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Social Responsibilities and Impact of Multinational Enterprises in Emerging Economies[i]

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Abstract

Multinational enterprises (MNEs) face complex challenges to their 'corporate social responsibility' when operating in emerging economies. Most CSR analysis focuses on singular issues, such as labor and the natural environment, and underrates the economic impact that directly and indirectly create social benefits. This paper reviews impact of MNEs in emerging economies, and on this basis proposes a more comprehensive and integrative perspective of CSR.

Work in progress

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Introduction

Businesses are under increasing pressures to act 'socially responsible' and to thus assume responsibilities that go beyond maximizing shareholder value. Especially multinational enterprises (MNEs) operating in emerging economies are often held responsible for many of the failures of the global economy, from persistent inequality, to sweatshop working conditions and to environmental degradation. Yet, businesses themselves point to benefits that global economic exchange and foreign investment may bring, from lower prices to consumers, to knowledge transfer, and the spread of modern values and management practices (Moran, 2002; Bhagwati, 2004). This paper aims to advance the discussion on corporate social responsibility (CSR) linking recent research on the impact of MNEs on host societies (Blomström and Kokko, 1998; Meyer, 2004; 2008) with the social responsibilities they may assume.

MNEs operate in emerging economies for a variety of purposes, and they interact with their hosts through a variety of channels. Subsidiaries are established (a) to access local markets through local production and/or sale of imported products, and/or (b) to establish production on the basis of local resources such as low cost labor, natural resources, or (less common) human capital with the aim to export (Dunning, 1993). MNEs' global operations are increasingly integrated, and assign subsidiaries are assigned specific roles that combine local advantages in their host economy with the resources and capabilities of the global firm (Birkinshaw and Hood, 1998). In emerging economies, MNEs find new opportunities to improve their market positions and to find new ways to reduce production costs, for instance through off-shoring of production or exploitation of natural resources. This diversity of strategies leads to a diversity of impacts, as each MNE subsidiary develops distinct interactions with local individuals, firms and institutions.

Figure 1 provides a simplified image of the multitude of channels by which FDI may impact on host societies. At a macro level, foreign investors interact with key macroeconomic variables and with the institutional framework. This influence on the host economy's development indirectly affects constituents such as local firms, labor and the natural environment. For instance, new production facilities create new opportunities for local firms (e.g. as suppliers) and workers (e.g. raising wages), but may have a negative effects on the local natural habitat. In addition, MNE interact directly at a micro level with these constituents.

****** Figure 1 approximately here ******

The literature on the impact of foreign direct investment (FDI) suggests many ways in which local firms may benefit (Lall, 1980): learning from example, labor mobility, export market access, improved supply bases, or direct relations as suppliers or customers. A vast literature on horizontal spillovers shows positive effects at least in some contexts (Görg and Strobl 1999; Meyer and Sinani, 2007), while the less pervasive literature on vertical spillovers consistently points to positive effects (Javorcik, 2004; Belderbos et al., 2001; Kugler, 2006). However, these effects vary with the characteristics of the subsidiary (Meyer, 2004), and can thus be influenced by the way the MNE manages its global operations.

The CSR literature focuses on the impact on the welfare of employees and the natural environment. The assessment of these issues depends on the benchmark applied: home or host country standards. On the one hand, MNEs have been shown to adapt global standards that are higher than those of local firms (Aitken et al., 1997a; Christman, 2004); on the other hand, they may apply lower standards abroad compared to their home operations.

This paper thus provides a conceptual framework to guide the analysis of CSR issues facing MNEs in emerging economies. I start with the theoretical and empirical literature on the impact of MNE to provide empirical and conceptual foundations. On this basis, I argue that an integrative discussion of the role of MNEs in emerging economies, rather than isolated treatment of headline issues is required to advance sustainable economic development.

The next section outlines the instrumental and normative perspectives as foundations for CSR. Then, I review different channels of MNE impact in the context of these two perspectives on CSR: macroeconomic effects, effects on local firms, wages and labor standards, the natural environment, and institutional development. Finally, I briefly discuss the role of standards, before concluding with a call for more integrative analysis of CSR.

Motivations for CSR

CSR has been approached from a variety of moral viewpoints, and from the perspective of different stakeholders. Broadly, two perspectives can be distinguished, normative and instrumental. This section briefly introduces these perspectives and derives possible principles for CSR.

Instrumental Perspectives

The instrumental view prioritizes economic objectives and thus argues that firms should pursue social issues only *if* this benefits their own profitability. In this view, the primary purpose of an MNE is to manage economic activities to the benefit of their shareholders, which would be the best way to create value and thus to benefit society at large (Friedman, 1962; Henderson, 2001). This view implicitly assumes that the interests of other groups of stakeholders, such as employees and local communities, are protected by contract law and regulation (Sundaram and Inkpen, 2004). On the basis of contract law and regulation thus markets are assumed to be efficient, and to generate an outcome that optimizes utility derived by all participants.

Several authors interpret this approach in the sense that MNEs should be pursuing CSR if it benefits their profit objective. If certain attributes such as social behavior are in demand, then profit-maximizing firms should develop these attributes up to their optimal level (McWilliams and Siegel, 2001). Moreover, a strategic approach to CSR may maximize 'social profits' such as to benefit both society and the business itself (Husted and Salazar, 2006). Such a strategic approach may focus on the following channels by which it may be in firms' own interest for businesses to adapt some aspects of CSR:

- High standards may raise productivity, for instance if environmental standards reduce wastage, or labor standards increase work motivation. Empirical evidence shows that such benefits can be substantial (e.g. Frenkel and Scott, 2002).
- High standards may help building a reputation of an "ethical" firm, which may increase the perceived value of its products by consumers. In efficient markets, if consumers would be willing to pay higher prices for "ethical" goods, then higher standards would translate into higher profitability (Auger, et al. 2003).
- Higher standards may shield MNEs against disruptive events and negative publicity. NGOs and the media highlight incidences of practices considered unethical, such that "the advantages of lower cost labor or lower cost inputs from more abusive suppliers must be weighted against the crush of negative publicity, the costs of public relations, and the possibility of consumer protests." (Spar 1998). Similarly, high standards reduce the risk of disruptive events such as environmental disasters or strikes that may undermine the viability of the firm.

- Positive contributions to the local community may help building reputation and legitimacy within the host society. This legitimacy may facilitate relationships with governmental authorities, and thus ease bureaucratic procedures or attract direct or indirect support, from tax benefits to improved infrastructure.

These four ways in which 'doing good' may support profits illustrate how economic and social performance may complement each other. As a consequence of these linkages between social and financial performance, various studies have suggested that CSR may positively affect financial performance (Cochran and Wood, 1984; Berman et al., 1999), and this has recently been confirmed in a meta-analysis (Orlitzky, Schmidt and Rynes, 2003).[ii] I refer to the four channels of complementarity when discussing specific channels of impact below.

Normative Perspectives

Scholars taking a normative view argue that MNEs have a moral responsibility to their stakeholders, not only their shareholders (Scherer and Smid 2000; Dunning, 2004; Scherer, et al., 2007). Proponents of this view reject the primacy of shareholders over other stakeholders, and expect MNE to act 'responsibly' independent of possible effects on their financial performance. Managers' primary moral obligation to their shareholders is generally acknowledged, yet they are also expected to meet other obligations, such as respect for core moral norms.

[ii] However, an implication of the instrumental view is that documentation of potential positive effects for society is at least as important as the creation of these effects in the first place. This is because reputation is a function of the *perception* of the MNE by others; it does not suffice to do well by one's own criteria and standards. The need for documentation, however, binds considerable resources.

Some proponents of this view start out from moral viewpoints based on religious beliefs, such as for example businesses grounded in the moral values of Quaker communities. Other proponents are grounded in moral philosophy (Donaldson, 1989; Arnold and Bowie, 2003; Matten and Crane, 2005) and the fundamental insight that nation-state based governance and free markets do not suffice to generate socially optimal outcomes (Scherer, et al. 2007).

These lines of reasoning suggest that managers ought to balance their obligations to shareholders with equally legitimate obligations to other stakeholders (Donaldson, 1989; Arnold, 2003). For example, such a view has been expressed by the United Nations Social and Economic Council:

> *"Recognizing that even though states have the primary responsibility to promote, secure the fulfillment of, respect, ensure respect of, and protect human rights, transnational corporations and other business enterprises, as organs of society, are also responsible for promoting and securing the human rights set forth in the Universal Declaration of Human Rights…" (United National Social and Economic Council, 2003: 1).*

The significance of this resolution lies in the fact that the UN departs from its traditional perspective of working with and through government, rather than directly with private organizations such as businesses. The United Nations thus recognize that MNE are among the few actors that can effectively influence conditions via their economic power, and seek to employ this potential (Williams, 2004). They address MNEs directly in view of the rising challenges for national governments to regulate super-national business organizations (Kobrin, 2005).

Yet, what does this responsibility entail? Value judgments on this normative question are personal and thus vary considerably. In consequence, no clear guidance exists for well-meaning managers what constitutes good practice with respect to labor, health and environmental standards in their operations abroad (Hartmann et al., 2003). In particular, there is no consensus how far moral responsibility would extend beyond the (legal) boundaries of the firm, for instance to workers employed by subcontractors in distant locations, to emissions into the natural environment, and to corrupt business practices by business associates.

In my reflections, I shall limit myself to three simplified principles that might guide social responsibility:

- Do not harm others – or if you do, compensate them for the harm caused! In the terminology of economics: do not create negative externalities!
- Obey the laws as well as informal norms of your country of origin, your customers, and the host society! This can be challenging if norms vary, as is likely when cultures differ.
- Share your good fortune with those who are less fortunate! Such corporate philanthropy aims to help people unrelated to the business.

Having identified some principles that may guide CSR policies, I proceed to apply these principles to core interfaces between MNEs and their hosts. This analysis illuminates the complexity of CSR, and raises questions that may help raising standards in mutually beneficial ways.

Macroeconomic Impact

Macroeconomic studies suggest that FDI on average has a positive effect on economic growth (Borenstein et al. 1998; Li and Liu, 2005). This contribution arises from microeconomic effects discussed below as well as direct impact of key macroeconomic variables: balance of payment, employment, gross domestic investment, and international trade. FDI is commonly believed to have a positive effect on each of these variables, yet theoretical considerations suggest countervailing effects that are often indirect and thus heard to measure empirically. In consequence the *net* effect of FDI is often hard to establish empirically:

1. FDI creates employment, notably when it comes in form of greenfield projects and if supplies are sourced locally. Yet FDI may also crowd out local firms that use more labor-intensive methods of production and thus more employment. The *net*-employment effect is thus hard to assert (Dunning 1993, chap 13, UN 1999, chap 9). In the case of acquisitions, the employment effect is even harder to assert because it requires an analysis of *what* would have happened to the local firm *if* it had not been taken over by the foreign investor (Estrin and Meyer 2004). The employment creation effect may be important in conditions of high unemployment or underemployment, yet, under conditions of full employment it would be offset by crowding out effects.
2. FDI generates exports. Yet FDI also generates imports, especially if it is market-seeking or processing imported components. MNE are typically more internationally oriented than local firms, which affects *both* sales and sourcing. Thus, the *net* effect of the trade balance may be much smaller than data on exports by FDI may suggest (UN 1999, chap 8). This effect is important for developing countries facing an imbalance on their balance of payments or shortage of financial reserves.
3. FDI imports capital, but at a later stage capital is repatriated through profit remittance or project discontinuation – and in this way, the host country pays for

the costs of capital. However, host governments appreciate FDI capital because it tends to be less volatile then other forms of capital inflow (UN 1999, chap 6).

4. FDI increases gross domestic investment (GDI), yet part of it may be domestically funded or the capital inflow may increase the exchange rate and thus costs of international borrowing; both effects can lead to crowding out of local investment. In efficient and internationally open capital markets, neither the capital import nor the GDI contribution of a single investor would have a substantive impact as these variables are determined by demand and supply equilibrium.

Macroeconomic considerations rarely feature in CSR discussions, possibly because of the complexity and prevalence of counter-effects. This discussion suggest to be cautions about positive effects claimed by MNEs on for instance employment or exports. MNEs contribution to a host country's employment or exports should be subjected to careful analysis to assess the *net* effect.

MNEs can pursue strategies that enhance the positive effects – or reduce negative ones. Positive effects on macroeconomic parameters promote economic growth and thus affect indirectly the focal constituents of CSR debates, local firms, labor and the natural environment. In particular, trickle down effects may increase economic activity in the local community, which increases demand for locally produced goods and labor, thus raising profitability of business and wages of employees. On the other hand, new industries are typically established on greenfield land, which brings investors in conflict with those wishing to protect the natural habitat, though this effect is more an outcome of industrialization as such than of MNE activity per se.

Table 1 outlines some ways in which considerations of a host country's macroeconomic situation may help CSR objectives. These linkages between MNEs and macroeconomic variables have been analyzed in the economics literature. Yet, they rarely feature in CSR discussions, although they may be of substantial importance to host societies.

****** Table 1 approximately here ******

Impact on Institutions and Politics

MNE become involved more broadly with host societies, thus influence the institutional framework governing business directly. Institutions here refers to 'rules of the game', formal or informal, as discussed in both the economics (North, 1990) and sociology literatures (Scott, 2005). This interaction has traditionally been analyzed from the perspective of MNEs adapting to external institutions beyond their control. The local institutional environment is thus widely recognized as a major factor influencing inward FDI flows, especially in developing and transition economies in terms of the volume in FDI inflow (Shapiro and Globerman 2003; Bevan et al. 2004) and its characteristics (Meyer, 2001; Henisz 2000).

However, foreign investors also influence local institutions in many indirectly ways, for instance when local policy makers accommodate their interests or by their living example of businesses practices based on different values and norms. For example, MNEs may become a change agent influencing the pattern of corruption (Kwok and Tadesse, 2006). Even formal institutions may be influenced if governments change legislation in view of attracting FDI, possibly under direct negotiations or lobbying by MNEs. In particular, MNEs may use their influence on national and supra-national policy makers to influence regulatory regimes, in particular in favor of regulatory convergence, which would facilitate business for those crossing borders (Dahan et al., 2006).

Corporate strategies, institutional change and the development of local capabilities are thus mutually interdependent. This relationship however has received comparatively little attention in the impact literature, nor in the CSR discourse. Instrumental views would suggest lobbying for changes in regulation benefiting the MNE, for instance reduction of corporate taxation but also maintenance of import taxes for whatever the local subsidiary produces. Normative views would suggest championing changes benefiting all economic agents such as creating fair conditions for competition and reducing corruption.

The interaction between MNEs and the institutional environment is important because it shapes the regulatory framework that in turn shapes the interaction between MNEs and their local stakeholders – firms, labor and the natural environment. Hence, the benefits or harm experienced by local stakeholders is influenced by a regulatory framework that evolves under the influence of both MNEs and the stakeholders. This complex and indirect impact of MNE via institutional development has to my knowledge rarely been addressed systematically.

Impact on local firms

Channels of Spillovers

Foreign investors may impact on economic growth more strongly via their interactions with local firms rather than via the aforementioned macroeconomic effects. MNEs function as a conduit for the transfer of technological and managerial capabilities. They interact with local firms, and thus generate spillovers that may enhance the productivity of local firms. The literature points to several channels (Lall, 1980; Blomström and Kokko, 1998, Meyer, 2004):

- Local firm observe MNEs employing new technologies and practices in the local context, and may thus benefit from *demonstration effects*. After observing an innovation adapted to local conditions, local entrepreneurs may recognize their feasibility, and thus strive to imitate them
- FDI contributes to human capital formation, especially through training and *labor mobility* (Gerschenberg, 1987). Trained local employees may move to locally owned firms or set-up their own entrepreneurial businesses. MNEs typically provide salaries and working condition that induce highly trained employees to stay (Aitken et al. 1997b);. However, even a small number of employees leaving to set up their own business may make a substantial difference to the local economy.
- FDI may help local firms to access *export markets***.** MNEs are more likely to share general trade knowledge, as its diffusion to local businesses does not endanger their own competitive advantage. Moreover, foreign investors may help building trade channels and a country of origin reputation that may help local followers may to develop their exports (Aitken et al. 1997a; Greenaway et al. 2004).
- Foreign investors may support local supplier industries. Beyond the quality of physical products, this may enhance in particular the quality of services provided by suppliers, such as just-in-time delivery and low default rates.
- Local firms may benefit from *vertical linkages* in a supply chain, benefiting from knowledge transfers to suppliers and customers. MNEs may help local suppliers to improve their product quality. Similarly, they may support their customers, for instance by providing training in sales and marketing.

However, negative spillovers on local firms are also possible, notably through *crowding out effects*. Foreign investors may gain market share at the expense of local firms. This would leave the local firms, at least in the short run, with excess production capacity and thus low productivity and low profitability (Aitken and Harrison 1999). Moreover, foreign investors may source internationally and thus weaken the local industry's domestic supplier base.

Empirical Evidence

Empirical research has focused on horizontal spillovers, i.e. benefits attracted by local firms in the same industry. The results of this empirical literature are mixed. While evidence on specific channels of impact is scarce, firm and industry level studies suggest that at least in some contexts, local firms do benefit in terms of increasing productivity (Haddad and Harrison, 1993; Aitken and Harrison, 1999; Görg and Strobl, 2001) or exports (Aitken, et al. 1997b; Greenaway, et al., 2004). A recent Meta-analysis of these studies finds strong association of positive spillovers with the GDP of the country, but not with other country level variables investigated (Meyer and Sinani, 2007). In particular, this analysis suggests that positive productivity spillovers are more likely in low income economies with a large catch-up potential, and in high income economies with strong absorptive capacity, yet less in middle income economies.

Empirical evidence of vertical spillovers is hard to establish, as this requires detailed data on industry-level input-output relationships. Among recent studies, Javorcik (2004) finds in Lithuania higher productivity in supplier industries to industries with high foreign presence, while at the same time finding no evidence of spillovers within the same industry. She moreover shows that the productivity effect is larger when the foreign investors are domestic market-oriented rather than export oriented. Similar evidence has been presented for Indonesia (Blalock and Gertler, 2003) and Columbia (Kugler, 2006).

MNEs and Spillovers

Spillovers vary greatly because investors and projects vary in their interactions with local businesses. MNEs actively manage their interfaces with local businesses and thus have some degree of control over the spillovers they create.

For subsidiaries of MNEs to generate knowledge spillovers, they first have to receive knowledge from outside the country. Typically MNEs would transfer 'know how' to their affiliates to enhance efficiency and productivity. Yet they would keep tighter control over their 'know why', because such knowledge could – if diffused to other firms – threaten the international market position of the firm. Hence, the knowledge transfer practices adopted by MNE are pivotal for the potential to generate spillovers from the subsidiary.

Another source of variation is the mode of entry. In a *joint venture*, two partners share their resources in return for access to the partner's resources. This can lead to mutual learning, and thus extend linkages and knowledge spillovers in the local business community. Yet MNEs would be more concerned about unwanted technology diffusion and thus be more reluctant to share crucial knowledge with local employees. *Greenfield* projects create new businesses and thus have direct positive effects on employment and domestic value added, yet they create fewer knowledge diffusion opportunities. *Acquisitions*, on the other hand, are at the time of entry fully operating enterprises. The new owners may or may not continue traditional business relationships, possibly drawing on their existing suppliers, which would strongly impact on local industries.

MNEs can influence the benefits they generate for the host economy by varying these and other aspects of their business strategies and practices (Table 2). However, they face the question how they can we help local businesses to develop their competences without undermining our own competitive advantage. Thus, an inherent conflict of interests exists between horizontal spillovers and business objectives: The essence of competition is to stay ahead of competitors!

****** Table 2 approximately here ******

In contrast, vertical spillovers are often in the interest of foreign investors: A stronger supplier base is able to deliver higher quality components and to secure reliable deliveries. As product quality and reputation is critically constrained by the weakest link in the supply chain, a strong and reliable supplier base is essential for competitiveness. Moreover, local suppliers can strengthen a firm's legitimacy in the local context, and thus the relationships with the authorities. Hence, businesses have strong incentives to create vertical spillovers, which are only limited by firms wish not to shift bargaining position towards the suppliers.

Foreign investors also generate lateral spillovers to unrelated businesses. They may in particular contribute to local entrepreneurship by demonstrating general business principles and fostering an entrepreneurial culture. MNEs are well placed to further foster entrepreneurship by working with the local community, and to offer, for example, training in collaboration with local universities. Such projects fostering local entrepreneurship may help building legitimacy, but they are also an area where corporate philanthropy may create a particularly large impact.

Impact on Labor

Globalization debates have taken a special interest in the welfare of employees in MNE affiliates and their subcontractors. These include a wide range of specific issues (Arnold, 2003; O'Rourke, 2003; Egels-Zandén, 2007) such as:

- Working hours and working days per week
- Minimum wages and overtime compensation
- Health and safety standards and procedures
- Child labor
- Freedom to form trade unions
- Accident and pension insurance cover

Some observers fear that the bargaining power of MNEs vis-à-vis their employees and potential host countries, and the competition among countries wishing to attract FDI leads to lowering of standards and a ”race to the bottom” (Spar and Yoffie, 1999). Empirical evidence suggests that MNE affiliates typically pay higher wages (Aitken et al. 1997b; Lipsey and Sjöholm, 2004) and establish higher labor standards than local firms (Moran, 2002), last not least because they want to retain and motivate their human capital. Moreover, internationally operating firms may standardize business practices and technologies across their subsidiaries, which would raise standards above local requirements in those countries that have the least demanding standards.

Yet, lower standards and lower wages present opportunities to reduce production costs in labor-intensive stages of the supply chain. In certain industries, such as textiles, footwear and assembly of electronics, this can trigger a race to the bottom if (1) firms and goods are mobile across borders, i.e. free trade and investment, and (2) ”regulation and factor costs are heterogeneous – and the heterogeneity leaves gaps that can be turned into the firm’s competitive advantage” (Spar and Yoffie, 1999:565). If these two conditions apply, other industry features would further facilitate the relocation of production in search of lower costs: (1) homogeneity of products, such that price is a key competitive parameter; (2) regulatory differentials are important for the cost structure of the industry; (3) MNEs would not incur major transaction costs or sunk costs when relocating a plant.

In these circumstances, competitive pressures may induce firms to lower standards. Theoretically, the race would stop if firms were to cooperate and implement common standards, and thus agree on a common cost base. However, this would require cartel-like cooperation, which would be are hard to enforce, especially if firms are heterogeneous. Industry self-regulation can achieve part of such regulation by creating common standards and certification. However, contrary to market cartels, policy makers may support initiatives by firms, industry associations to raise standards and to reverse the ‘race to the bottom’ (Spar and Yoffie, 1999).

These pressures on labor standards raise many issues that have occupied CSR advocates (Table 3, col. 2). Case evidence suggests that high standards for labor in the supply chain can enhance productivity. For example, Frenkel and Scott (2002) compare two similar subcontractors of sports-shoe manufacturer adidas in the South of China and found that the supplier that adapted a collaborative approach to introducing a new corporate code of conduct achieved better performance in terms of for example reject rates or employee turnover.

****** Table 3 approximately here ******

High standards for labor or the environment (see next section) may also enhance a firm’s reputation; yet it is not clear to what extend consumers are willing to pay more for products from an ‘ethical firm’. Markets may not be very efficient in linking consumer preferences to business practices in distant locations. Consumer surveys often suggest that consumer value ‘ethical’ qualities of the products they buy, and experimental evidence suggests that consumers would pay a premium for certain features (Auger et al., 2003). Yet informed consumer decisions would require full information, which is hard to realize in practice.

Impact on the natural environment

The literatures on labor and environmental issues are largely separate, but the lines of argument are similar. In both cases, locating production in sites where regulation and monitoring are less stringent may reduce costs. The theoretical discussion focuses on two lines of argument. First, MNEs are likely to adopt more stringent standards than local firms because they are more closely monitored by various stakeholders in their home and host economies. Moreover, they may gain scale advantages by applying common standards across operations, which would be higher than the local requirements at any specific location. Comprehensive evidence on this argument is scarce, yet some studies provide evidence of MNEs reacting to pressures outside the local environment to raise standards (Christman, 2004), while others suggest that local community pressure is more important than ownership in explaining environmental performance (Zarsky, 1999).

Second, the ‘pollution haven hypothesis’ contents that MNEs would relocate polluting production facilities to locations with less stringent regulations, or they might use the threat of such relocation to pressure politicians not to raise their standards. MNEs are thus feared to evade stringent environmental standards in their home countries and locate to ‘pollution havens’, thus triggering a ‘race to the bottom’ in environmental standards. Empirical evidence suggests that escaping environmental regulation is not a substantive motivation for relocation of production as compliance costs are for most firms small relative to total costs of production, with some studies finding no effect (Eskeland and Harrison, 2003; Javorcik and Wei, 2004) while others find a small significant effect increasing pollution, especially if indirect effects via increased industrial activity are incorporated in the study (Hoffmann et al. 2005; He, 2006). Other evidence suggests that firm adopting global environmental standards actually perform better in financial terms (Dowell, Hart and Yeung, 2000). Moreover, legal changes in developing countries have narrowed the regulatory gap that may have existed in the 1970s (Zarsky, 1999; Dasgupta et al., 2002).

Environmental performance is increasingly becoming of economic interest to businesses as various mechanisms are strengthened that link green performance to financial performance: emissions trading and green taxes create direct costs, global warming awareness influences consumer behavior, and ‘green’ investment funds gain importance as investor. This strengthens instrumental arguments to implement green CSR policies, notably with respect to CO_2 emissions and other common indicators.

However, good reasons suggest taking a broader perspective on environmental impact (Table 3, col. 3). Good practice when handling dangerous substances reduces the likelihood of a disruptive event such as a fire of production facilities or a major spillage of pollutants that cause clean up costs and create negative publicity Positive action towards the local environment may also help building community relations.

Discussion: Raising Standards

MNEs contribute to host societies in many ways, and they are likely to increase this contribution if such contribution indirectly enhances their performance, or if moral beliefs held in the organization compel the firm to do so. MNEs thus aim to raise standards in ways that simultaneously enhance competitiveness (or at least does not harm it). Hartman et al. (2003) provide a hands-on approach and tell the story of positive examples of MNEs who aimed to raise the standards in their global supply chain. On the other hand, rich case evidence suggests that many well intended initiatives actually fail to create the desired outcomes, and even create negative side effects for the intended beneficiaries (Frynas, 2005; Bird et al., 2004). Two issues, at least, thus have to be resolved by CSR advocates.

Firstly, defining standards is the easy part of CSR. The main challenges concern the implementation and monitoring of these standards both within the firm and among its business partners. Case evidence suggests that creating a code of conduct is insufficient and the main challenge is “accepting responsibility down the chain and introducing all the management systems necessary to make adherence to the code possible” (Waddock and Bodwell, 2003:134). Thus, an integrated approach to managing labor issues as well as broader issues of corporate social responsibility may be required. For example, Waddock and Bodwell (2003) outline three mutually reinforcing processes that MNEs are suggested to set in motion “(1) *inspiration* or vision setting and leadership commitment processes; (2) *integration* of the vision and values into strategy, human resource, and operating practices; and (3) *innovation* processes, which involve establishing indicators that measure responsibility performance and provide a basis for improvements, remediation where necessary, and learning” (p. 119, emphases in the original).

Secondly, CSR policies have to be contextualized; application of ‘global’ standards does not always create positive effect for the disadvantaged groups supposed to be protected by these standards (Bird et al., 2004). Moreover ethical standards are grounded in culture, and cultures vary. For instance, local labor standards would be different in a context where working conditions are typically considerably worse in local firms then in those firms working with or for MNEs. Many children in poor countries are involved in selling goods on the streets, help running family businesses such as restaurants, or are begging to be able to survive. They would love to work under conditions that outside observers would find objectionable. For example, Khan (2004) has studied the long-term effects of the campaign to eliminate child labor in Pakistani football manufacturers and found that many poor women and children are worse off as they no longer have access to work.

Ethical principles and standards may have converged somewhat in recent years, and have been encoded in international conventions. But these conventions reflect, among other views, the interests of labor unions in North America and Europe wishing to limit competition. It cannot be taken for granted that these standards are also what local ethical standards would demand, especially in communities where the alternative to sweatshop work would be rural poverty.

Third, the benefits of higher standards may be larger if all major players in an industry jointly raise their standards. This would avoid burdening early movers without disproportionate costs, reduce the scope for freeriders to profit. However, concerted industry on the international stage action has to overcome substantial co-ordination challenges (Scherer and Smid, 2000; O'Rourke, 2003).

Conclusions

Ethical aspects of business have become a major concern as higher standards may create positive effects on the host economies. The main insight from this review is that MNEs interact with many local stakeholders and thus influence directly or indirectly macroeconomic variables, productivity of local firms, labor conditions, the natural environment, institutional development and other aspects of society. Hence, the impact of FDI is inherently complex, and cannot really be reduced to a small number of indicators, or by assessing the compliance with a singular standard. There are important trade-offs, for example a production plant facilitating industrial development and creating employment may have environmental side effects, while environmental programs made have side effects on labor.

The CSR debate ought to move forward by addressing these multiple impact channels and the resulting trade-offs (Tables 1 to 3). This however is a major challenge for managerial leadership and communication: scholars may advocate a comprehensive impact assessment, yet many interest groups and media are focused on single issues, and they appear to assume and benchmark values on key variables would to apply globally.

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Figure 1: Channels of Impact of FDI

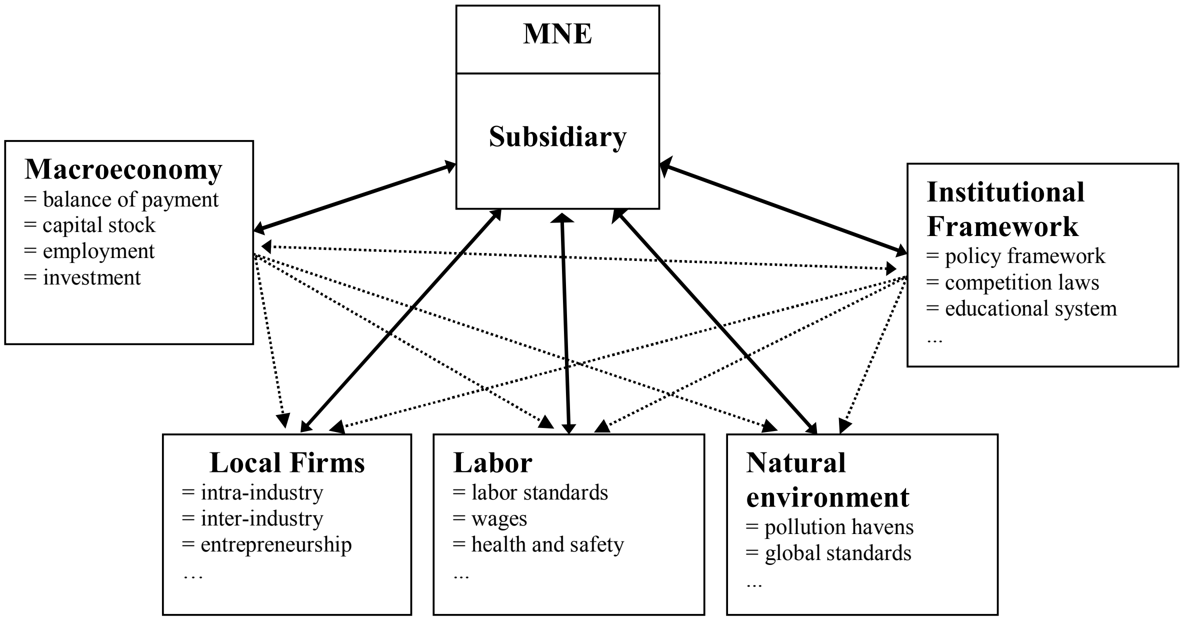

Table 1: CSR Questions on Macroeconomic Impact

	Exports and balance of payments	Employment (quantity)
Instrumental Perspectives		
1. Productivity benefits	How can we utilize untapped local resources to enhance our products?	How can we reduce costs by employing labor-intensive production processes where unemployment is high?
2. Reputation with consumers and other stakeholders in home or third countries	---	How can we avoid layoffs or manage them without causing negative publicity?
3. Protection against disruptive events (incl. negative publicity)	How can we reduce exposure to exchange rate risk by balancing exports and imports?	---
4. Reputation with stakeholders in host countries	Can we generate exports in ways that would strengthen our relationship with local authorities?	Can we generate employment in ways that would strengthen our relationship with local authorities?
Normative Perspectives		
1. No negative externalities	Can we reduce imports, or create offsetting exports?	Can we avoid layoffs and crowding out of local firms, or create new employment for those laid off?
2. Obey the laws, norms and values in the host country	How can we fulfill local content requirements without lowering our quality standards?	How can we fulfill employment promises made during initial entry negotiations?
3. Philanthropy	How can we help local firms, e.g. small entrepreneurs, to reach international markets?	How can we help local entrepreneurs to grow business that employ local labor?

Table 2: CSR questions on Microeconomic Impact

	Horizontal spillovers	Vertical spillovers	Lateral spillovers
Instrumental Perspectives			
1. Productivity benefits	Normally, horizontal spillovers are not in the interest of an MNE.	How can we train our suppliers to deliver higher quality?	---
2. Reputation with consumers and other stakeholders in home or third countries	=”=	Can we supply training or sales aids to distributors that support their business?	Can we sponsor educational activities in the business community?
3. Protection against disruptive events (negative publicity)	=”=	How can we secure that our suppliers don’t disrupt our supply chain? How can we secure that our supplier deliver safe products?	---
4. Reputation with stakeholders in host countries	=”=	How can we document and publicise the benefits for our suppliers?	How can we document and publicise the benefits for the host community?
Normative Perspectives			
1. No negative externalities	=”=	How can we avoid undue demands on our suppliers while receiving the quality we need?	---
2. Obey the laws, norms and values in the host country	How can we increase profits while staying within the rules of competition law?	How can we ensure that our suppliers obey locally relevant laws and norms?	---
3. Philanthropy	---	---	How can we encourage local entrepreneurship?

Table 3: CSR Questions on Social and Environmental Impact

	Labor and Social Welfare	Environment
Instrumental Perspectives		
1. Productivity benefits	How can we reduce accidents by better safety standards? How can we improve motivation and reduce absenteeism and labor volatility by improving working conditions?	How can we reduce wastage by recycling?
2. Reputation with consumers and other stakeholders in home or third countries	How can we create and sustain a 'social image' with our customers? Are they willing to pay more for 'social' products?	How can we create and sustain a 'green image' with our customers? Are they willing to pay more for 'green' products?
3. Protection against disruptive events (negative publicity)	How can we avoid to be associated with labor 'scandals' or hostile relations with unions?	How can we avoid to be associated with environmental 'scandals'?
4. Reputation with host countries and their governments	How can we demonstrate support for social objectives of the government?	How can we demonstrate support for environmental objectives of the government?
Normative Perspectives		
1. No negative externalities	How can we ensure that our employees have better working conditions than they would have elsewhere in the local economy?	How can we avoid, or offset, negative effects on the environment?
2. Obey the laws, norms and values in the host country	How can we operate most profitably while complying with health and safety standards? How to manage conflicting standards of local and home country unions?	How can we operate most profitably while complying with environmental standards? How to manage conflicting standards of local governments and home country NGOs?
3. Philanthropy	How to improve the welfare of the poor?	How to create projects that protect the natural environment while allowing for economic development?