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Workshop 2: The Role of Voluntary Approaches in Managing the FDI-Environment Relationship

**FOREIGN DIRECT INVESTMENT AND THE ENVIRONMENT:
THE ROLE OF VOLUNTARY CORPORATE ENVIRONMENTAL MANAGEMENT**

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Executive Summary

Foreign direct investment (FDI), like any direct investment, can have an impact on the environment of the host country or beyond. FDI attracts particular interest however partly because investment projects may be of a larger scale than domestic-sourced investment in many small to medium-sized countries. Multinational enterprises are also thought to have greater possibilities either to introduce cutting-edge environmental technologies and practices on the one hand, or to be able to exert pressure for reduced environmental performance standards on the other. Given rapid rates of growth of FDI, and increased pressure from stakeholders such as shareholders, communities, employees, NGOs, financiers as well as regulators for improved corporate environmental performance, there is an increasing amount of scrutiny of the environmental consequences of foreign direct investment. A growing number of companies and industries are responding in advance or instead of host government mandatory requirements in addressing environmental aspects of their international operations through voluntary approaches.

These voluntary approaches, their strengths and weaknesses, and the emerging best practice in these fields, are the subject of this paper.

Voluntary Approaches: What are they ?

The main voluntary approaches examined here are voluntary codes or statements of corporate conduct for the environment and corporate environmental reporting. Environmental management systems will also be mentioned. So-called 'voluntary agreements' whereby companies or industries reach agreements with governments over how they will tackle a particular environmental issue are not covered here.

Voluntary Codes of Conduct or Guidelines for the Environment

As a general rule, corporate or industry codes of conduct are not specifically directed at either the process of making a particular investment or the ongoing operation of foreign establishments. One exception is that of the Japan Federation of Economic Organisations (*Keidanren*) "Environmental Guidelines for Japanese Enterprises Operating Abroad". However as codes of conduct are predominantly adopted by multinational enterprises (MNEs) they are relevant to FDI because they cover the global operations of the enterprise. Environmental conditions more directly related to the investment process include the World Bank Environmental Guidelines and similar environmental performance requirements of some regional development banks and some national export credit agencies. These are, however, of the nature of

contractual conditions attached to loans or insurance rather than voluntary approaches, and are not further discussed here.

There is a wide range of voluntary codes of environmental conduct currently in the marketplace. The earliest dates from the 1970s, but the majority of activity seems to have arisen around the 1992 UNCED at Rio. They range from inter-governmental, to international and national business declarations, to industry-based codes to individual corporate policy statements. The subject matter, the level of detail, the degree of commitment required by these statements varies enormously. Some statements are written in terms of the environment, whereas some of the newer ones have adopted the broader newer concept of sustainable development, incorporating both environmental and social aspects.

Agenda 21 is particularly important because it is a statement that Governments have already subscribed to, and it was prepared with wide community and business input. It dedicates a chapter to business and addresses other recommendations throughout the document to enterprises.

The OECD also has *Guidelines for Multinational Enterprises* which, since 1991, have contained a chapter on the environment. The Guidelines date from 1976, and they are still the only international code of conduct for multinational enterprises endorsed by governments as well as business and labour representatives (*i.e.* by BIAC and TUAC, the OECD's advisory bodies of employers and trade unions, respectively). The Guidelines have been considered to be an important component of the overall set of OECD principles and decisions concerning investment. This broader set of legal instruments includes rules on non-discriminatory treatment of foreign-owned enterprises. Each OECD Member country has agreed to recommend these guidelines to their enterprises, and has established a contact point in its administration to deal with inquiries etc. Argentina, Brazil and Chile have also adopted the OECD investment instruments, including the Guidelines.

These OECD Guidelines are currently the subject of a periodic review within the OECD, which is aimed *inter alia* at modernising the environmental chapter. The review process will include consultations with all stakeholders, including NGOs.

Also of particular interest are two leading international business codes of environmental conduct, namely the Business Charter for Sustainable Development of the International Chamber of Commerce (ICC) and the CERES principles. The former is the most widespread and well known of the generic codes of environmental conduct. The latter is the most ambitious and demanding of the general statements.

The Business Charter for Sustainable Development, sponsored by the International Chamber of Commerce (ICC), is the most widespread and well-known business statement on the environment. More than 2000 companies have endorsed the Charter, many of them large MNEs, and the ICC covers all business sectors. The Charter consists of 16 principles that are described as a framework to help industries and individual corporations define their own more specific environmental policies.

The Coalition for Environmentally Responsible Economies (CERES) was formed in 1989. It brought together fifteen major US environmental groups and an array of socially responsible investors and public pension funds representing more than US\$150 billion in invested funds¹. This Coalition designed the ten principles, originally known as the Valdez Principles, but now called the CERES Principles. CERES endorsers are businesses and other organisations which have publicly committed to the CERES Principles. According to the CERES website, 46 companies and organisations have endorsed the CERES Principles including General Motors, Polaroid, Bethlehem Steel, the Body Shop, Aveda, Sun Oil and H.B. Fuller.

¹ www.ceres.org/about

The ten principles are briefly stated and they aim high. They cover the substantive environmental issues of protection of the biosphere (emissions and biodiversity), sustainable use of resources, disposal of wastes, energy conservation, risk reduction, safe products and services and environmental restoration; as well as the process issues of public information, management commitment, and audits and reports. They recognise explicitly that companies endorsing the Principles pledge to go voluntarily beyond the requirements of the law.

Apart from the substantive content, the CERES Principles are also the high water mark in terms of commitment to monitoring implementation and reporting on progress. Endorsers commit to annually complete a CERES report on progress in implementing the Principles and to make it public. In addition, CERES has a 'Global Reporting Initiative' which is attempting to bring together the various initiatives world-wide on corporate environmental reporting and to turn them into one set of coherent, consistent global standards. The aim is to generate standard environmental information akin to existing standard financial information.

Industry associations across resources, manufacturing and services industries are adopting codes of environmental conduct to guide their constituent member companies. They can be international industry associations, national industry associations, or national cross-sectoral industry associations. Some prominent examples are² listed below.

- The chemical industry's Responsible Care[®] programme. Responsible Care[®] has international, regional and national versions. At least 38 countries have national programmes. Many secondary codes and guidance documents are developed on specific issues such as hazardous chemical management, product stewardship etc. Self-assessment against the requirements of Responsible Care[®] is a mandatory part of all national programmes.
- The "UNEP Statement by Financial Institutions on the Environment and Sustainable Development", revised in 1997 with about 115 signatories. Similarly, UNEP has worked with insurance companies to develop the "Statement of Environmental Commitment by the Insurance Industry"³. This was officially launched in November 1995 and about 75 insurance companies have signed the statement.
- The 1993 International Council on Metals and the Environment (ICME) Environmental Charter⁴.
- The 1996 Australian Minerals Industry Code for Environmental Management⁵.
- World Travel and Tourism Council, "Green Globe" environmental guideline⁶.
- The Japan Federation of Economic Organisations (*Keidanren*), *Keidanren Global Environmental Charter*. The *Keidanren* also has "Environmental Guidelines for Japanese Enterprises Operating Abroad".

Large numbers of individual companies have published corporate environmental policies, value statements or reports of some kind. They can range from ethics statements which lay down expected standards of behaviour of employees; to value statements which give an organisation's operating

² A longer list is contained in "Voluntary Industry Codes of Conduct for the Environment", UNEP Technical Report No. 40. This Technical Report provides guidance to industry associations and others on how to develop and use voluntary codes.

³ See www.unep.ch/eteu/insura/statemen.htm

⁴ See www.icme.com

⁵ See www.minerals.org.au

⁶ See www.wttc.org

philosophy; to dedicated environmental policy statements; to highly sophisticated published environmental accounts and reports.

The 1991 UNCTAD Benchmark Survey of around 170 MNEs found that 43 per cent of all respondents had a published international environmental policy statement: 70 per cent of North American respondents, 41 per cent of European respondents, and 18 per cent of Asian respondents. It also found that MNEs in the top-third sales group were almost twice as likely to have a policy statement as MNEs in the bottom-third sales group. The extractive-based sector was found to be by far the sector most represented at 60 per cent of the total⁷.

The content and nature of corporate policy statements which refer to environmental issues varies substantially, and it is therefore difficult to generalise. They range from simplistic generalisations to detailed guidelines and targets. It does seem however that the emphasis is more often placed on internal corporate environmental, health and safety issues than on environmental issues more broadly. Protecting the immediate environment surrounding a production facility seems to come next in frequency, followed by more general environmental commitments. Not surprisingly, companies in industries with traditionally the largest public relations problems in the environmental area such as chemicals, petrochemicals, energy and resources companies have the most far-reaching policy statements.

The *UNCTAD Benchmark Survey* noted that the level of detail varied, with decentralised and diversified companies producing more general statements than more centralised, focused companies. It found that “in general, the statements covered the following issues: a definition of environmental protection (preventative, integrative, international validity); research and development, aspects of process and product safety, health protection, production technology, environmental protection technology, control and environmental information instruments, responsibility of employees, environmental management practices, environmental protection measures, emergency plans, information to the public, and relations with customers.”⁸

Some policy statements also spell out implementation procedures. Some specify the appropriate officer in the company to whom suspected breaches of the codes or policies are to be reported. Others have annual systems of reporting where each level of management seeks written confirmation from their subordinates of adherence to the policy. Royal Dutch/Shell Group for example, had an independent auditor⁹ verify the fact that its revised “General Business Principles” had been formally adopted by all Shell companies world-wide.

Despite these efforts of the leading companies, implementation of corporate and industry environmental codes is clearly their weak point. Too often there are no implementation procedures spelt out. In the absence of effective implementation, voluntary codes may well simply add to public scepticism of the bona fides of business and industry with respect to the environment. Even if codes are implemented, they are not likely to inspire solid public confidence in the absence of quantifiable performance targets against which environmental performance is monitored, assessed, externally verified and publicly reported.

⁷ *Environmental Management in Transnational Corporations: Report on the Benchmark Corporate Environmental Survey*, United Nations, Geneva, 1993, p.13

⁸ *Ibid.*, p.15

⁹ The auditors were KPMG Accountants and Price Waterhouse. See <http://www.shell.com/shellreport/pages/audit.htm>.

Corporate Environmental Reporting

Policy statements or codes of conduct therefore are increasingly only the background against which real efforts in terms of corporate environmental policy takes place. Real efforts are now being made by the most progressive companies in the more concrete areas of environmental accounting. Policy statements are being converted into measurable performance targets, which are set, measured, audited and publicly reported. An even more advanced version includes social reporting as well. The philosophy behind these efforts is that actions are more convincing than words, and in business it has to be measured if it is to be taken seriously.

An important element of corporate environmental management therefore is setting performance targets, measuring progress in environmental performance against the targets, and publicly disclosing that information. Many large companies, particularly in the manufacturing, energy and resources industries, now compile annual environmental reports which contain environmental data such as emissions to air, land and water; hazardous and other waste generation; energy efficiency; environmental technology improvements; site remediation projects, environmental research programmes; employee incentive schemes or prizes for environmental improvement, etc. These reports are increasingly being independently audited and verified, to meet the demands of shareholders, customers, and the general public for rigour and accountability on environmental performance.

An environmental consultancy firm SustainAbility, in co-operation with UNEP, has compiled a survey of 100 selected company environmental reports and ranked them against 50 reporting criteria¹⁰. The survey found a seven-fold increase in the proportion of company environmental reports which were independently verified from the initial 1993-94 survey¹¹ to the most recent 1997 survey (of a different 100 companies). Independent verification was however still only performed by 28 per cent of the companies in the survey. This survey provides a lot of very interesting company-specific information on environmental reporting, including rating the 100 selected companies. The Body Shop is awarded the highest score for its environmental reporting. Environmental reporting is of course not the same as environmental performance – there could be very full reporting of bad performance - although full reporting is more likely to promote good environmental performance.

An even more ambitious kind of environmental accounting is being attempted by some leading companies. This involves developing sustainability performance indicators from both an environmental and a social perspective, and plotting progress against these indicators. It is called ‘triple bottom line performance’ in the SustainAbility/UNEP report referred to above. The aim is to augment traditional financial bottom line measurements with environmental and social measurements. This methodology is very much in its infancy, but demonstrates the need felt in the corporate community to make environmental policy statements increasingly quantifiable and verifiable, and to make commitments operational to sustainable development by taking social factors into account as well as environmental ones. For example, Royal Dutch/Shell Group is currently working on how to devise and report a triple bottom line performance, as is The Body Shop and others.

As well as individual company efforts, there is work underway in several international business forums on how companies can quantify and assess sustainable development indicators. For example, the World Business Council for Sustainable Development (WBCSD) is currently working on a project called

¹⁰ “Engaging Stakeholders: The 1997 Benchmark Survey – The Third International Progress Report on Company Environmental Reporting”, Report prepared by UNEP, SustainAbility. 1997. See also <http://www.sustainability.co.uk>.

¹¹ “Company Environmental Reporting – A Measure of the Progress of Business & Industry Towards Sustainable Development”, UNEP Technical Report No. 24, 1994.

Corporate Social Responsibility (CSR) which is aiming to add consideration of the social side of sustainable development to the economic and environmental sides. As part of the project, fifteen organisations with a code or principles document, including the OECD Guidelines, were examined. The documents were analysed and six common primary values were distilled: human rights, worker rights, environment, community involvement, supplier relations and monitoring. Building on this, environmental and social 'ledgers' have been developed which set out performance indicators, performance measurements and evaluation mechanisms. The environmental performance indicators are in four areas: material use, energy consumption, non-product output, and pollutant releases. The social ledger has four areas of performance requirements: employment practices, community relations, ethical sourcing, and the social impact of the product¹².

On another front, environmental management systems such as ISO 14000 can also be seen as a way in which companies can put their environmental policy statements into practice. Such environmental management systems of course only concern management systems and process questions, not environmental performance itself. Nevertheless the two are likely to be closely related, and should be seen as complementary.

Emerging Best Practice ?

Some generalisations about what constitutes best practice approaches in environmental codes can be made as follows:

- Firstly, state-of-the-art codes commit to *sustainable development* and to managing their activities such that economic, social and environmental considerations are integrated into decision making and management.
- Second, commitments are made to *setting measurable goals* for improving environmental performance,
- Third, *monitoring, assessment and independent verification* of environmental performance is included.
- Fourth, newer more progressive codes place a greater emphasis on *public reporting* of environmental information. They are moving to greater transparency
- Fifth, *community consultation and partnership* are emphasised.
- Sixth, a *culture of environmental responsibility* is encouraged through activities such as environmental management systems and staff training, rather than focusing solely on concrete performance issues like emissions and materials use.
- Seventh, compliance with relevant legislation is the minimum starting point, with the focus on continuous improvement and *best practice*.
- Eighth, *corporate standards are applied on a world-wide basis*.
- Ninth, they specify how *implementation of the policy is to be monitored*.

Building on these approaches, the following set of illustrative environmental guidelines indicates the main areas where progressive corporate codes are making commitments. Attached is a synthesis of issues dealt with in different codes, and all the elements listed here are most probably not found in any one single code.

¹² See www.wbcsd.org for a summary of the "Corporate Social Responsibility Stakeholder Dialogue Session" held in the Netherlands on September 6-8, 1998; the environmental and social ledgers, and other information on the CSR project

Hypothetical Principles for Environmentally Responsible Corporate Behaviour

Sustainable Development

Enterprises should establish world-wide policies on sustainable development.

Integrated Environmental Management – a Corporate Priority

Enterprises should recognise environmental management as among the highest corporate priorities and as a key determinant of sustainable development. They are encouraged to implement recognised environmental management systems such as ISO 14000 and EMAS. Environmental and social factors should be integrated into all strategies, decisions and activities.

Corporate-wide Environmental Policies and Practices

Enterprises should apply the same corporate-wide environmental policies across their international operations. Particular environmental practices and performance standards should be adapted to suit the local environment, but should reflect the higher of home country or international best practice as concerns the management of harmful substances and wherever else this is practicable.

Environmental Impact Assessment

Enterprises should assess and take into account the full environmental impact of activities or projects prior to their commencement. Monitoring and assessment should be ongoing.

Sustainable Use of Natural Resources and Clean Production

Enterprises should use energy and materials in an efficient manner and conserve non-renewable natural resources and biodiversity. They should minimise the generation of wastes in production processes and emissions to the environment. The objective should be pollution and waste avoidance rather than clean-up. Measurable targets should be set, and performance measured against them regularly.

Accident Prevention and Emergency Preparedness

Enterprises should take all possible action to prevent accidents which cause health or environmental damage, and should develop emergency contingency plans in conjunction with relevant authorities and communities, recognising potential transboundary impacts.

Life Cycle Approach to Products and Services

Enterprises should develop and provide products and services that have no undue environmental impact and are safe in their intended use, that are efficient in their consumption of energy and natural resources, and that can be (preferably) recycled or re-used, or (at least) disposed of safely.

Precautionary Principle

Enterprises should act to prevent serious or irreversible environmental degradation even in the face of scientific uncertainty.

Research

Enterprises should conduct or support research on the environmental impacts of raw materials, products, processes, emissions and wastes associated with the enterprise and on ways to minimise adverse environmental effects.

Environmental Education and Training

Enterprises should educate, train and motivate employees to conduct their activities in an environmentally responsible manner.

Technology Diffusion

Enterprises should contribute to the diffusion of environmentally sound goods, services and technologies throughout the private and public sectors, particularly in developing countries.

Supply Chain Management

Enterprises should encourage and assist their suppliers and customers to adopt best environmental practices and to conform to these Guidelines.

Multilateral Environmental Agreements

Enterprises should comply with the requirements of multilateral environmental agreements and do their best to move toward targets and objectives as quickly as possible.

Contribution to Public Policy

Enterprises should contribute to the development of sound environmental policy and to activities in industry and the community that contribute to increased environmental protection and awareness.

Environmental Reporting and Auditing

Enterprises should conduct environmental audits to measure the environmental impact of their activities and make this information publicly available through annual company environmental reports, through providing information for toxic release registers and through information dissemination to employees, shareholders, directors, the authorities and the public.

Public Openness and Dialogue

Enterprises should foster openness and dialogue with employees and the public, anticipating and responding to their concerns about the potential hazards and impacts of operations, products, services or wastes, including those of transboundary or global significance.

Monitoring Implementation of these Principles

Enterprises should construct methods to ensure these principles are implemented and should make regular assessments of their performance against these principles.