive to local laws and customs and ignore the reality of Chinese labour relations by claiming that the principle of freedom of association is adhered to.

The proliferation of corporate codes of conduct does detract from a factory's capacity to comply with the Labour Law of the PRC. In isolation, codes cannot be relied on to protect workers' rights or promote worker empowerment, nor should they be seen as an alternative to national labour laws. Codes of conduct are, however, a useful first step in harnessing an enterprise's commitment to promoting sustainable FDI. What may be of greater value is a code of ethics or similar document that goes beyond regulations and compliance, and captures the spirit or organisational culture and willingness to progress corporate responsibility.

### *Sustainable FDI and competitive advantages*

The BSL's experience in China has confirmed that some factory managers are increasingly interested in how a business can be both ethical and competitive, particularly in sectors such as the optical industry, which are highly competitive. There is increasing awareness that corporate responsibility and improved compliance with both corporate codes and national laws could be turned into a competitive advantage. Improved compliance is already resulting in certain factories being more desirable to large brand name customers, and could be used by those companies to bolster their reputation as an organisation committed to sustainable FDI. This situation provides benefits for the factory through

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<sup>9</sup> Liu Kaiming, (unpublished) *Working Together to Build a Sustainable Improving Model*, China, 2002

<sup>10</sup> Dong Baohua, (unpublished) *Labour Law and Reform in China*, China, 2002

increased production contracts, benefits for the enterprise that is investing in the factory through improved supply chain management and corporate responsibility, and benefits for the factory workers who enjoy improved labour conditions. This is an area that deserves considerable attention, and foreign enterprises have significant scope to pursue innovative mechanisms based on this concept. Investigation of the competitive advantages that flow from sustainable FDI could be a more meaningful approach to protecting workers rights amongst transnational supply chains.

## ***2.2 Opportunities for enterprises to support sustainable FDI***

*How can companies ensure their impact is positive?*

Enterprises have a significant role to play in ensuring that FDI is sustainable and that the benefits are more evenly distributed throughout society. Supply chain management and offshore trading relationships are an important part of ensuring an organisation has a consistent approach to corporate responsibility that recognises the global dimensions. For example, an organisation cannot claim to be pursuing ethical business practices based on a code of conduct, without giving consideration to the labour and environmental practices amongst supply chains abroad. This is particularly important in a developing country that may have a weaker regulatory environment. In addition, those companies that pursue ethical business practices abroad are well placed to appropriate the competitive advantages that flow from sustainable business and contribute to FDI for development.

There is no one answer or quick fix remedy to ensure sustainable FDI amongst supply chains. What is required is a variety of responses that have been customised to suit the needs of all stakeholders and the business and regulatory environment offshore, and the size of the enterprise in which investment occurs. No one approach is completely right or wrong, however compliance with universal treaties and national laws to uphold basic labour rights and environmental standards should be the non-negotiable starting point. How enterprises then apply these conventions and statements, many of which are addressed to States, is the real challenge. It is necessary for an enterprise to then translate these principles into a form that can be applied in individual workplaces. This could include an emphasis on governance and SRI (particularly for publicly listed companies), improved compliance with local law, occupational health and safety, education and training programs for workers and managers etc. All these undertakings contribute to the necessary incremental and progressive steps that will contribute to sustainable FDI and a more even distribution of the benefits.

*Stakeholder dialogue: opportunities for enterprises—the BSL Model of Engagement*

China's astonishing capacity to change and develop provides an important backdrop against which to address the issue of sustainable FDI. It means that the opportunities for stakeholder dialogue are significant, and enterprises, both large and small have a role to play in contributing to discussion and promoting the development value in sustainable ethical business practices and investment.

Enterprises and factories in China do not yet have well developed communication systems and processes. This means valuable opportunities to communicate with workers, NGOs and other external players are not being taken up. The BSL has developed a Model of Engagement, a creative response to the complex issue of supply chain management. It involves undertaking research, the establishment of stakeholder dialogue and building long-term meaningful relationships with contractors and suppliers to discuss innovative ways to improve supply chain management and protect workers' rights.



The Model of Engagement promotes education and training as the most appropriate mechanism to encourage worker empowerment and self-determination, and to the development of sustainable improvements to labour and environmental standards. It is, in effect, a mechanism that surpasses the use of codes of conduct and monitoring mechanisms.

This Model is a dynamic process that requires a commitment to continuous dialogue and establishing partnerships and alliances with all stakeholders. The BSL has adopted a non-confrontational approach in discussions with factories. This supports the view that the most useful first step is to engage directly with workers in some way that benefits them and which will be acceptable to the local management. This latter qualification is essential to have any hope of success.

To this end, the BSL is pursuing a number of innovative strategies, all of which involve global collaboration with brand name customers, NGOs and other key stakeholders. A series of factory-based workshops are being planned. These will build on the existing education and training that is currently being provided by a global brand. Discussions are under way to investigate opportunities for small and large enterprises to work together in shared factories in a way that allows each to benefit from the purchasing power of the global brand, and the production and industry knowledge of Mod-Style. An occupational health and safety (OH&S) needs assessment involving workers, managers and external technical expertise is also being considered.

The checklist below may assist organisations that are committed to sustainable FDI within a framework of social responsibility. It is by no means exhaustive, and the inherent risks associated with checklists in terms of omitting important issues and narrowing the complexity of the debate must be recognised. It may, however, provide new ways of thinking to assist organisations in ensuring ethical business practices are embedded in the corporate culture and are factored into FDI decisions.

**Improved corporate responsibility and sustainable FDI in China: a checklist**

- Acknowledge that the organisation's corporate responsibility includes its global activities, including supply chains and subcontracting relationships and ensure this is included in any triple bottom line reports
- Undertake research and allocate resources to ensure social responsibility and sustainability is an ongoing component of international trade and investment
- Understand and map all supply chains and subcontracting arrangements
- Visit factories and workplaces regularly and continue to discuss issues of corporate responsibility and sustainable FDI
- Develop non-confrontational ways of communicating with factory managers
- Understand the labour, environmental conditions and regulatory framework in the countries of operation
- Respond to the central government's current regulatory emphasis on OH&S and other efforts to improve workplace conditions
- Develop open, transparent and direct long-term relationships with suppliers rather than relying on 'arms length' contracting and licensing agreements.
- Develop joint venture and other business contracts that incorporate criteria for sustainable FDI and corporate responsibility—this is currently particularly important in the electronics and petrochemical industries in China
- Invest in capacity building offshore, including education and training for workers and managers, and the promotion of ethical business practices
- Avoid the attraction of searching for the cheapest labour and goods, at the expense of social and environmental responsibility and sustainability
- Commit time and resources to understanding the business environment and culture of the countries of operation and be prepared to employ specialist staff

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| <ul style="list-style-type: none"> <li>❑ Recognise that corporate responsibility becomes more complex as transnational activity increases</li> <li>❑ Recognise that a Code of conduct and monitoring does not provide all the answers or protect workers rights</li> <li>❑ Recognise the limitations and opportunities facing enterprises seeking to contribute to sustainable FDI— incremental progress based on a commitment to action is worthwhile</li> <li>❑ Develop alliances and partnerships with NGOs, worker representatives, academics, other enterprises and government representatives to contribute to corporate and social responsibility through global collaboration</li> <li>❑ Commit to and act in accordance with the appropriate international treaties, conventions and guidelines—particularly the OECD Guidelines for Multinational Enterprises, in all dimensions of the business</li> <li>❑ Document your experiences in managing supply chains offshore, both the good and the bad, and make this information available to others, including Chinese officials who will welcome feedback on how to continue to attract FDI</li> <li>❑ Encourage your industry association or professional body to engage with the issue of sustainable FDI and develop an industry wide strategy and plan of commitment for incremental improvement</li> <li>❑ Contribute to consumer education and campaigns—assist consumers to make informed choice based on a clear understanding of where goods are produced and investments made, this could include labelling</li> </ul> |
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### ***2.3 Limitations to enterprise capacity***

#### *Core labour standards*

The core labour standards themselves create limitations to an enterprises’ capacity to influence sustainable FDI. Core labour standards are ‘big picture’ issues addressed to States and it is all the more difficult for enterprises to support compliance as many factory managers in China—and indeed, in many developed countries—do not see the links between labour rights and human rights, environmental standards and social justice.

#### *Complexity of the issue: conceptual and ethical considerations*

It is important to recognise that corporate responsibility amongst supply chains is a very complex issue. The conceptual and ethical task of dealing with Chinese factories is difficult for the small firm, even one committed to operating in an ethical manner. It requires time, resources and commitment. Specialist staff are needed with expertise and knowledge of the labour and environmental issues and regulatory environment of developing countries.

To demonstrate this complexity, the BSL has recognised that there are no easy answers to the difficult questions raised by our work. For example:

- What is the best approach to ensure sustainability and an enduring culture of corporate responsibility amongst our supply chains? Can this realistically be achieved?
- Do we only deal with factories that are open to our approach of continuous improvement and withdraw from dealing with the bad ones?

- To what extent can we accept willingness to change as a basis for an ongoing relationship with a supplier, irrespective of the time frames for achieving real change?
- How do we determine the point at which conditions are just so bad that nothing is to be gained by our continued involvement with that factory?
- How do we honour the ILO principles to which we are committed where they are simply impossible in the non-complying State?
- In which areas should we concentrate our efforts in terms of improved compliance—wages, hours, social security entitlements or the less threatening area of occupational health and safety—and who should make this decision?
- Would dealing with fewer suppliers increase the capacity to bring about an improvement in individual factory conditions as production increases?

#### *Complexity of the law and ineffective regulation*

The existence of a system of law that ensures compliance is essential to protect workers rights. However, the complexity of the Chinese legal system is, in itself, a limitation to enterprises pursuing sustainable FDI. Chinese labour law, whilst reasonably progressive, is diminished as a result of poor implementation and enforcement. Enterprises interested in investing in China need to work within the regulatory environment as best they can, and where possible, contribute to dialogue concerning simplification of the law. Enterprises need to become familiar with the Labour Law of the PRC and then make decisions about where they stand on issues such as wages, hours, access to social security entitlements, OH&S, freedom of association, collective bargaining, and the role of the ACFTU. They need to determine criteria by which they will assess FDI in terms of the social, environmental and economic impact. This requires a good understanding of the working and living conditions amongst the supply chains, opportunities to improve those conditions and mechanisms to monitor compliance. The prospect of such an undertaking can in itself be a limitation for enterprises.

#### *Costs of compliance*

In highly competitive industries, product cost and relationships are often the only differentiating factor. Improved compliance means operating costs will escalate and lead to higher unit costs for customers. The failure of enforcement and the tight competition means that managers believe they cannot afford to comply with local laws in the absence of any guarantee that competitors will also do so. There is a fear of losing customers to less compliant factories, or even to other countries such as Vietnam and Indonesia where labour is even cheaper and more compliant, and the regulatory environment less well developed. In this regard, foreign enterprises have a responsibility to ensure production is not moved from factory to factory in search of the cheapest labour and least rigorous standards, and that improved corporate responsibility amongst supply chains does involve some costs but many more benefits in terms of sustainable business practice.

#### *Customer leverage*

The reality for many small or medium enterprises is that, on their own, they have limited influence. Even those enterprises such as Mod-Style with the best intentions and enterprise commitment to core labour standards, are limited in what they can do as a result of their relatively small production.

However, factory managers have, for the most part, appreciated the Mod-Style approach of direct dialogue to pursue corporate responsibility rather than arms length directives and threats to cut production. Currently, large enterprises need to lead the way in terms of sustainable FDI in China, however the total number of small to medium enterprises investing in China is significant and this needs to be harnessed through global collaboration and industry-led initiatives.

#### *Corporate governance and production networks*

A further limitation for enterprises is the difficulties they can encounter in navigating global production networks that are often a maze of licensing arrangements shrouded in secrecy. Trading houses are responsible for managing the production of various products in China, yet many are unwilling to acknowledge that they are being made in China. This lack of transparency and accountability hinders efforts to promote sustainable FDI. Too often, poor transparency and corporate governance is defended under the guise of commercial confidentiality. In this regard it is important to recognise that these global production networks that can be a limitation to sustainable FDI.

#### *Industry associations*

Industry associations and professional bodies can be another limitation on enterprises' ability to influence FDI for development. They do not prevent enterprises from exerting influence, but they do not encourage corporate governance and transparency either. For the most part, they are primarily interested in developing new markets, sourcing new production techniques and meeting industry specific requirements. Protecting workers rights and environmental standards in China is not a high priority for these organisations.

### **3. The OECD Guidelines for Multinational Enterprises and supply chain management in China**

Implementation of the OECD Guidelines for Multinational Enterprises (Guidelines) in non-adhering countries such as China is problematic, however opportunities do exist for enterprises to pursue sustainable FDI. There is little doubt that complex subcontracting and supply chain arrangements make application of the Guidelines more complex, however, there is a role for home governments in supporting those enterprises seeking to do the right thing. Assistance can be provided to firms, particularly small and medium sized enterprises, through ensuring they understand the realities of sustainable and socially responsible investment in developing countries. This requires governments to make the connections between human rights and international business, and to accept some responsibility for the business activities of enterprises abroad to contribute to compliance with labour and environmental standards. Enterprises need to be persuaded to improve their transparency and accountability, particularly regarding their global production networks, licensing arrangements and portfolio investments. This will require a shift from the current emphasis on 'confidentiality', which is often presented as a commercial imperative, but can be also be interpreted as a calculated risk management strategy to reduce perceived negative consumer or shareholder backlash. Similarly, the contractual relationships along supply chains could be disclosed, for example, in annual reports of firms. This is consistent with the Guidelines in terms of disclosure.

### *Maximising the benefits of existing responsibility regimes*

The Guidelines are currently the highest set of standards available amongst the global corporate, social and environmental responsibility regimes that can contribute to sustainable societies. They are the most important code of conduct that exists for business, and allow opportunities for citizens to raise concerns about the practices of international companies with the home government<sup>11</sup>. In conjunction with the Global Reporting Initiative (GRI), there is significant scope for enterprises to contribute to sustainable FDI in a manner that becomes increasing comparative and useful in contributing to socially responsible business practices. There are, however, still significant implementation issues that remain a barrier to their potential success.

### *Implementation—the case for improved transparency*

Considerable work needs to occur to bolster the OECD Guidelines in the area of implementation and verification, and NGOs and trade unions are well placed to do this. In addition, the OECD member State National Contact Points (NCPs) have a responsibility in terms of better promotion of the Guidelines and ensuring that when cases are raised the process of investigation and progress is transparent, accountable and speedy. NCPs need to do more than just support the Guidelines in principle or until they cause ‘discomfort’, a reality given that many NCPs are government officials who work closely with the private sector securing investment at home and abroad<sup>12</sup>. A central registry of cases that have been presented to NCPs is required, as are more detailed NCP annual reports with information on the cases that have been raised and the companies involved<sup>13</sup>. This would go some way to addressing the concerns of many NGOs that the Guidelines fail to empower affected communities and are limited in their effectiveness because they are not binding or enforceable. The issue of improved transparency and accountability needs further consideration if the Guidelines are to contribute to sustainable corporate responsibility in a meaningful way, and to achieve uniform respect from all stakeholders—NGOs, TUAC, BIAC and the OECD and adhering country representatives.

### *Integrated trade and investment*

The OECD Guidelines, whilst not binding, do commit OECD member States to active participation in the corporate responsibility debate and practice. This requires Governments to respond to the increased global integration of trade and investment and to ensure policies aimed at corporations are in keeping with the OECD Guidelines. Incentive packages, such as subsidies and export credit regimes, designed to both attract inward investment and promote external investment, both trade and portfolio, need to be consistent with the OECD Guidelines<sup>14</sup>. Negotiating global rules for investment is undoubtedly high on the agenda of the OECD Committee on Investment and Multinational Enterprise (CIME). The business community is seeking increased access to foreign markets through direct investment (Greenfield), mergers and acquisitions, privatisation, portfolio investment, financial

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<sup>11</sup> Van der Gaag, P., *Governments and Corporate Social and Environmental Responsibility* (presentation text), Washington DC, 2001

<sup>12</sup> *Making Companies Accountable: an NGO Report on Implementation of the OECD Guidelines for Multinational Enterprises by National Contact Points*, 2002

<sup>13</sup> *Making Companies Accountable: an NGO Report on Implementation of the OECD Guidelines for Multinational Enterprises by National Contact Points*, 2002

<sup>14</sup> Van der Gaag, P., *Governments and Corporate Social and Environmental Responsibility* (presentation text), Washington DC, 2001

services and global production networks. In addition, they are applying pressure to CIME to encourage developing countries to accept more liberal investment regimes<sup>15</sup>.

At the OECD Roundtable on Corporate responsibility<sup>16</sup> it was claimed that supply chain issues were outside the scope of the Guidelines and that trade and investment should be considered separately. Such a position does not acknowledge the explicit references to “suppliers and sub-contractors”<sup>17</sup> in the text, which clearly recognises the global integration of trade and investment and the mandate to include supply chain and subcontracting relationships within the scope of the Guidelines. Efforts to separate trade and investment and supply chain management, and thereby dilute the potential of the OECD Guidelines, should be discouraged and would further increase the scepticism of some NGOs and trade union groups as to the Guidelines effectiveness.

### **Concluding remarks**

China’s astonishing capacity to change and develop provides an important backdrop against which to address the issue of sustainable FDI. It means that the opportunities for stakeholder dialogue are significant, and enterprises, both large and small have a role to play in contributing to discussion and promoting the development value in sustainable, ethical business practices and investment. The BSL experience, and the contribution of many other organisations such as the Northern Alliance for Sustainability (ANPED), TUAC and the Asia Monitor Resource Centre (AMRC) to name a few, as well as the progressive enterprises, clearly demonstrates that there is no one solution to ensure sustainable FDI, particularly in developing countries.

What is required is a variety of innovative responses that suit the needs of all stakeholders and that are based on internationally recognised principles that contribute to the protection of labour rights and environmental sustainability. This is best achieved through alliances and partnerships between business, NGOs, trade unions and governments. The OECD Guidelines for Multinational Enterprises in conjunction with the GRI are currently the best placed corporate responsibility mechanisms, and with additional attention to the issues of implementation, monitoring and improved transparency could be a powerful tool.

Trade and investment are clearly integrated in the global economy and greater attention needs to be given to the complex area of corporate responsibility amongst supply chains and subcontracting arrangements. The experience of the BSL with its optical enterprise firmly entrenched in China clearly demonstrates that it is possible for small enterprises to contribute to the global debate and practice if there is a strong commitment and willingness to invest in ethical and sustainable business practices.

For further information on this paper or the ongoing work of the Brotherhood of St Laurence, please contact Serena Lillywhite, Manager, Ethical Business ([slillywhite@bsl.org.au](mailto:slillywhite@bsl.org.au)) or visit the website: [www.bsl.org.au](http://www.bsl.org.au).

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<sup>15</sup> [www.anped.org](http://www.anped.org) , (electronic) Van Bennekom, S., *OECD re-launching the MAI?* [accessed 27 November,2002]

<sup>16</sup> OECD Roundtable on Corporate Responsibility, June, 2002

<sup>17</sup> OECD Guidelines for Multinational Enterprises, general Policies, Chapter II, paragraph10