

Millennium Cities Initiative

EARTH INSTITUTE | COLUMBIA UNIVERSITY

MCI WORKING PAPER SERIES ON INVESTMENT IN THE MILLENNIUM CITIES

N° 12/2012

GUIDANCE PAPER ON EVALUATING SUSTAINABLE FOREIGN DIRECT INVESTMENT

Prof. John Kline, Georgetown University

July 2012

MCI Working Paper Series

N° 12/2012

The Millennium Cities Initiative (MCI) is a project of The Earth Institute at Columbia University, directed by Professor Jeffrey D. Sachs. It was established in early 2006 to help sub-Saharan African cities achieve the Millennium Development Goals (MDGs).

As part of this effort, MCI helps the Cities to create employment, stimulate enterprise development and foster economic growth, especially by stimulating domestic and foreign investment, to eradicate extreme poverty – the first and most fundamental MDG. This effort rests on three pillars: (i) the preparation of various materials to inform foreign investors about the regulatory framework for investment and commercially viable investment opportunities; (ii) the dissemination of the various materials to potential investors, such as through investors' missions and roundtables, and Millennium Cities Investors' Guides; and (iii) capacity building in the Cities to attract and work with investors.

For more information, please refer to the MCI website at: <http://mci.ei.columbia.edu>

Copyright © 2012 by the Millennium Cities Initiative (MCI). All rights reserved. Unless otherwise indicated, this working paper may be reproduced, quoted or cited without permission of the author(s) provided there is proper acknowledgement. The responsibility for the contents of this Working Paper remains with the author(s). Accordingly, this publication is for informational purposes only and is meant to be purely educational. While our objective is to provide useful, general information, the Millennium Cities Initiative makes no representations or assurances as to the accuracy, completeness, or timeliness of the information. The information is provided without warranty of any kind, express or implied. This publication does not constitute an offer, solicitation, or recommendation for the sale or purchase of any security, product, or service. Information, opinions and views contained in this publication should not be treated as investment, tax or legal advice. Before making any decision or taking any action, you should consult a professional advisor who has been informed of all facts relevant to your particular circumstances.

Acknowledgments

We would like to thank the following individuals for their contributions:

Susan Blaustein
Birgit Braunwieser
Paulo Cunha
Russell Curtis
Maggie Kigosi
Laban Mburu
Karin Millett
Rene Samek
Karl Sauvant
Joerg Simon

Guidance Paper on Evaluating Sustainable FDI¹

Professor John M. Kline

Executive Summary

Foreign direct investment (FDI) provides a business channel through which multinational enterprises (MNEs) seek to establish coordinated networks with globally profitable operations. Host countries can benefit from FDI in their territory, but such projects typically generate a multitude of impacts that involve both costs and benefits for the local society. While most FDI project assessments focus mainly on quantifiable economic aspects, environmental, social and governance effects also merit careful evaluation. Unfortunately, many such impacts are difficult to quantify and lack the established methodology of economic analysis. The result can be a “more-is-better” mind-set toward FDI that overlooks or undervalues non-economic impacts on the host nation.

Sustainable FDI can be defined as FDI projects that yield profits sufficient to maintain effective corporate engagement without harming vital host country interests while producing positive net benefits for the country’s long-term development goals as evaluated on prioritized economic, environmental, social and governance indicators. This paper proposes an approach and applied methodology for host countries, regions and municipalities to use in attracting and assessing prospective investors, seeking sustainable FDI that maximizes the benefits and minimizes the costs to the host country. The approach encourages broad participation and transparency in selecting national and regional development priorities and offers a Project Assessment Matrix to evaluate FDI proposals on economic, environmental, social and governance indicators.

The Guidance Paper offers an applied assessment tool to evaluate a FDI project’s impact against a host country’s chosen development priorities. The focus is on practical process and decision making rather than policy and regulation. Other studies analyze a country’s macro FDI climate and suggest steps for improvement. This paper concentrates on aiding the micro assessment of particular FDI projects, encouraging consideration of their full societal impact across economic, environmental, social and governance indicators. Inclusive and transparent evaluation of FDI project impacts is essential to promote sustainable FDI that will support sustainable development.

¹ This paper was commissioned on behalf of the Millennium Cities Initiative, under the Regional Partnership to Promote Trade and Investment in sub-Saharan Africa, funded by the Government of Finland.

Introduction

Attracting foreign direct investment (FDI) constitutes an increasingly important component of national development strategies. In part, this change reflects constraints on other development resources such as official assistance, private bank loans or potentially volatile portfolio investments. More directly, host countries have recognized that FDI offers unique advantages over traditional development mechanisms that mainly involve financial transfers. In addition to financing, FDI can incorporate technology transfer, market access, managerial skills and other advantageous resources into a functional business package where risk is borne by the investor rather than by public sector agencies.

However, just as FDI can mobilize an array of development resources, the societal impacts from FDI are similarly multidimensional involving economic, environmental, social and governance issues. A natural tendency is to evaluate FDI mainly in terms of its economic effects, relying heavily on familiar financial assessment tools that can yield quantifiable results, whether or not they capture an investment's broader impacts. Recent environmental awareness has sparked increased attempts to evaluate these effects as well, but social and governance issues still typically draw little attention in FDI assessments. A 2010 survey of investment promotion agencies (IPAs) found the economic dimension most prominent in FDI development strategies followed by environmental concerns over natural resource management; only labor standards registered as a significant social issue while governance standards were least apparent.ⁱ

While FDI can generate significant positive development results, this outcome is not the primary objective of the private multinational enterprises (MNEs) that control the vast majority of FDI flows. These enterprises seek strategic investments that will increase their global competitiveness and profitability. Governments should seek to attract MNEs that will formulate FDI projects in ways that maximize the positive and minimize the negative developmental impacts of the investment. Such a determination requires a robust assessment of a FDI project's potential consequences on the host country's economic, environmental, social and governance goals over a substantial period of time, as well as the interests and goals of the region or metropolis where the investment will be anchored. This type of integrated, multidimensional evaluation should inform governmental decisions and direct public support toward sustainable FDI projects that can most readily promote the national, regional and local development priorities.

Sustainable FDI for Sustainable Development

The concept of sustainable development is generally attributed to the 1987 Brundtland Report of the World Commission on Environment and Development that tied traditional economic objectives to environmental concerns by recognizing the needs of future generations. Subsequent international discussions have added social and, more recently, governance issues as similarly essential components of sustainable development.ⁱⁱ Sustainable FDI is a relatively new

term that is meaningful when considered in conjunction with sustainable development. In order for FDI to aid sustainable development, FDI projects must be commercially sustainable themselves while also promoting the host country's development on economic, environmental, social and governance measures.

Sustainable FDI can be defined as FDI projects that yield profits sufficient to maintain effective corporate engagement without harming vital host country interests while producing positive net benefits for the country's long-term development goals as evaluated on prioritized economic, environmental, social and governance indicators.

Sustainable FDI must serve the interests of both the foreign investor and the host country by establishing a "win-win" scenario where each party derives enough significant benefits to maintain the relationship over a substantial period of time. Private foreign investors usually calculate the benefits and costs of a particular foreign investment in terms of its contribution to the corporation's global profitability. Although types of operational benefits vary, their impact on the corporate "bottom line" is generally quantifiable. Host country benefits and costs at the national, regional and metropolitan levels are more diverse and many are very difficult to quantify and compare. The tendency is often to focus on more easily quantifiable economic factors that directly correspond to the foreign investor's project proposal. This approach can present an image of definitive certitude, even when time projections are uncertain, and often overlooks or undervalues potential project impacts on less quantifiable interests.

Inadequate evaluations of FDI projects can produce unexpected and unwelcome results that prove detrimental to the host society and to the MNE investor. Both a project's time horizon and its diverse impacts should be well assessed in advance of the investment to provide the basis for a shared understanding and realistic expectations of a FDI's likely long-term, cost/benefit results. When assessed using traditional short-term quantitative measures, some projects that promise economic gains measured by financial inflows, initial employment and/or increased exports lose their allure as capital repatriation and profit outflows reverse balance of payments effects, jobs remain oriented to low-skilled labor and/or exported components create domestic shortages with rising price effects. The challenge of evaluating long-term FDI project impacts on less quantifiable non-economic effects is even more daunting but nevertheless necessary.

Particularly for developing countries, the concept of sustainable FDI should correspond to achieving positive, long-term impacts on development goals assessed on economic, environmental, social and governance indicators. Each nation seeking to attract FDI must decide its own priorities among multiple specific goals both within and between each of these four categories. FDI projects will advance certain goals more than others while possibly causing harm to some interests. Therefore, decisions on whether or how to support FDI projects should be informed by as complete an assessment as possible regarding projected sustainable development impacts.

Unfortunately, little guidance has been available on how to conduct such project-level assessments, particularly in a time and cost-effective fashion under conditions of constrained governmental resources and capacity. A new *Investment Policy Framework for Sustainable Development*ⁱⁱⁱ outlines a set of core principles to help governments improve their macro FDI policy climate. This Guidance Paper on Sustainable FDI employs a complementary process approach, offering an operational methodology for the micro assessment of individual FDI projects in relation to a host country's development priorities.

Assessment Methodology: Challenge and Approach

A foreign investor and a host country have shared interests in promoting sustainable FDI. The foreign investor will look primarily to insure that a FDI project delivers operational benefits that meet or exceed expected contributions to the firm's global profitability. However, the investor's self-interest also requires maintaining good governmental relations, premised on a satisfactory flow of benefits from the project to the host country. Foreign investors with meaningful corporate social responsibility (CSR) standards may seek to generate local benefits above the necessary minimum, but the challenge of promoting sustainable FDI for development falls primarily on host country governments and in the regions with interests at stake.

The host country has an interest in retaining foreign investors, but its initial concern is to attract the type of sustainable FDI that best matches its development needs and priorities. This guidance paper suggests how to approach this task, outlining a methodology to assess the "fit" between potential FDI projects and host country development objectives, while providing measurement standards to assess their follow-up attainment. A preliminary step involves a host country's self-assessment of its relative attractiveness to foreign investors. Evaluating the country's areas of comparative advantage can indicate the most promising business sectors for prospective FDI and help identify country factors that might be further improved. A parallel assessment of national, regional and metropolitan development needs in the host country will determine which types of FDI project benefits best advance sustainable development goals.

Host countries may pursue dual strategies in attracting and evaluating sustainable FDI projects. In a search strategy, the country's IPA or other mandated body targets business sectors and firms to approach, seeking to raise the country's profile as a potential investment site and stimulate interest in possible FDI proposals. A response strategy disseminates general information about the country and answers corporate inquiries but essentially relies on prospective investors to discover and discern attractive regional or metropolitan sites for their FDI project. Although the strategies can be pursued in tandem, they require different types of assessments by host countries, and hence different methodologies are suggested in this guidance paper.

A search strategy must evaluate and choose companies as targets without knowing whether the company will consider investing in the country or exactly what project it might undertake. Without the details of a proposed project to evaluate quantitatively, a search strategy can only

assess the company as a whole in selecting which firms to target. The company's standing on various international qualitative standards can help guide this type of decision. If the search strategy successfully generates a FDI proposal, the situation becomes similar to a response strategy where a project proposal's specific information permits a different approach. A host country's real interest lies in assessing what benefits it could derive from a specific FDI project located within its territory. Once a FDI project is proposed, a more quantitative methodology becomes possible even though many assessments will still be based on qualitative judgments.

The following sections outline and discuss these three steps, from a country's self-assessment to FDI promotion to FDI proposal evaluation. Devised from the perspective of a host developing country, the guidance paper nonetheless recognizes that both a foreign investor and the host country must realize satisfactory expected gains from a project for sustainable FDI to be achieved. The host country's task is more difficult, however, because it must evaluate a much broader range of interrelated factors that cannot be easily quantified and compared. The approach and methodologies below propose a way to organize and coordinate this assessment in a more explicit, comprehensive and transparent manner.

Preparation: Host country self-assessment

Transparency in Prioritizing Development Objectives and Recognizing Trade-Offs

A country seeking to attract sustainable FDI should first undertake a candid and thorough self-assessment of its development priorities, the relative attractiveness to FDI of both the country as a whole and the region(s) in question, and potential ways to improve its investment climate if the analysis should reveal areas where that would be necessary. Perhaps the most crucial yet politically difficult first step is identifying and then prioritizing development objectives. Consensus gathers more easily around generalized rather than specific goals, a process that can make the differential impacts of a FDI project difficult to gauge.

Some objectives are always relatively better served than others, but the critical divergence lies in assessing which objectives may be harmed in the process of advancing favored goals. Although an ideal outcome yields all positive results, in reality trade-offs will occur across the broad diversity of national and regional economic, environmental, social and governance interests, with some impacts potentially negative. To complicate matters further, there can be negative local impacts of a given investment even in circumstances where the national-level impact is positive, and vice versa. Governments should seek to maximize positive and minimize negative developmental impacts, a balancing act that requires a transparent scale of priority objectives.

The inherent challenge of prioritizing development goals stems from the multiple, cross-cutting ways in which interests are conceptualized and distributed within a society. Typically FDI projects are viewed through an economic prism that starts with a FDI proposal, focusing on its overall quantitative estimates regarding the size of the financial investment, number of new jobs,

quantity of local purchases and projected exports, etc. This initial perspective tends to encourage a “more is better” criterion using early evident indicators of new business production. Slower-appearing secondary or tertiary effects are harder to discern and calculate, particularly for indicators of environmental or especially social and governance effects. The cost/benefit ratio is thus easily skewed in favor of the largest, most financially-calculable FDI proposals.

Rather than focusing only on economic-oriented factors that dominate a FDI proposal, a project assessment should evaluate all FDI projects relative to a pre-established list of priority development objectives that considers local and national environmental, social and governance interests along with economic goals. To follow the sustainable FDI assessment methodology proposed in this paper, a country would begin by choosing its top ten priority development objectives from the array of goals listed below and described in detail in the Appendix 1. (These goals are also used in a later Project Assessment Matrix to evaluate individual FDI proposals.) Other economic, environmental, social or governance goals can be added or substituted on this list to best reflect the host country’s unique development objectives. Some possible alternatives are also suggested in the Appendix 1.

Choosing Priority Development Objectives for FDI Projects

<u>Economic</u>	<u>Environmental</u>	<u>Social</u>	<u>Governance</u>
Capital	Resource management	Balanced development	External transparency
Employment	Pollution controls	Labor rights	Local management
Taxes	Low carbon footprint	Skills enhancement	Supply chain standards
Local business linkage	Water usage	Public health	Marketing practices
Technology transfers	Waste reduction	Non-discrimination	Stakeholder dialogue
Infrastructure	Other	Other	Other
Exports			
Other			

Selecting only ten priority goals (actually, a top five and a second five for the Matrix) forces a recognition and explicit choice of potential trade-offs among development objectives. These national priorities should reflect an appropriate distribution of costs and benefits among societal groups, both to promote equitable growth and to build long-term support for FDI development strategies. Establishing development priorities should therefore actively engage representatives from diverse economic and social sectors as well as geographic regions. Impacts on geographically-based interests should receive explicit consideration, particularly where regional and/or city officials possess some authority and competence on matters affecting economic, environmental, social, and governance interests.

Often FDI promotion, evaluation and approval are treated as the exclusive domain of national authorities. This perspective is reinforced by the economic elements of a FDI project that are

presented and assessed primarily in terms of their impact on the nation's macro economy. However, although an MNE invests in a country, the actual FDI project is sited in a local jurisdiction, where sub-national officials usually possess significant influence over matters such as zoning, utilities, transport, education, taxes and fees, etc. The role of city or regional political authorities therefore merits special consideration.

As FDI's importance increased in the global economy, sub-national governments around the world have recognized the potential benefit to their local jurisdictions from attracting new FDI projects. Many states and provinces as well as larger cities extended traditional economic promotion activities to cover attracting FDI, sometimes even establishing overseas offices devoted to promoting local business products and FDI opportunities. These actions can be seen as complementary to national government programs to attract FDI, or they can create tensions over turf and mandates. Of course, the potential for cooperation or conflict already exists when national IPAs pursue strategies that favor one local jurisdiction over another or make commitments that impact local resources without the participation of local officials.

These dynamics are partly influenced by whether a country has a federal system of government. Many variations exist, with some federal systems based on a formal division of legal powers while others rely on more informal arrangements tied to political processes. There is some evidence that countries with federal systems are more successful in attracting FDI, mainly due to MNE perceptions of greater political stability in maintaining market-friendly policies. Interestingly, a study that empirically tested the impact of federal institutions on FDI inflows found this effect only in federal systems where sub-national governments participated in shaping national policies and could potentially mobilize a political "veto" over changes. The same result was not found in federal systems where sub-national governments possessed primary fiscal responsibility for their area, or where they held policy autonomy short of taxing and spending, if they did not also participate in shaping national policy.^{iv}

While many factors will determine the level of sub-national political participation in national FDI policies, a necessary if not sufficient condition for such participation is transparency regarding the basis for governmental decisions on FDI projects. City and/or regional officials in particular are often kept distant from the dialogue between MNEs and national FDI promotion agencies. If not favored by national decision-making, cities frequently learn about new FDI projects only when announced to the general public, with the location already decided. No transparent criteria are provided to explain and validate the national interest choices favored by the location decision. Even cities contacted for discussions with a prospective MNE investor often gain more insight to the MNE's decision criteria than to the particular set of interests being pursued by the national government.

Transparency in the decision process holds the key to greater participation for regional and local officials as well as for civil society groups. And the fundamental basis for transparency rests on the identification and explicit prioritization of development objectives, taking into account likely

impact trade-offs between and among economic, environmental, social and governance goals. A society will generally benefit from broad participation in setting national development priorities. Access to the decision criteria used to evaluate FDI projects is essential to show that the project's results were well-assessed and that the decision, considering likely cost/benefit trade-offs across national interest issues and areas aligns with specified national development priorities. Transparency permits FDI decisions to be seen, understood and tested against society's priority interests.

Assessing the Host Country FDI Climate

Once priority development objectives are established, a host country should conduct a candid self-assessment of both positive and negative factors that shape its FDI climate as viewed from the perspective of potential foreign investors. The overall climate for doing business is also important, as once foreign investors are established they are generally functioning within the same business operating environment as local companies. Fortunately, this step has been broadly studied, and materials are available that explain both the concept and demonstrate the practice of a FDI climate assessment.^v Countries can often begin with a review of existing assessments and perhaps request a new evaluation, drawing on the expertise and perceptions of external organizations. External evaluations offer advantages in being less susceptible to self-justifications or domestic political constraints. However, external reviews still rely to some degree on information provided by national authorities, and the host country will be the final arbiter of how well such reviews can serve or supplement their own self-assessment process.

A FDI climate assessment considers a wide variety of factors that can affect the operations, profitability and sustainability of a new or expanded MNE investment. Significant elements include public policies and institutions; national physical and human assets; and the country's linkages with the global economic system. Relevant public policies encompass domestic laws, regulations and procedures on topics such as taxation, labor, competition, inflation and intellectual property, as well as FDI-specific policies governing the approval and conditions that affect a FDI project. Associated institutions are also important, at both the local and national levels, to assure respect for the rule of law, including a fair and efficient judicial system, and a stable government representative of the public's best interests.

National and local physical and human assets must at least meet a foreign investor's minimum requirements but are seldom susceptible to quick policy-related change. A national government cannot create oil or mineral deposits where they do not exist, although it could facilitate exploration and, if discovered, infrastructure improvements to make them more accessible. Better education can produce a higher skilled workforce, but such progress takes time. Population size and relevant income levels determine the near-term attractiveness of a country's internal market, a principal FDI climate factor for MNEs driven by local market-seeking motivations. Once a certain threshold is reached on such physical and human assets, further

assessment generally involves a comparative evaluation of country endowments among potential alternative FDI sites.

The existence and effectiveness of host country linkages to the global economy also constitute important elements of a nation's FDI climate. Increasingly FDI projects are tied into an MNE's global business chain rather than operating as stand-alone facilities dedicated to serving local or regional markets. This change means that both export and import policies as well as foreign exchange regimes will be assessed, as will a nation's network of trade, investment and taxation treaties. MNE investors generally look for national policies and multilateral guarantees that facilitate global business transactions while offering the protection of agreed international rules. Of course, the potential trade-off with national development goals is that borderless business operations and multilateral FDI guarantees necessarily limit a national government's options to guide and shape the domestic impact of FDI projects.^{vi}

While it is important to know how its FDI climate is perceived by potential MNE investors, a host country's goal is not simply to respond to whatever deficiencies MNEs may perceive in order to attract any FDI. The goal is to understand how current MNE perceptions relate to the country's prioritized development objectives and how they might provide useful guidance in improving the climate for sustainable FDI. In other words, the self-assessment process must evaluate where MNE perceptions will affect prioritized development goals, identifying the relevant FDI climate factors and determining whether and how such elements might be improved at both national and local levels.

Identifying Target Sectors for FDI Promotion

Target sectors for promoting sustainable FDI can be determined by matching the strongest national and regional areas of comparative advantage for FDI with corresponding priority development goals that FDI projects would advance. This process balances feasibility with desirability, based on the trade-off between a country's relative attractiveness for particular types of FDI and its preferred regional and local development objectives. The matched target sectors will point toward the cluster of MNEs capable of undertaking desirable FDI projects. This group of enterprises then becomes the primary audience for any FDI promotion programs the host country may wish to undertake.

Governments may also complement FDI promotion programs with efforts to improve national and/or regional comparative advantages in areas central to development priorities. Enacting relevant policy reforms is one possible step. If funds are available, upgrading of infrastructure, education or other key investment climate factors can also enhance both FDI prospects and local investment. Given scarce resources, the scope of desirable improvements may need to be limited, but target sectors should not be too narrowly conceived.

For example, Costa Rica gained prominence in 1996 when Intel decided to locate a new semiconductor plant there. A comparative advantage in the country's investment climate was its strong education system. When the government decided on a proactive search strategy to attract advanced manufacturing FDI, it further expanded high school and college curricula on technology to emphasize electronics. However, in order to retain its relevance to a range of potential FDI targets in the electronics sector, this promotional effort did not focus narrowly on the semiconductor sub-sector. More specialized training in semi-conductors was only added later, in an initiative designed cooperatively with the new Intel investor.^{vii} A similar search strategy attracted another FDI cluster to Costa Rica in life sciences, especially medical devices.

Perhaps the most controversial and potentially costly element of FDI promotion programs is the use of incentives. General improvements to education, infrastructure or other investment climate factors can be viewed as incentives, but few object to such steps when taken on a macro scale and available to domestic as well as foreign investors. Unfortunately, such macro improvements take time to work and the temptation is to offer project-specific incentives to "win" a short-term competition with an alternative site for a prospective FDI project. Such competition can easily become a "bidding war", where resources are wasted and the MNE emerges with excessive benefits. While countries often vie for FDI projects, regions or cities within the same country may also be drawn into competition, sometimes tempted to weaken local environmental or labor regulations when fiscal incentives are unavailable.

Some legitimate reasons exist for the use of FDI incentives (correct market failures; mitigate risk; gain later externalities, i.e., technology spillovers), but project-specific incentives are often ineffective, inefficient and burdened with opportunity costs. Any incentives package should be subjected to a rigorous cost-benefit analysis and transparency rules. Fiscal incentives (tax and duty reductions or exemptions) are most common in developing countries because they are often subject to administrative discretion and do not cost immediate budget resources. Financial incentives such as cash grants and various subsidies can provide more leverage in FDI project negotiations and are easier to calculate (and harder to hide), but these incentives generally involve an up-front drain on the national budget. Governments should try to avoid front-loaded incentives because MNE investors may leave after a short time. Claw-back provisions (formal recovery and payback procedures) are desirable, but investors usually seek a "market conditions" contract provision that allows them to scale down operations or leave without penalties.

Once national, regional and local authorities have agreed on prioritized development objectives, evaluated the FDI climate and settled on an approach to FDI promotion, the following sections provide guidelines for a transparent process of assessing MNEs and sustainable FDI projects in terms of their likely impacts on the host country's economic, environmental, social and governance interests.

Investor Search Strategy: Qualitative Targeting

A qualitative approach can be used to help host countries initially assess the sustainable FDI potential of enterprises being screened as possible targets for FDI promotion. After evaluating which sectors best match the country's comparative advantages and development needs, an IPA would identify a list of foreign corporations with investment potential in those sectors. Appraising corporate endorsements of current standards of good business conduct could serve as a low-cost method to screen and rank the best investors to approach, before there is any specific FDI proposal or even expressed interest from the enterprise.

Unfortunately, no single standard exists that is universal in its geographic and business sector coverage; specific enough for practical guidance and measurable compliance; and inclusive of economic, environmental, social and governance interests. However, the selected standards listed below provide overlapping coverage of many important issues, sectors and regions. Each country could select the sustainable FDI standards most relevant to that country's development priorities. Enterprise endorsement of these standards can serve as criteria to rank enterprises as the most favorable FDI promotion targets.²

In category A, corporate endorsement of the first two general international standards is both highly desirable and easily accessible online.³ The Global Reporting Initiative (GRI) offers well-recognized process standards designed to increase available information regarding international corporate operations. A prospective investor subscribing to GRI standards will publish a broad range of corporate information useful to evaluating its compatibility with host country development goals and conditions. While there are graded levels of implementation, the GRI presents a practical test of an MNE's commitment to transparency and stakeholder dialogue.

A list of MNEs endorsing the UN Global Compact is also easily accessible online. This brief statement of broad international principles of good corporate conduct covers labor, environment, human rights and anti-corruption issues. The Global Compact allows MNEs to self-report summaries of their compliance activities, providing self-serving but nevertheless potentially useful information regarding corporate operations.

The OECD Guidelines for Multinational Enterprises contain more comprehensive and detailed statements of "good conduct" principles for all corporations. No list is maintained of MNEs endorsing the OECD Guidelines but company websites often state their support of such standards in sections on corporate social responsibility or mission statements. Similarly, there is no easily accessible list of MNEs employing two management systems that incorporate many

²Note: This method of qualitative screening, if made public, has the potential side benefit of encouraging more enterprises to adopt/endorse the good conduct standards used to select target companies.

³ Appendix 3 contains website addresses for organizations identified in this section, linking to a description of the organization's standards, a corporate ranking of compliance, or a membership/endorsement list.

sustainable FDI principles, but company websites often report their use of such management practices. The ISO26000 provides general guidance in how to relate social responsibility principles and practices to sustainable development, while SA8000 offers a compatible business management process standard. Both instruments are designed for use by a broad range of MNEs.

Corporate Endorsement of “Core” International Standards⁴

A. General Standards

- Global Reporting Initiative (GRI)
- UN Global Compact
- OECD Guidelines for MNEs
- Social Accountability International SA8000
- ISO 26000

B. Sector Standards

- Ethical Trading Initiative
- Extractive Industries Transparency Initiative (EITI)
- Voluntary Principles on Security and Human Rights
- Equator Principles
- Principles for Responsible Investment (PRI)

C. Issue-Specific Standards (environment example)

- ET Global 800 Index
- World Business Council for Sustainable Development (WBCSD)
- Corporate Knights Global 100

D. Inclusion/Exclusion in SRI Funds (for publicly listed companies)

- FTSE4Good Index
- Domini Social Investments
- Calvert Investments
- Dow Jones Sustainability World Index

Category B can prove useful when a host country’s self-assessment points the investor search strategy toward specific sectors. MNE endorsements of standards relevant to those sectors can then be used to establish a rank-order prioritization of which companies to approach as potential

⁴ An exemption may be considered for smaller companies if membership costs to participate in some standards are prohibitive; the evaluation of later, project-specific assessment standards would remain.

targets for sustainable FDI projects. The MNEs and other institutions subscribing to the following examples of sector standards are easily accessible on each organization's website.

The Ethical Trading Initiative (ETI) covers labor and work conditions across a range of consumer products. The Extractive Industries Transparency Initiative (EITI) is designed for MNEs, host governments and NGOs engaged in the natural resource sector. The Voluntary Principles on Security and Human Rights is another relevant public-private partnership that lays out operating standards and reporting obligations for natural resource firms. The Equator Principles apply to the project finance operations of private banks, while the Principles for Responsible Investment (PRI) provides environmental, social and governance standards for international institutional investors.

Category C covers international standards that relate to a country's priority development goals that are issue-specific, for example, focusing on the environment or specific aspects of it, such as carbon emissions. The ET Global 800 Index of the Environmental Investment Organisation offers an example of corporate rankings (available online) based on intensity of carbon emissions and verified disclosure. The Corporate Knights Global 100 (available online) uses a resource-productivity metric to rank so-called "clean capitalism leaders." The World Business Council for Sustainable Development (WBCSD) reflects a more general commitment to sustainable environment goals with work programs in specific sectors. A list of WBCSD corporate members is easily accessible online. Other social or governance standards could be added to this category to cover sustainable "best practices" on those issues as relevant to each country's development priorities,

A final Category D covers social responsibility investment (SRI) fund indices that select publicly listed companies on the basis of their performance on social responsibility criteria covering various combinations of economic, environmental, social and governance concerns. Indices can be chosen that best reflect a host country's particular combination of sustainability concerns or the indices can be aggregated for more comprehensive coverage. The presence of a firm in the indices would count favorably in its evaluation as a potential target firm for sustainable FDI. Unfortunately, many such funds provide only limited information about companies on their lists (such as subsector leaders or recently added/deleted firms) unless special access provisions can be arranged.

MNEs that score the most endorsements of desirable standards in Categories A, B and C and appear on SRI fund indices in Category D would be prioritized in an investment agency's search strategy as the most likely investors to develop sustainable FDI project proposals that match the host country's development objectives.

Project Response Strategy: Quantitative Method with Qualitative Judgments

Countries differ in how open and non-discriminatory their policies are toward inward FDI. Even countries with generally permissive policies will restrict FDI in certain sectors and countries that offer incentives to encourage FDI in high priority areas may impose limitations or requirements in other sectors. This proposed methodology is designed to assist the host country to evaluate FDI proposals against measureable sustainable FDI criteria weighted to reflect the country's chosen development goals. How the resulting evaluation is used will depend on each country's national policies and priorities. For example, evaluations could be used to screen some or all FDI proposals prior to granting formal approval; or to select the most desirable FDI proposals to receive incentives; or simply to prioritize an IPA's limited time and resources in facilitating new FDI proposals. The assessment methodology for sustainable FDI can be applied flexibly to a range of policy positions, and it is beyond the scope of this guidance paper to suggest which FDI policy framework or process is best for all or individual host countries.

Potential FDI projects reaching a proposal stage can be assessed for sustainable FDI objectives using a quantitative methodology, recognizing that some quantitative scoring will still be based on qualitative judgments. An early step should be to establish the basis for good communication by sharing information that can foster a mutual understanding of sustainable FDI objectives. Governments can send their list of prioritized development objectives (see page 6) to prospective investors to indicate the most important areas where the government seeks to maximize benefits and minimize costs. In turn, MNEs can offer initial comments on whether or how the potential FDI project would affect each objective. This proposed exchange would systematize what now is often an ad hoc, incremental accrual of information biased toward quantifiable economic impacts. A more balanced project assessment will emerge if prospective investors respond to the full range of likely societal impacts and government agencies likewise recognize that FDI projects have multiple cost/benefit trade-offs in areas that lie outside a single agency's purview.

Based on early information submissions, an exclusion conditions test should be used to assure that all projects will yield substantial benefits for the host country and the company within a minimum time period while not causing significant harm to vital host country interests, including the environment. This general test may be sufficient for small FDI projects whose scale does not warrant a more detailed analysis of potential impacts. Each host country or region could set a threshold amount appropriate to its circumstances. For example, FDI projects up to \$250,000 that pass the exclusion conditions test might be exempted from the next more lengthy assessment.

Exclusion Conditions Test

The proposed FDI project must show predictable short⁵ and projected longer-term benefits to the host country and the company over a minimum period of time⁶, while not causing significant detriment to the environment, exploited group(s), or national security. For example, using the following list of possible standards, if an FDI project would result in any of these excluding conditions, the project fails a sustainable FDI test and should not be supported.

Examples of Specific Excluding Conditions

Economic: FDI where costs outweigh benefits in the short term (3-5 years after operations begin), even if longer-term benefits are anticipated.

Environmental: FDI that causes substantial, irreversible environmental damage or loss (e.g., biodiversity).

Social: FDI that would violate fundamental ILO standards; FDI that leaves the poorest population worse off, even in the short-term; FDI that jeopardizes public health.

Governance: FDI involving bribery (or substantial unreported payments that benefit public officials).

Security: FDI that would pose a threat to the national security and/or strategic national assets, as defined and determined by the host country.

Project Assessment Matrix

Proposed projects exceeding the assigned threshold FDI level that pass the exclusion conditions test should then be evaluated using a Project Assessment Matrix. The project value indicators in the Matrix are the same factors used earlier in prioritizing the host country's development objectives. If additional indicators were added or substituted at that stage to better reflect the host country's national, regional and metropolitan development priorities, the Matrix should be adjusted to match those changes.

Potential investors should be provided a copy of the country's Project Assessment Matrix sheet in advance, including any sector-specific factor adjustments. The project score on each indicator should be based on a qualitative evaluation of both quantitative data and descriptive information submitted for the FDI proposal, including annual input, output and impact estimates for the project's predicted effective life. The FDI proposal should address each indicator, including if warranted statements asserting that specific indicators are irrelevant to the proposed project. Any indicators not addressed in the investor's proposal should be assigned an appropriate negative score.

⁵ Normally 3-5 years from project's operational start-up date.

⁶ A sustainable FDI project should normally have an effective life expectancy of at least 8-10 years beyond the project's operational start-up date.

Project Assessment Rating & Rationale

Project Value Indicators Benefit/Cost Rating (+5 to -5)⁷ Main Factors for Rating Assessment

ECONOMIC		
Capital		
Employment		
Taxes		
Local business linkage		
Technology transfers		
Infrastructure		
Exports		
Other		
ENVIRONMENTAL		
Resource management		
Pollution controls		
Low carbon footprint		
Water usage		
Waste reduction		
Other		
SOCIAL		
Balanced development		
Labor rights		
Skills enhancement		
Public health		
Non-discrimination		
Other		
GOVERNANCE		
External transparency		
Local management		
Supply chain standards		
Marketing practices		
Stakeholder dialogue		
Other		

⁷ As assessed at 3-5 years from beginning operations of project.

The Project Assessment Rating and Rationale sheet provided above would be used by the individuals or agencies authorized to evaluate and/or determine whether a proposal represents a sustainable FDI project that merits government support. Each project value indicator in the first column would be assessed and rated in column two on a +5 to -5 scale. A positive (+) scoring reflects how much the project benefits the indicator, whereas a negative (-) scoring reflects how much the project imposes costs on the indicator. Indicators irrelevant to a specific project are scored as “0”. The third column provides space to record the main factor(s) that influenced the rating for each indicator so that the evaluator’s reasoning is clear and transparent.

The Project Assessment Matrix sheet provided below records in column two the average or consensus numerical ratings assigned by evaluators to the FDI project’s impacts on economic, environmental, social and governance indicators listed in column one. These ratings are then weighted where relevant by each indicator’s priority importance to the host country’s development objectives as reflected in column three.

The top five ranked indicators chosen in the preparatory step (page 6) as priority development objectives are given a weighted score of 3, while the next five ranked indicators receive a weighted score of 2. Indicators ranked below the top 10 receive a score of 1. Each project indicator rating from the second column is then multiplied by the weighted development priority number from the third column. The resulting score is recorded in the fourth column and summed to achieve a total Net Project Benefit Score.

The total score of a project would indicate its relative attractiveness to the host country while the criteria employed to assign numerical ratings to specific indicators can be used later to monitor the project’s implementation and evaluate its achievement of projected outcomes. (An illustration of a completed Project Assessment Matrix is shown at the end of Appendix 2.)

Potential Incentive Expenditure Adjustments

The net project benefit score in the Project Assessment Matrix should be decreased by a percentage that reflects the value of any incentives provided to a FDI project. The percentage can be determined by dividing the financial value of the incentives, ideally adjusted for lost opportunity costs of possible alternative uses of the incentive’s resources, by the project’s total FDI.

“Clawback” requirements should be imposed on projects for the value of any FDI incentives received if related performance standards are not met, without business condition escape clause provisions (i.e., treat FDI incentives similar to a bank loan that does not have to be repaid only if performance standards are met).

Project Assessment Matrix

Project Value Indicators⁸ **Project Indicator Assessment Rating⁹** X **Development Priority Weighting¹⁰** = **Assessment Score**
 (+5 to -5) (Top 5@3; 2nd 5@2; rest@1)

Economic			
Capital			
Employment			
Taxes			
Local business linkage			
Technology transfers			
Infrastructure			
Exports			
Other			
Environmental			
Resource management			
Pollution controls			
Low carbon footprint			
Water usage			
Waste reduction			
Other			
Social			
Balanced development			
Labor rights			
Skills enhancement			
Public health			
Non-discrimination			
Other			
Governance			
External transparency			
Local management			
Supply chain standards			
Marketing practices			
Stakeholder dialogue			
Other			

Net Project Benefit Score =

⁸ See Appendix 1 for additional micro or macro project value indicators that can be substituted or added to the matrix.

⁹ Indicators irrelevant to the project are scored as “0”.

¹⁰ Only 10 indicators are selected as development priorities; the top five are weighted as 3, the next five as 2 and all others receive a 1. See discussion of the process for selecting national development priorities, page 6.

Conclusion

This Guidance Paper outlines an approach designed to assist ministries and agencies in developing countries' regions and municipalities to identify and evaluate potential FDI projects in terms of their impact on sustainable development objectives. Recognizing that a broad range of host country impacts are more qualitative than quantitative, the paper offers a methodology where qualitative assessments of specific indicators can be quantified, permitting a more direct comparison between different factors regarding a FDI project's costs and benefits for a host country's regions and municipalities. The numerical rating given each factor's qualitative assessment will increase the transparency of how a FDI project is assessed.

The indicators chosen as measures of project value in each category of the Project Assessment Matrix represent common discrete benefit or cost factors for FDI projects. Appendix 1 contains a brief explanation of each indicator to clarify its meaning and identify elements that should be evaluated to assign a matrix score. While some items have interactive effects, the indicators were selected to reflect distinguishable factors and minimize double counting. Other indicators listed in Appendix 1 for each category may be added or substituted for current matrix indicators if needed to reflect specific national, regional and local development priorities. Overall the Project Assessment Matrix helps assure that FDI project evaluations will cover a comprehensive checklist of sustainable development indicators, incorporating a weighted emphasis for priority development objectives.

Although the paper's design assumes national government authorities will decide the country's development priorities and assess FDI proposals accordingly, the same prioritization and evaluation process can be utilized by regional or city government officials. The paper also assumes MNEs as the principal prospective investors, but the prioritization process and matrix assessment technique may also be adapted for other cross-border or even domestic investments. Many of the assessment techniques may prove particularly useful to help evaluate domestic investment proposals that might be considered for financial or other new business incentives.

This approach maintains each country's sovereign right to decide its own development priorities and to use FDI project assessments to support policy and process decisions about whether or how to regulate inward FDI. The proposed methodology seeks to provide more systematic and comprehensive information for policy makers regarding the sustainable development effects of FDI projects. Standardized use of the Project Assessment Matrix will elicit useful information from prospective investors relevant to the full range of a project's impacts on regions and municipalities in the host country. The Matrix will also help to match priority development goals more transparently with the promotion and approval of new FDI projects. In doing so, the approach may additionally serve to encourage foreign corporations to consider enhancing the sustainable development impacts of their proposed FDI projects, even above the commercial sustainability that must be a project's own minimum requirement.

Appendix 1

Explanation of Project Value Indicators

Indicators were chosen to represent common development objectives in terms of maximizing benefits and minimizing costs in each of the four categories. The following sections explain the intended meaning of each indicator and key component elements that should be assessed. Additions and/or substitutions to this indicator list can be made where necessary to reflect the particular development priorities of individual countries, regions or cities. Some additional possible indicators are suggested for each category.

Sustainable Economic Development: Minimum short-term¹¹ economic benefits for the host country's regions and metropolitan areas should at least balance any short-term costs while contributing significantly to domestic value-added capabilities. Economic benefits predicted to occur more than three years after the project's start-up date should be discounted in value. The specific economic indicators selected encompass both traditional direct project benefits and broader indirect national impact measures.

Selected Economic Indicators

1. Capital investment: The rating assigned to this indicator should consider that maximum host country or regional benefits are likely to arise from projects that invest (a) large amounts of capital (b) early in the project's development (c) largely through financial transfers from abroad (d) with a slow repatriation of initial capital and (e) local reinvestment of profits.

Evaluated as a single factor, the larger the amount of capital invested in a FDI project, the better for the host country, region or metropolitan area. This indicator will vary in part by the type of industry involved; for example, natural resource FDI projects are generally more capital-intensive than many service sector investments. However, relevant cross-sector comparisons should be reflected in the weighting of development priorities rather than adjusted scoring on this indicator.

Timing is significant. The higher the proportion of up-front capital invested in a FDI project, the higher this indicator should be rated. Although the eventual total of a FDI project's proposed investment may be high, MNE plans change and capital projected to be invested in later stages may be delayed or never materialize.

The total projected capital investment in a FDI project seldom represents the amount of capital inflow to the country. Proportions can differ significantly between projects, but often between 40 to 60 percent of the capital may be raised locally. Although mobilizing local capital can be

¹¹ Normally evaluated at 3-5 years from project's operational start-up date

counted as a benefit, the addition of foreign capital is generally preferred so that local capital remains available for local firms.

Regional and/or metropolitan benefits will grow the longer FDI capital remains in the host country, increased incrementally by reinvested local profits. On a macro level, the capital indicator can be assessed by the FDI project's net financial resource transfer over time, calculating FDI inflows minus capital and profit repatriation. The longer initial capital and new profits remain in the host country, the higher the rating score on this indicator.

2. Employment: The number of new jobs created by a proposed FDI project is the obvious central element in evaluating the employment indicator. However, additional considerations are the planned wage and benefit levels, the type and level of skill required, the number and function of foreign employees, and opportunities for skill development among local workers.

Creating new jobs is a principal benefit that FDI projects can offer to a host country or region and, in this case, the more the better. One potential qualification that should be recognized is that a trade-off sometimes exists between labor-intensive and capital- or technology-intensive production methods. The MNE investor will propose whichever method best suits its global operations strategy in terms of overall profitability. Depending on the host country's priority development objectives, efforts could be made to shape the level of employment or technology use to fit regional and local needs. This qualification would be reflected in the Matrix through the weighting given employment as a development priority.

Wage and benefit considerations may also be assessed as part of the employment indicator. Legal minimums will set a floor for wage rates and required employee benefits, but studies have shown that MNEs generally pay somewhat above the local legal and industry wage levels. Whether such standards are motivated by competition for the best workers or as part of corporate social responsibility programs, the resulting higher income for local workers is desirable.

The type of work and associated skill levels required constitute other important elements of the new jobs. Higher skilled employment is desirable, particularly if it matches the available local workforce. FDI projects may initially require some foreign workers for positions where local individuals with sufficient skills do not exist. In such cases, plans that include specific opportunities for local skill acquisition and timely replacement of foreign personnel would be preferred. Cooperative training programs between the MNE and host government might be considered.

3. Tax/royalty payments: The payment of taxes, royalties and other fees represent the most direct and calculable benefit a host government derives from a FDI project. The fair-share amount and timing of payments are elements to consider in evaluating this indicator as well as harder-to-calculate indirect tax benefits that a new FDI project can generate. Some of these

items may be determined in negotiations over the terms and conditions applied to a FDI project's approval.

Corporate taxation or royalty payments to a host government from a new FDI-based enterprise represent a direct increase in disposable revenue that can be expended for any public purpose. Sustainable FDI projects can broaden and deepen the country's tax base, presumably generating budgetary revenue for many years. However, project assessments should consider that new FDI projects frequently incur start-up losses and corporate income taxes are not paid until a company is profitable. In addition, common FDI incentives often include tax reductions or exemptions that must also be calculated.

MNEs can use transfer pricing techniques to lower their global tax bill by shifting income between FDI sites. MNEs that employ arms-length pricing methods are more likely to make fair tax payments to host governments. Both a potential investor's past history and the host government's capacity to monitor the relative complexity of a project's financial transactions should be considered in evaluating likely tax revenue benefits from the project.

Indirect tax revenue can arise from value-added taxes (where such a value-added tax system is already in place) applied to new business activity generated by the FDI project, including both production sales and purchased supplies and services. Jobs created by the FDI project also will yield increased income tax payments from newly employed workers.

4. Local business linkages: A FDI project can establish many types of local business linkages, but the most valuable for development objectives generally arise from the amount of value-added derived from local content purchases and the integration of local companies into the FDI's business processes. Purchases of local components, supplies and services help create a larger, stable sales base for local companies. A companion benefit can emerge when the MNE affiliate requires (and sometimes assists) improvements in local product quality. On the potential down side, the project's production could to some degree displace the sales of existing local producers.

Deeper relationships may also develop between the FDI project and the local business community, particularly where an MNE progressively spins-off lower-skill operations to local firms. Sometimes former MNE employees experienced in the relevant process create entrepreneurial local enterprises to supply the needed goods. However, these potential benefits take time to develop and will often fall outside the 3-5 year post-start-up evaluation period used to assess the initial project proposal.

5. Technology transfers: Only technology transfers accompanied by local control should be considered in determining the valuation rating for this indicator. When technology is transferred by an MNE for its own local affiliate use, while retaining control, the technology's value will generally be captured by other measures of the project's productive output. Technology that is transferred, intentionally or unintentionally, to local business control increases domestic

capabilities and offers potentially additive development benefits. This type of technology transfer should receive credit on this indicator if it will occur during the initial evaluation period.

As part of a FDI project, technology transfers may be difficult to define, measure and value. Technology can be embodied in a process, equipment or know-how. Some common transfer mechanisms include in-house training for local employees; workshops or mentoring programs open to suppliers or other local businesses; sharing production specifications and quality control methodology with local suppliers; licensing patented products or processes to local companies; loan or lease of equipment; and knowledge taken away by employees to start their own businesses.

6. Infrastructure: A FDI project's impact on the host country's existing infrastructure should determine the positive or negative value rating assigned to this indicator. Infrastructure is meant to be construed broadly to cover most physical components such as roads, rail, ports, airports, electrical grid, etc. It should also encompass other types of sectors such as the country's telecommunications network and domestic financial system where physical elements may be less dominant.

FDI projects centered on infrastructure development will presumably largely benefit the country by expanding capacity and improving capabilities. Other FDI projects may burden existing infrastructure to the detriment of current users, earning a negative rating on this indicator unless the project proposal includes steps to at least offset the increased load on key facilities. Of course, FDI projects may strengthen some infrastructure components while overloading others. The net cost/benefit impact of the project would determine the indicator's value rating.

7. Exports: The rating for the export benefit derived from a FDI project should be a net calculation that considers both the export and import effects from the project. The value of project exports should be increased by the amount saved by any import substitution effects where the project's domestic sales replace previous imports. Conversely, the export total should be reduced by the value of imported components used by the project.

Some FDI projects may include proposals to use the local affiliate's MNE network to facilitate domestic company exports. For example, proven domestic suppliers might be recommended to other affiliates in the MNE's global supply chain. The local MNE affiliate may also provide a certification of domestic suppliers that facilitates exports to other foreign customers. Any such increased third party exports could also be included in evaluating FDI project benefits for this indicator.

Possible Additional Economic Indicators

Competition: Increased or decreased competition effects from how a new FDI project changes a sector's market concentration. The assessment may also consider the specific impact on existing national enterprises.

Consumers: Impacts on local consumers can include changes in the range of product choice, quality, and safety.

Investment reputation: A new FDI project can beneficially raise a country's profile as a prospective FDI site among other potential foreign investors, particularly in the same or related industries.

Sustainable Environmental Development: In evaluating FDI projects for sustainable environmental development, an initial three-level assessment may be used, followed by the assignment of more specific numerical ratings. Actions that will protect or preserve the environment should be viewed as a benefit. Processes that provide for replenishment or restoration of the environment should generally be considered neutral. Impacts that require financial compensation or reparations due to irreplaceable environmental loss should be assessed as a cost. The numerical rating assigned each environmental project value indicator should reflect the significance of the project's impact (benefit or cost) on that indicator.

Specific Environment Indicators

1. Resource management: This indicator is meant to evaluate how well a proposed FDI proposal adopts project design and management techniques appropriate to the natural resources it will affect with a goal to efficiently exploit non-renewable and/or replenish renewable resources while generally protecting the natural environment. FDI projects will vary widely in how directly they relate to natural resources. Oil and gas or mining projects should receive a negative score on this environmental indicator simply because they will permanently deplete the country's natural resource endowment. This cost may be outweighed by other types of benefits, but it is still a cost. The negative value assigned to a project should reflect how efficiently it exploits non-renewable resources, with the most efficient processes earning a -1 score.

Many natural resource projects will have multiple effects on different aspects of the environment. For example, a mining project should be evaluated not only on depletion of a non-renewable resource but also on how it may affect water, air or other environmental elements. Such impacts may raise or lower the assigned score. Renewable resource projects should be similarly assessed for both the quality of replenishment actions (for example, are hardwood forests replanted or replaced with faster-growing softwood species) and other spin-off impacts (such as the effects on proximate animal species). FDI projects not based directly on natural resource exploitation may still significantly consume local resources or otherwise affect environmental conditions and should have their impact evaluated and scored on this indicator.

2. Pollution controls: Assessing the presence and effectiveness of pollution controls is most essential for FDI projects related to heavy industries where the potential for environmental

damage is greatest. However, many different types of FDI projects may generate pollution that negatively impacts local air, water or soil.

An assessment should consider the type and level of potential contaminants, the project proposal's steps to prevent or at least substantially reduce their occurrence, and any commitment to clean-up and restoration if significant pollution occurs. Proposed pollution controls should be evaluated against the processes used in the MNE's home country as well as industry "best practices".

3. Low carbon footprint: Although the immediate local impact will be less significant or discernible than some other environmental effects, a FDI project proposal should still be evaluated in terms how much its carbon footprint may contribute to the threat of global warming. This indicator should assess both the amount of greenhouse gas emissions and their intensity (as a proportion of project revenue) to account for the project's relative size.

The scope of a project's full value chain is relevant to its carbon footprint, but the complexity and resources required to carry out such an assessment argue against imposing this step as a requirement. Projects presenting such data should be considered favorably, as should proposals that specify steps to reduce or off-set carbon emissions, including use of renewable energy sources, reduction in energy usage, and recycling of production by-products and final product output.

4. Water usage: Water is a critical resource component for some FDI projects such as hydroelectric facilities, beverage production, fish farms and tourism services. However, substantial new commitments for water usage are likely to add to an existing competition for water supplies required by growing metropolitan areas, industrial processes, agricultural irrigation, transportation, fishing and recreation. Establishing an indicator rating for new water-intensive projects entails a careful evaluation of the relative cost/benefit trade-offs among such varied uses. Particularly with reliable availability of water subject to annual weather conditions and longer-term climate change, establishing clear criteria for an equitable distribution of dependable water resources constitutes an increasingly important development decision.

Other FDI projects will place less demand on water use but may present some danger of contaminating or degrading the quality of water supplies. If minor, these risks may be assessed as part of the general pollution controls indicator, leaving the water usage indicator unrated. However, if the risks and associated costs are substantial, the assessment should be made using this indicator in order to incorporate the possible priority weighting given the use of water resources among the country's development goals. Potential cost components would include the type of user adversely affected, the nature of the damage (deaths, loss of business, inconvenience), probable duration of the pollution, and monetary cost of clean-up and compensation.

5. Waste reduction: FDI project proposals with clear plans to reduce waste and responsibly recycle or otherwise dispose of the remainder should receive a positive score on this indicator. Depending on the nature of the project, waste may range from extremely hazardous (mercury in mine tailings) to simply costly and bothersome to collect, dump and decompose. Waste reduction lessens stress on land resources while decreasing potential air and water pollution. Recycling processes cut waste and recover some costs for the company and/or local government. Although optimal waste reduction should be managed throughout the business value chain, the complexity and resources needed to conduct such a full evaluation suggest this as an optional rather than a required step in assessing FDI project proposals (similar to the carbon footprint indicator).

Possible Additional Environment Indicators

Project/product life cycle management: Extending waste reduction processes to cover both suppliers and consumers in the business value chain.

Energy efficiency: The relative effectiveness of energy usage by business processes, aiming to minimize consumption while favoring cost-effective renewable energy resources.

Land management practices: A scarcity of productive, arable land raises this factor's importance (similar to water) and increases the role of zoning and other regulatory decisions.

Biodiversity: Both plant and animal species represent valuable natural endowments that are vulnerable to (especially man-made) environmental changes, requiring careful protection and management.

Sustainable Social Development: Social development indicators are seldom explicitly assessed when evaluating FDI project proposals. Yet more than other categories, these indicators encompass some of the actual improvements to a society's standard of living that represent end goals for a country's development process. Principal attention is generally paid to economic indicators that, in reality, are simply instrumental measures whose ultimate aim should be to enrich a society's way of life as reflected in personal and interpersonal social value indicators. Evaluated in this category, FDI projects should clearly contribute to improvements on several relevant social indicators without incurring corollary costs that cause a significant decline in any of the category's other indicators.

Specific Social Indicators

1. Balanced development: The distribution of development benefits (and costs), both regionally and among individuals, has important social implications for a nation. A focus on national

macroeconomic development indices does not reflect how gains are shared among social groups and across geographic locations, or whether people and areas bearing the costs of development receive reasonable adjustment assistance. Social tensions and divisions can arise from the maldistribution of development impacts. Individual FDI projects can either exacerbate or ameliorate social inequities, affecting public reaction and longer-term societal support for FDI policies.

Evaluating the anticipated impact of a prospective FDI project requires identifying elements that are likely to shape the project's distributional effects. For example, balanced development is more likely to result from locating a project in an economically depressed region rather than the already developed capital city. Providing jobs at an appropriate skill level for locally unemployed workers, or with relevant associated training programs, should also earn a positive score on this project value indicator. Such steps may not naturally emerge from normal corporate cost calculations and therefore might warrant government inducements through closely linked incentives.

It is possible that economic multiplier and indirect spill-over effects could produce a lagged redistribution of development benefits from a FDI project. However, because longer-term impacts are easy to assert but hard to assess at a project proposal stage, the magnitude, timing and corporate commitment to balanced development indicators should be carefully evaluated and short-term steps toward those goals established. Project proposals should also contain provisions to help alleviate local hardships that may arise from social displacement effects. Missed targets should lead to a cut-off and claw-back of any government incentives while a corporate history of underachievement on such goals justifies a skeptical view of new FDI project assertions.

2. Labor rights: FDI projects should be expected to respect and uphold fundamental labor rights as developed by International Labor Organization (ILO) Conventions. Key labor rights include freedom of association, collective bargaining, non-discrimination and workplace safety. Although the laws of most nations embody these rights, their observance and practical enforcement are often lacking. The MNE's history and FDI project proposal should reflect an acceptance of basic labor rights and willingness to engage fairly with local workers.

Many governments lack the political will or sufficient resources to adequately monitor labor conditions at industrial facilities throughout the country. Often perceived as possessing the leverage to ignore or evade local labor regulations, MNEs are under increasing international pressure to follow "best practice" standards that may be even higher than local legal requirements. FDI project proposals that contain credible commitments to specified high labor standards should receive positive ratings on this indicator. Pledges to respect local labor law merit at most a neutral rating. Silence or evidence of corporate abuses of fundamental labor rights elsewhere should elicit a negative score.

3. Skills Enhancement: Positive development impacts can arise from FDI projects that include corporate programs designed to provide skills-enhancement training to employees, suppliers or other local residents. FDI project proposals often contain plans to upgrade the current skills of new local employees through work-related training that teaches specific operational knowledge and techniques needed to perform their jobs in the new corporate facility. Similar function-specific training may be provided for local suppliers to assure they can meet necessary product quality and delivery standards. These training benefits deserve recognition on this project value indicator even though their application may be self-interested and narrowly focused.

Other types of training opportunities might also be offered that enhance more general skills, helpful for current employment but also readily applicable to other jobs or possible self-employment. These remedial or supplemental basic education programs may also merit positive scoring on this indicator. For example, the company might sponsor seminars or furnish information on life-skills topics such as personal budgeting, savings plans, or time management. Broader educational opportunities could also be extended to suppliers or opened to some local community residents. Corporations might offer financial grants to support further formal education for employees or provide philanthropic scholarships for deserving local students.

4. Healthcare: The provision of adequate healthcare is a fundamental component of a decent standard of living that comprises a core objective of sustainable development. FDI projects can positively affect local healthcare through direct provision of basic in-facility health services to employees, company-sponsored health insurance coverage for employees and their families or wages sufficient to permit individual insurance purchases, and financial support for local healthcare facilities.

Potential negative impacts on healthcare from FDI projects relate mainly to production processes. Project proposals should contain information on workplace health and safety standards sufficient to identify if conditions meet or exceed local legal requirements. Meeting legal minimums merits a neutral rating whereas standards aimed at higher industry “best practices” should earn a positive assessment. Conditions to consider include workplace ventilation, electrical and machinery safeguards, potable water access, emergency fire and medical equipment, and evacuation and training procedures. Project proposals that fail to address healthcare issues or companies with a history of production or product safety problems should be viewed skeptically and receive a negative initial rating.

5. Non-discrimination: A FDI project proposal should reflect a corporate social responsibility standard of non-discrimination in dealings with all stakeholders. This core standard should be founded on principles of fair and equal treatment that is free from prejudice based on personal or social characteristics.

Non-discrimination policies should be embodied in the project’s description of corporate employee practices covering issues such as hiring, benefits, assignments and advancement. Non-

discrimination standards that go beyond legal mandates would merit a positive scoring on this project value indicator. Similar scoring could be awarded for non-discrimination commitments that apply to how the company will structure and manage interactions with other stakeholder groups, including suppliers, customers and community organizations.

Possible Additional Social Indicators

Entrepreneurship: Recognition and reinforcement of local employee personal initiatives, including an openness to facilitate small start-up enterprises by former employees as suppliers to the FDI firm.

Respect for culture: Operational designs and management procedures that show an understanding and respect for local cultural practices and traditions that are not enforced by law but constitute an evolved and valued way of doing business.

Housing: Cooperation with local authorities to address shortages of suitable housing, especially when investment proposals may provoke significant population shifts that can exacerbate this common development challenge.

Poverty alleviation/Income equity: Decreasing the absolute number of people living below the country's poverty line and/or narrowing the relative "gap" between the richest and poorest segments of a society.

Sustainable Governance and Development: A FDI project's duration and its relative importance within the enterprise structure will be shaped by the corporate governance system responsible for specific FDI decision making and the related process of business-government relations with the host country and other governments. An MNE affiliate differs from a purely domestic enterprise in that a foreign investor adapts business procedures to operate under and between various national law requirements that may compete or even conflict. The MNE goal of achieving global profitability and the cross-national span of its operations provide latitude for choices and actions unavailable to solely domestic enterprises. An assessment of the governance procedures for a proposed FDI project and its relationship to both the parent company and the interests or involvements of other governments constitute relevant factors for a project evaluation.

Specific Governance Indicators

1. **External transparency:** FDI project proposals with business structures that incorporate external transparency through monitoring, auditing or personnel systems facilitate beneficial access to information regarding corporate policies and operations. At a minimum, the enterprise should employ professional independent auditors. Ideally, several outside members on the Board of Directors should include local residents. This composition would encourage a level of

confidence that public interests have been considered and announced decisions reflect real corporate intentions. Annual reports and regulatory filings should offer enough operational information to assess the health of the enterprise, its contribution and role within the MNE's global network, and the nature of the affiliate's local impacts.

Legitimate reasons exist for maintaining certain business information confidential, especially where competitive strategy is involved. However, public interests can at times conflict with such practices, particularly as relates to negotiated agreements struck between an MNE investor and host government officials. Transparency standards such as those advocated in the Extractive Industries Transparency Initiative (EITI) for natural resource contracts permit a level of external monitoring justified by past abuses of public trust. Other levels of disclosure may vary to fit industry circumstances. Overall, fair and public negotiation standards serve the interests of both the corporation and the host country when the objective is to establish a FDI project sustainable over the long term. FDI project proposals that provide for transparent processes permitting some measure of external restraint should receive positive scores on this indicator.

2. Local management: The type of mutually beneficial conditions that will sustain a FDI project can be promoted by incorporating, advancing and enlarging the role of local management personnel. A general government requirement that local managers always be used can prove counterproductive. However, if local personnel can assume management responsibilities from the outset, the FDI project should be expected to incorporate and progressively advance such individuals within the enterprise and hire others in their place. If insufficient experience or capacity exists initially, the project proposal should outline training provisions to introduce and enlarge the role of local managers over time.

Resident managers will bring knowledge and understanding of local conditions and practices that can improve operations and enhance communication with stakeholders, including community groups and public officials. The host country also benefits when local personnel are given the opportunity to gain broader management experience that involves an MNE's global supply chain and marketing networks. All parties benefit when integrating local managers into the FDI project helps avoid cultural misunderstandings that tend to highlight the "foreignness" of the new investor, potentially encouraging an "us" and "them" attitude to emerge. FDI project proposals that recognize and facilitate the timely incorporation of local personnel into significant management positions merit a positive rating on this indicator.

3. Supply chain standards: Most FDI project proposals focus narrowly on only the proposed new investment. Increasingly, such new FDI is tied in closely to an MNE's global network rather than operating as a stand-alone enterprise. The affiliate's sustainability often depends on the role it plays within this network and the degree of responsibility the MNE exercises over other parts of the supply chain. A growing trend among civil society groups as well as some governments is to hold MNEs responsible not only for the safety and quality of all components in their products

but also for the conditions under which they were made, whether or not the MNE actually owns the supplier factories.

The standards of other operationally-linked enterprises can thus affect the FDI project's production, quality and future growth. FDI proposals should discuss how the new project is tied into an international production and marketing network and how much control the MNE exercises over its suppliers. Just as affiliate firms and their host locations can benefit from ties to a global sales network, the affiliates can also be harmed by actions elsewhere in the supply chain that damage the overall MNE's reputation and its sales prospects.

4. Marketing practices: Although most FDI project assessments focus on the production aspects of a business, it is worth noting that many projects will engage in host country sales, some as a primary activity. Fair marketing standards then become an important part of evaluating a proposed FDI project. Marketing depends both on the appropriateness of the product for the consumers and the techniques used to promote sales. Both these decisions require an understanding of the local market beyond whether potential demand and adequate income levels are present.

For example, some products may be appropriate for certain segments of the local market but require "demanding use conditions" that other market segments cannot meet, as illustrated by the controversy over infant formula marketing in developing countries. This illustration also serves as an example of some inappropriate marketing techniques that have been restricted in subsequent marketing codes and many national laws. If a FDI project includes a significant local market objective, this indicator should evaluate the appropriateness of outlined proposals covering both product and promotional marketing decisions.

5. Stakeholder dialogue: Stakeholders comprise groups that can affect or are affected by a FDI project. Project proposals should provide a mechanism for corporate contact and communication with local stakeholders, both to keep them informed and to monitor and respond to local concerns. Maintaining an ongoing dialogue with local stakeholders is important because these groups form the most proximate, knowledgeable and self-interested parties whose continuing support is essential for a sustainable FDI enterprise. Project proposals should recognize such groups and identify how communication with them will be managed.

Possible Additional Governance Indicators

Respect for rule of law: Adhere to host country laws and regulations, including those promulgated by regional and local authorities; prefer host country court jurisdiction.

Responsible political involvement: Refrain from interference in host country internal affairs, including responses to extraterritorial application of home government law or interests. FDI projects by state enterprises may receive added scrutiny to evaluate their policy control and operational objectives.

Appendix 2

Notes on Using the Assessment Methodology

The list of Priority Development Objectives (page 6) is meant to be flexible; it should be adjusted to reflect the unique development goals of each country and/or region. This Guidance Paper uses a concise list of common, broadly inclusive development objectives. Appendix 1 suggests other possible alternatives under each category. Longer lists of goals can offer a more comprehensive view of both development objectives and FDI project impacts, but increasing the number of goals will make the assessment process more complex and time-consuming.

A balance should be struck that captures the most important potential FDI impacts on development (both benefits and costs) across all four categories while keeping the assessment process manageable. Selected objectives should also minimize potential double counting in the Project Assessment Matrix (page 18). For example, increased local value-added processing is a common development objective, but this goal is an intermediate step rather than an outcome such as more jobs or higher export value. To avoid double counting, only the project's final results should be evaluated against development goals.

When used with the Exclusion Conditions Test (page 15), the Priority Development Objectives can serve as a summary checklist for making quick assessments on relatively small, simple FDI proposals. For larger, complex and/or controversial projects, the more complete Project Assessment Matrix can be employed – especially to assure clarity and transparency in the decision process. In both types of cases, the Corporate Endorsement Standards (page 12) utilized in the Investor Search Strategy should also be checked as a broad additional indicator of the investing firm's reputation and social responsibility.

If the Project Assessment Matrix yields a negative net benefit score for a FDI proposal, the overall expected impact on the host's sustainable development process will be negative, indicating that the project should not be encouraged and/or approved. The Matrix may show a negative rating in one or more categories but as long as the overall score is positive, reflecting priorities given various development goals, the FDI project should produce a net positive benefit for the country and/or region. By identifying specific areas where a FDI proposal is likely to generate negative impacts, the Matrix may also facilitate project adjustments that could minimize or eliminate some negative effects. An illustration of a completed Matrix is provided at the end of this appendix.

The Guidance Paper does not make any judgments on the appropriate policy or proper role of government authorities to restrict, regulate, shape, encourage, incentivize or otherwise affect a FDI project. The paper simply offers a more comprehensive and systematic way to evaluate projects for their impact on sustainable FDI objectives. The results may be used to weigh the

project's relative attractiveness as a basis for taking whatever action is deemed appropriate by governmental authorities.

The assessment approach proposed in this Guidance Paper aims to improve both the process and the results of national, regional and/or metropolitan government evaluations of prospective FDI projects. An important step is adopting a systematic process of selecting agreed development priorities that incorporates economic, environmental, social, and governance considerations. Although each nation determines its own selection procedure, the approach favors a process broadly inclusive of societal interests that can affect and be affected by FDI projects, including regional and metropolitan authorities who will provide site-specific governance.

Under the proposed methodology, decisions to approve and/or incentivize FDI projects would be transparent, evaluated against a specific list of prioritized development goals. Assessment results would also be improved by using the Project Assessment Matrix to evaluate a FDI proposal's impact across a range of economic, environmental, social, and governance indicators. Overall, the evaluation methodology can produce more open and comprehensive assessments of whether project proposals represent sustainable FDI that will contribute positively to host development objectives.

Illustration: Completed Project Assessment Matrix

Project Value Indicators ¹²	Project Indicator Assessment Rating ¹³ (+5 to -5)	Development Priority Weighting ¹⁴ (Top 5@3; 2 nd 5@2; rest@1)	Assessment = Score
Economic			
Capital	3	2	6
Employment	2	3	6
Taxes	1	1	1
Local business linkage	2	3	6
Technology transfers	1	3	3
Infrastructure	-1	2	-2
Exports	1	1	1
Other			
Environmental			
Resource management	1	1	1
Pollution controls	-2	2	-4
Low carbon footprint	-2	1	-2
Water usage	-3	3	-9
Waste reduction	-2	1	-2
Other			
Social			
Balanced development	2	2	4
Labor rights	1	1	1
Skills enhancement	0	3	0
Public health	-1	1	-1
Non-discrimination	0	1	0
Other			
Governance			
External transparency	1	1	1
Local management	2	2	4
Supply chain standards	3	1	3
Marketing practices	1	1	1
Stakeholder dialogue	1	1	1
Other			

Net Project Benefit Score = 19

¹² See Appendix 1 for additional micro or macro project value indicators that can be substituted or added to the matrix.

¹³ Indicators irrelevant to the project are scored as “0”.

¹⁴ Only 10 indicators are selected as development priorities; the top five are weighted as 3, the next five as 2 and all others receive a 1. See discussion of the process for selecting national development priorities, page 6.

Appendix 3
Investor Search Strategy
Internet Addresses for Sample Standards

Global Reporting Initiative (GRI) (Accessed on July 17, 2012)

<http://database.globalreporting.org/search>

(provides standards and reports)

UN Global Compact (Accessed on July 17, 2012)

<http://www.unglobalcompact.org/participants/search>

(search for all business or specific company)

<http://www.unglobalcompact.org/AboutTheGC/index.html>

(overview page)

OECD Guidelines for MNEs (Accessed on July 17, 2012)

http://www.oecd.org/document/28/0,3746,en_2649_34889_2397532_1_1_1_1,00.html

(Guidelines text; no published company list)

Social Accountability International SA8000 (Accessed on July 17, 2012)

<http://www.sa-intl.org/index.cfm?fuseaction=Page.ViewPage&PageID=937>

(description of standard)

ISO 26000 (Accessed on July 17, 2012)

http://www.iso.org/iso/iso_26000_project_overview.pdf

(project description)

http://www.iso.org/iso/about/iso_members.htm

(country members of organization)

Ethical Trading Initiative (Accessed on July 17, 2012)

<http://www.ethicaltrade.org/about-eti/our-members>

(labor conditions for consumer goods)

Extractive Industries Transparency Initiative (EITI) (Accessed on July 17, 2012)

<http://eiti.org/supporters/companies>

(companies and other actors in extractive industries)

Voluntary Principles on Security and Human Rights (Accessed on July 17, 2012)

<http://voluntaryprinciples.org/participants/>

(participating governments, NGOs, observer groups and companies)

Equator Principles (Accessed on July 17, 2012)

<http://www.equator-principles.com/index.php/members-reporting/members-and-reporting>

(project finance institutions managing environment and social risk)

Principles for Responsible Investment (PRI) (Accessed on July 17, 2012)

<http://www.unpri.org/signatories/>

(asset owners, investment managers and professional service partners)

ET Global 800 Index (Accessed on July 17, 2012)

http://www.eio.org.uk/etindex.php?page=overview1&ranking=Global_800

(environmental ranking)

Corporate Knights Global 100 Most Sustainable Corporations (Accessed on July 17, 2012)

<http://www.global100.org/annual-lists/2012-global-100-list.html>

(ranking based on resource-productivity metric)

World Business Council for Sustainable Development (WBCSD) (Accessed on July 17, 2012)

<http://www.wbcd.org/about/members.aspx>

(full member list with breakdown by sector)

FTSE4Good Index (Accessed on July 17, 2012)

http://www.ftse.com/Indices/FTSE4Good_ESG_Ratings/Downloads/Supersector_Leaders.pdf

(ESG leaders by supersector only)

Domini Social Investments (Accessed on July 17, 2012)

<http://www.domini.com/GlobInvStd/index.htm>

(fund standards; no company list)

Calvert Investments (Accessed on July 17)
<http://www.calvert.com/sri-index.html>
(social index with searchable feature for companies)

<http://www.calvert.com/sri-signature-criteria.html>
(SRI Signature criteria)

Dow Jones Sustainability World Index (Accessed on July 17, 2012)
<http://www.sustainability-indexes.com/>
(overview)

http://www.sustainability-indexes.com/images/review-presentation-2011_tcm1071-337427.pdf
(2011 index with additions, deletions and supersector leaders)

ENDNOTES

ⁱ “Investment Promotion Agencies and Sustainable FDI”. Vale Columbia Center (VCC) and World Association of Investment Promotion Agencies (WAIPA), June 25, 2010.

ⁱⁱ Graeme Buckley, Jose Salazar-Xirinachs and Michael Henriques, *The promotion of sustainable enterprises*, Geneva: International Labour Organization, 2009.

ⁱⁱⁱ “Investment Policy Framework for Sustainable Development”, United Nations Conference on Trade and Development (UNCTAD), Geneva: United Nations, 2012. Available at:
http://unctad.org/en/PublicationsLibrary/webdiaepcb2012d6_en.pdf. Accessed July 17, 2012.

^{iv} Nathan Jensen, *Nation-States and the Multinational Corporation*, Princeton: Princeton University Press, 2006; see also Nathan Jensen and Fiona McGillivray, “Federal Institutions and Multinational Investors: Federalism, Government Credibility, and Foreign Direct Investment”, *International Interactions* 31: 303-325, 2005.

^v For example, see the World Bank’s Investment Climate Assessment and other research and diagnostic tools outlined at: <https://www.wbginvestmentclimate.org/overview/index.cfm>; the OECD Business Climate Development Strategy approach described at:

http://www.oecd.org/document/19/0,3746,en_2649_34529562_40349267_1_1_1_34529562,00.html; and the Investment Policy Reviews conducted by UNCTAD at:

<http://unctad.org/en/Pages/DIAE/Investment%20Policy%20Reviews/Investment-Policy-Reviews.aspx>. Accessed July 17, 2012.

^{vi} See *Economic Development in Africa*, Special Issue, United Nations Industrial Development Organization (UNIDO), 2011, chapters 4 & 5.

^{vii} Deborah Spar, *Attracting High Technology Investment: Intel’s Costa Rica Plant*, FIAS Occasional Paper 11, Washington, D.C.: The World Bank, 1998.