Hosted by:

Government of India

OECD

OECD Global Forum on International Investment
Hotel Intercontinental The Grand
20-21 October 2004, New Delhi, India

INVESTMENT FOR DEVELOPMENT:
FORGING PARTNERSHIPS

Supported by:

CII
Confederation of Indian Industry

Session 3:
Government Responsibility and Corporate Responsibility – OECD and non-OECD Perspectives

PROMOTING CORPORATE RESPONSIBILITY – DEFINING THE ROLES OF GOVERNMENT AND BUSINESS: WHERE THE IDEALIST MEETS THE PRAGMATIST

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The theme of this session is to explore where and how the governments' and corporate responsibility should interplay. My goal is to highlight the concepts of the dialogue and cooperation and cooperation between the government and business, less so the practicalities thereof.

The following (3) issues will be addressed:

- Clarity of positions and expectations
- Parity and reciprocity
- In the above context the role of OECD Guidelines

Nowadays, it is widely believed that FDI can and, in reality, does significantly contribute to the development of the host countries and to the global economy as a whole—greater volume of foreign trade takes place between the multinational enterprises than between the nation-states.

Notwithstanding the older, i.e. "dependencia" argument and more recent disscussions centering on potential disaccord between the strategy of the foreign investors and the policies of the host countries, substantial quantitative and anecdotal evidence attests to the development-stimulating function of the FDI. And if anybody has doubts, please take a look at the new skyline of Shanghai. FDI relative to Gross Fixed Capital Formation amounts in recent years on the average to 8-15% (author's calculations based on WIRs). It would appear then that foreign investment acts as a valuable supplement to local investment rather than a primary factor of economic growth. So why does it attract so much attention? Of course we know the answer: It is the expectation that FDI play a role of the catalyst embodying to a greater extent the features of technology and efficiency above the average level of its local counterpart in the developing host countries.

It is this perception supported by the evidence of economic success stories around the world that makes FDI a much sought after proposition (McKinsey, 2004). Given the appropriate host-country policies and a basic level of development, a preponderance of studies shows that FDI triggers technology spillovers, assists human capital formation, contributes to international trade integration, helps create a more competitive business environment and enhances the local enterprise development. All of these produce a higher economic growth--the most potent tool for alleviating poverty in developing countries. Moreover, beyond the strictly economic benefits, FDI may help improve environmental and social conditions in the host country by, transferring "cleaner" technologies and leading by example to more socially responsible corporate policies.

Naturally, the MNCs are aware of the attractiveness of their FDI to the target countries who often become its bevy suitors. Rhetorically, couldn't we ask: Aren't the multinationals doing enough by simply bringing their capital, skills and global connections to a new location? And then the following question: What could they (not <u>should they</u>) do more?

<u>The Framework of the Cooperation</u>

The rules of cooperation can be worked around 3 principles:

1. Realistic expectations
2. Persuasion is rather than coercion
3. Rewarding good action

In view of all the advantages of FDI, the rapport between MNCs and the host governments needn't be (and actually is not) adversarial. The importance of social issues to resolve requires that we go beyond the old thinking of MNCs vs. host nation states and the implicit confrontation and advocate a cooperative framework. Perhaps the business approach as espoused by the MNCs could be summed up in the following statement addressed to the governments of the developing host countries governments: 1/please create ever better conditions to facilitate FDI and it will flock to your markets, 2/please recognize the contribution our FDI makes to your economic and social development and treat us accordingly.

It is important to realize that FDI generates many beneficial effects <u>naturally</u> without a need to force the investors to pursue such goals explicitly in their agenda. At the same time it a rather an underexplored at the microeconomic level—i.e. individual project level[1]. While staying so much

[1] While not complete, my own list of criteria of quality investment would encompass the following:

First

- Industries with dynamic long term growth potential.
- Reputation of the investor to assure the soundness of the project and the enhancement of the image of the locale.
- Potential for multiplier effects realized through: 1/subsequent investment by the suppliers of components, 2/ attracting competitors and "cluster building."
- Quality of the jobs created (high skilled versus low skilled), including training.
- Labor intensity (when relevant) as measured by the number of jobs created.
- Export potential.
- Cleanliness of the technology.

The second subset encompasses the supplementary effects and the desirable (not universally, though) legal format of FDI.

- Project-related development of general infrastructure.
- Operation-related local R&D activities.
- Fit with the ownership format (JV) to preserve control and the equitable distribution of the benefits from the point of view of the host country.
- "Greenfield" investment rather than acquisitions.

preoccupied with the volumes of FDI, we only pay a lip service to the issue of its quality. To illustrate the point, it is a common belief that a bad local business climate reduces the inflow of FDI. This not the only casualty, though. To put it bluntly, "a junk environment attracts junk FDI". One can often hear government officials emphasizing the need for quality projects especially when the sheer volume expectations of FDI are met or some bottlenecks emerge. But far too seldom specific sets of priorities are conceptualized, even less so conveyed to the investing community. This leads me to the first stipulation:

Make it possible for the MNCs what can they do best. Keeping in mind that the definition of a "corporate social responsibility" is not particularly clear (Ward, 2004), and that "a good investment project" means different things to different audiences, the investors need unambiguous signals[2]. Ladies and gentlemen who represent the national investment promotion agencies, please have the information about what you consider quality FDI available for the prospective investors. Only then can you expect the most suitable opportunities knock on your door.

Alternatively, one should encourage MNCs to formulate their own stance on social responsibility issue.

<u>Structuring the relationship.</u>

Let me propose a framework which I have used elsewhere for a broader analysis between international investors and governments. It consists of 5 pairs of relations:

- Foreign investors and the host country governments
- Local investors and the host country governments
- Foreign investors and their home country governments
- Foreign investors and local businesses
- Home country and host country governments

One can certainly not forget international organizations who would be positioned in between.

For the sake of this paper, let me just briefly look at the social and development aspects of the above diagram. In terms of the nature of the relationship between the governments and the foreign investors, the attitude aspect needs to be addressed first. Since FDI is such a welcome guest, then it should be encouraged to stay for a long, long time. The goal is as much to attract FDI as to keep it. If FDI ventures are expected to get intrinsically involved in the development of the host country economy, then they would more and more blend with the market in question. One would expect that, consequently, the stigma of "foreignness" would disappear from the image of FDI.

It is an important stipulation as it touches on too often a differential treatment of local and foreign investors. Sometimes, it is the local businesses who enjoy the advantage (from the outset they are better familiar with the administrative environment), sometimes FDI—it is very rare that similar incentives are offered to local investors. Any form of discrimination (like for example, limiting privatization of public enterprises to local investors) distorts competition. In terms of social responsibility, one can expect FDI demand equal treatment with the local businesses. After all, ideologically one can argue that local companies have a stake in developing their own country. Therefore, in terms of reciprocity for the FDI input (which I strongly believe in) it is incumbent upon the governments to imply that the imperative of social responsibility is equally valid for all the businesses.

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[2] By the way "laissez faire" is one such signal which creates confusion when revoked.

As said before corporate social responsibility is not a very clear notion. In implementing their social agenda, the host governments clearly count on leveraging the "leading by example" concept: have the revered icons of global brands educate the people in the consumption benefits and patterns and the fellow local businesses in the practices of efficient management derived from the more demanding (socially as well) economic environment. But the same should apply for the host governments as well: good governance, transparency, stability of practices enhance the efficiency and attract cooperation. How can one expect a serious business commitment to the government's cause if at the same time it is plagued by corruption, show off projects, divisiveness and disregard of political process? What is more: overly complicated, ambiguous, biased rules by the government only invite opposition and cheating from business. In improving governance, both business and government can thus show genuine social responsibility. And importantly, it is not just the central administration but the public sector agencies (central bank, utilities, social security, transportation sector, even police) as well who need to demonstrate leadership as harbinger of progress. Needless to say, public sector represents a big part of GDP in many relevant countries—Iran, China. Importantly, public private partnerships (PPPs)—popular in the infrastructure development projects-- constitute a testing ground for improvement of mutual governance

Delineating boundaries of social responsibility is clearly essential: how far astray from their main activity should foreign investors go? Should they go "extra" mile just to please the governments or because it is a good thing to do not just for the host society but for the business itself? In terms of revealing the woes and the needs, conflicting thoughts emerge. From the government's perspective, the most acute problems need to be addressed first and the participation of the business community is called upon. At the same time, however, those very same problems reflect poorly on the social (=business) climate and are often underplayed by the governments.

Positive social effects arising from the MNCs' activities originate in 2 areas:

1. own business operations and what is directly related to it
2. outside activities: charitable, public relations, joint undertakings/recommendations with other companies/associations

The two do not exclude each other and because it is hard to prescribe a <u>specific</u> conduct which can be universally most beneficial. However, I would be a strong proponent of having businesses stick to their guns. Before venturing outside the perimeter of investors' direct concerns there are still many paramount practical issues in social responsibility of mutual concern for business and government. To offer just 2 examples.

1. Marketing the products and services to the poor—issues of concerns and best practices. It is a good challenge for capitalism yet still a profitable proposition.
2. Responses to economic and financial crises—downsizing, accepting sacrifices, new "bare bone" product/services, less "pushy" promotion, credit facilitation.

There is perhaps one possible overriding circumstance when the businesses (foreign and locally-owned) should feel the duty of pitching in. These are the cases of social disasters reaching pandemic proportion. The HIV/AIDS disease meets those criteria. What we mean here is not the pharmaceutical companies whose mission and core business is health care. Rather, the focus is on all MNCs with large work forces in affected regions. Apart from other disastrous consequences, the disease has clear managerial implications--it affects productivity, increases absenteeism and turnover[3]. executives from consumer goods companies consistently stressed the long-term implications of HIV/AIDS on their global performance. There is further fear that HIV/AIDS could reduce future product sales in emerging economies they have targeted for growth if the pandemic significantly erodes purchasing

[3] In a 2003 study of the economic impact of HIV/AIDS in South Africa, conducted by the South Africa Bureau for Economic Research and the South African Business Coalition on HIV/AIDS, more than half of the manufacturers surveyed said the disease had led to lower labor productivity or increased absenteeism. Forty percent of manufacturers reported that HIV/AIDS had reduced their profits.

power in those locations. But what can businesses do? They might be after all well positioned to capitalize on their infrastructure and contacts to help with the dissemination of information, in-house testing and treatment programs[4].

What is the task of the government? I can think of sharing information about the projected market developments, initiating research and providing ideas on how the government and business can jointly face the challenge. The new homework for the governments is to re-examine what can be best accomplished while maintaining a liberal regime. One example to attest that not all the positive changes follow a linear function is the issue of competition. . The presence of foreign enterprises may spur domestic competition. However, a healthy competition may evolve into much less desirable "cut throat" variety. Conversely, the entry of MNEs also tends to raise the levels of concentration in host-country markets, which in turn can hurt competition. Consequently, crowding out can also become a problem. Hence, in their anticipatory function, governments need to set certain benchmarks on their own so as to avoid sending mixed signals thereafter.

One thing is obvious: without clear and alternative priorities conveyed, the companies might end up mimicking each other in pursuit of one idea to ingratiate themselves with the government[5].

What is a good behavior when the model or standard is absent. After all, we live in the fast changing times. How do we define "best efforts"? These reveal themselves through companies' practices.

Public governance may be improved more rapidly than other aspects of the environment: infrastructure, labor productivity, technology. Poor governance favors local as opposed to the foreign investors. The former are simply better acquainted with the mode of operation of the local bureaucracy on the top of knowing their own (=local companies' vices)[6].When vying for FDI, countries do compete also on perception of their administrative governance. While we have a clear set of rules and standards at least for the OECD-based multinationals, a detailed checklist for governments still needs to evolve. Where is the quid pro quo in the relations between the host country and FDI? It is assumed that FDI contributes to better governance in the host countries but we also believe that the quality of the host country business climate attracts better FDI. Local companies certainly would like to be rewarded too for facing foreign competition and instituting changes

There are many little important things to be done before more ambitious (=more difficult to manage) are undertaken. After all the strength of business lies in the creativity to find promptly efficient solutions. The first basic task is to let the public know where the companies stand on the issue of the social responsibility in general and regarding pressing development issues. Next, encourage them to voice support and add clout to government, NGOs and other constituencies' action plans. This idea advertising concept is nothing new but can certainly be expanded—it is good marketing, too. It does not have to cost much and, more importantly the substitute does not exist as

Most managers do agree with the (politically correct) CR principles, but they would love to see the others make the first step. Thus it can still be viewed as a marketing tool and thus becomes window dressing for companies looking to outdo their competition in the short run and not a long term process aimed at developing the enterprise further and assuring effective management of the company.

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[4]. In India, Tata Steel is utilizing its existing infrastructure of medical programs to mobilize resources to fight the pandemic. Tata Steel also developed a "Safe Highway" project to establish HIV/AIDS clinics targeted at truck drivers.

[5] This is author is familiar with one such practice where in a herd like various fashion foreign companies donated a hodge podge of equipment and vehicles to the major government health centre in one of the Central European states. Although on paper the equipment was worth a lot, its efficient use was limited because of the compatibility problem.

[6] Locals might find it easy to cheat on taxes and inflate costs, foreign investors in general might find it difficult.

The issue first is to transplant the social values to private business—it is happening but remains still a difficult task. At the heart of CSR at first is the issue of involvement—change of attitudes (indifference), next sharing of the costs.

After all, it is quite a formidable task. And if accurate estimates cannot be obtained, isn't it better to focus on attitudes—which companies are willing to pitch in when called upon, which are coming with their own initiatives. Similarly, the international ranking of socially responsible MNCs could generate a lot of publicity

The OECD Guidelines

Many of the suggestions developed in this paper derive from the spirit of the OECD Guidelines and attempt to put them in a symmetrical setting to endorse fairness and efficiency. Same high standards of disclosure should apply to MNCs and governments alike.

"Let go" approach needed by home countries.

In promoting responsibility prioritization is a key issue and in practical terms need to be localized to make things realistic.

Adherence not a condition sine qua non.

For the MNs conduct within the host country and outside (and then overlaps) better be consistent. Adherence to Guideline and home country rules benefit hosts as well.

In that context position re. Guidelines to be communicated upfront to potential investors by the Investment Promotion Agencies. Adherence to Guidelines not necessarily a straitjacket but also an important PR factor (like ISO).

How to monitor progress? There is a fear that a global approach to CG will result in high cost of monitoring administered from a far-away post, can it be done at the local level? One issue remains: who and how is to measure benefits created. Cannot it be done locally in order to cope with the high costs of monitoring from a far –away location if done globally?

Guidelines define the role of adhering governments and in a sense prescribe the ISO -9000 like standards.

While some of the points in Guidelines appear less realistic than others, adherence or sharing the values can take place on a partial basis.[7]

Whether non-adhering countries want to adhere or not, it is good for them to know that somebody (through NPC) can review the conduct of foreign subsidiaries on their soil.

What about the 10% of global FDI originating from the developing (=non adhering countries)?

[7] If there are problems with some stipulations like: "Governments recommend that, in general, enterprises avoid efforts to secure exemptions not contemplated in the statutory or regulatory framework related to environmental, health, safety, labour, taxation and financial incentives among other issues, without infringing on an enterprise's right to seek changes in the statutory or regulatory framework. The words "or accepting" also draw attention to the role of the state in offering these exemptions. While this sort of provision has been traditionally directed at governments, it is also of direct relevance to MNEs. Importantly, however, there are instances where specific exemptions from laws or other policies can be consistent with these laws for legitimate public policy reasons. The environment and competition policy chapters are examples

Might separating the Guidelines from the remainder of the OECD Investment Declaration enhance the likelihood of non-adhering country engagement?

Foreign investors should be invited to play a role in recommending revisions without being accused of meddling.

What should be the platform for cooperation and discussions between the governments and MNCs? MNCs tend to be atomized so Chambers of Commerce should represent an appropriate conduit. Solo and perhaps as a group, the MNCs are certainly interested in discussing the future of their existing investment in the individual developing countries. That is when the social agenda of the government should be brought to the discussion table.

The main problem to tackle is poverty and in the short to medium run even 4,000 new skyscrapers of Shanghai cannot alleviate it. Social sensitivity of the governments needs to reach beyond just administering current affairs, social responsibility of business must demonstrate involvement. Those preconditions are not fully met. Yet when they are, planning for cooperation between the governments and business can develop spontaneously. It is not about the legislative vs. the economic power but about the best combination of both.

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