American University International Law Review

Volume 23
Issue 3 *Conference: The Ninth Annual Grotius Lecture Series* | Article 2

2007

Balancing Rights with Responsibilities: Looking for the Global Drivers of Materiality in Corporate Social Responsibility & the Voluntary Initiatives That Develop and Support Them

Rachel Kyte

Recommended Citation

Kyte, Rachel. "Balancing Rights with Responsibilities: Looking for the Global Drivers of Materiality in Corporate Social Responsibility & the Voluntary Initiatives That Develop and Support Them." American University International Law Review 23, no.3 (2007): 559-576.

2007 GROTIUS LECTURE RESPONSE

BALANCING RIGHTS WITH RESPONSIBILITIES: LOOKING FOR THE GLOBAL DRIVERS OF MATERIALITY IN CORPORATE SOCIAL RESPONSIBILITY & THE VOLUNTARY INITIATIVES THAT DEVELOP AND SUPPORT THEM

RACHEL KYTE*

INTRODUCTION 560
I. CORPORATE SOCIAL RESPONSIBILITY IN CONTEXT 561
A. GROWTH PATTERNS IN THE DEVELOPING WORLD 561
B. WHAT IS CORPORATE SOCIAL RESPONSIBILITY? 563
II. THE BUSINESS CASE FOR CSR IN THE FINANCIAL SECTOR AS DRIVER 565
A. PROJECT FINANCE: THE EQUATOR PRINCIPLES 568
B. THE UNEP PRINCIPLES OF RESPONSIBLE INVESTMENT 569
C. MATERIALITY: THE PROOF OF THE PUDDING IS IN THE EATING 570
III. CONDEMNING EMERGING MARKETS TO REPEATING THE MISTAKES WE HAVE MADE 573
IV. ACCOUNTABILITY 574
V. THE FUTURE 576

* Rachel Kyte is Vice President for Business Advisory Services at the International Finance Corporation, a member of the World Bank Group. Formerly Director of Environment and Social Development, she oversaw the introduction of a new risk/opportunity based environment and social management system which acts as a global benchmark for those financing in emerging markets.

INTRODUCTION

Professor Joseph Stiglitz's Grotius Lecture[1] discusses three main issues: Is there a need for international economic agreements concerning the regulation of multinational corporations ("MNCs")? If so, what should the scope of an agreement governing such MNCs be, and what global institutional arrangements might be most effective? If these global institutional arrangements cannot be created, at least in the short run, what can individual countries do?

Professor Stiglitz has addressed these issues in a previous work, *Making Globalization Work*,[2] which asks what can be done to minimize the damage that MNCs cause, while maximizing their net contributions to society. Indeed, this is a critical question because private sector development is taking an increasingly large role in the development agenda. Professor Stiglitz proposes corporate social responsibility ("CSR") as a tool for ensuring that MNCs make net contributions to the communities in which they operate. However, Professor Stiglitz relies on moral suasion and cites behavioral examples from the Organisation for Economic Co-operation and Development's ("OECD") MNCs to make a case for a set of prescribed regulatory fixes that he believes would foster greater corporate responsibility. He offers these as a flimsy riposte to his assumption that there will always be a corporate "race to the bottom"[3] if the private sector is left to its own devices.

This Response to Professor Stiglitz's Grotius Lecture argues that there is something more exciting, fast moving and, ultimately with much greater leverage, afoot in the fast growing markets of the developing world. There is emerging evidence that better corporate behavior does pay and that what leading corporations do best—understand their enlightened self-interest—can better achieve the

1. Joseph E. Stiglitz, *Regulating Multinational Corporations: Towards Principles of Cross-border Legal Frameworks in a Globalized World: Balancing Rights with Responsibilities*, 23 AM. U. INT'L L. REV. 451 (2008).

2. JOSEPH E. STIGLITZ, MAKING GLOBALIZATION WORK (2006).

3. *See* Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 VA. J. INT'L L. 563, 567, 635 (1998) (defining the "race to the bottom" as a competition between countries to create the least restrictive regulatory environment to entice corporate investment in the least regulated regime).

social benefits that Professor Stiglitz desires.[4] Undoubtedly there is a need for partnership between the public and private sectors in encouraging and rewarding CSR, but not the kind of partnership described by Professor Stiglitz. To better demonstrate the form this partnership should take, let me first define the world of which I speak.

I. CORPORATE SOCIAL RESPONSIBILITY IN CONTEXT

A. GROWTH PATTERNS IN THE DEVELOPING WORLD

Today's world evinces patterns of growth in markets and investment that are changing rapidly.[5] We must acknowledge that we are observing CSR in a world in which the traditional north–south view[6] is increasingly redundant. Our new lens will show with clarity and precision that the trends of corporate performance and CSR are global.

Foreign direct investment ("FDI") is outstripping official development assistance ("ODA"). Although total ODA from OECD members rose by 32% in 2005 to $106.8 billion, a record high, only two countries—Afghanistan and Iraq—accounted for most of this increase.[7] In the meantime, FDI flows to developing countries in

4. *See* Veronica Besmer, Note, *The Legal Character of Private Codes of Conduct: More Than Just a Psuedo-Formal Gloss on Corporate Social Responsibility*, 2 HASTINGS BUS. L.J. 279, 291-92 (2006) (noting that CSR is profitable for the company in terms of saving in operating expenses and overhead costs, optimizing existing resources, and improving public image while also benefiting society).

5. *See* Ruth L. Gana, *Prospects for Developing Countries under the TRIPS Agreement*, 29 VAND. J. TRANSNAT'L L. 735, 739-40 n.11 (1996) (citing to Ford Foundation study demonstrating that trade in developing and developed countries has undergone a more dramatic transformation during the "Uruguay era" than at any other time since World War II).

6. *See* Robin Broad & John Cavanaugh, *Don't Neglect the Impoverished South*, FOREIGN POL'Y, Winter 1995, at 18, 21 (defining the South as the "third world" and the North as developed countries, and discussing why the gap between the two is growing).

7. *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, FINAL OFFICIAL DEVELOPMENT ASSISTANCE (ODA) DATA FOR 2005, at 1 (2006), http://www.oecd.org/dataoecd/52/18/37790990.pdf (noting that if Afghanistan and Iraq are excluded, core development programs increased by only 2.9%).

2005 rose by 22% to reach a record high of $334 billion.[8] This signifies an FDI/ODA ratio of around three to one.

The increase in "South-South" investment is significant. Foreign direct investment from developing countries is growing and reached a record level in 2005.[9] Most of these investments end up in other developing countries, contributing to "South-South" economic growth. In fact, many low-income countries now rely mainly on other developing countries for inward FDI.[10]

In 2005, MNCs based in developing or transition economies, excluding major offshore financial centers, generated FDI outflows of $120 billion, more than official development assistance in 2005.[11] In fact, in 2005 fifty-seven MNCs from developing and transition economies were listed in the Fortune 500, as compared with only nineteen in 1990.[12] This trend is expected to continue.[13]

Today's world is not a place where examples of reputational crises as a result of environmental or social events, an oil spill, complicity with human rights abuses of host government armed forces, events in the United States or the E.U. from the late 1980s and 1990s are particularly instructive. Such corporate scandals did serve to alert corporate executives and their bankers to the perils of reputation risk from environmental or social disaster, and they instigated the soul searching that has led to many of today's voluntary initiatives.[14]

8. *See* UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT [UNCTAD], WORLD INVESTMENT REPORT 2006, at 4 (2006), *available at* http://www.unctad.org/en/docs/wir2006_en.pdf.

9. *See id.* at 108.

10. *See id.* at 117 (finding that the bulk of South-South FDI is intraregional).

11. *See* UNCTAD, *supra* note 8, at xxiii (documenting the level of FDI from developing and transition countries as the highest ever recorded by UNCTAD and predicting that these figures will continue to grow given that the value of stock of FDI from developing countries accounted for $1.4 trillion in 2005).

12. *See id.* at 122 (detailing the growth of MNCs that originated in developing nations and finding that one-fourth of MNCs overall come from developing or transitional countries).

13. *See, e.g.*, Lynn Cowan, *Foreign Companies Cash in on U.S. Exchanges*, WALL ST. J., Aug. 28, 2006, at C6 (finding the most significant increase in foreign investment to be in the United States since the tech boom, despite regulations imposed by the new Sarbanes-Oxley rules).

14. *See* Besmer, *supra* note 4, at 279-81 (explaining how the Enron and WorldCom bankruptcies compelled corporations to adopt CSR policies); *see also* Lisa M. Fairfax, *Easier Said Than Done? A Corporate Law Theory for Actualizing*

However, these examples are being replaced by examples of organizations that seek value in good performance, in addition to managing the risks associated with bad performance. Such organizations—whether they are entrepreneurs, industrialists, and bankers from the developed and developing world, or trustees of the public pension funds—seek financial returns in sustainable ways. This provides an important lesson in the creation of value through sustainability.

B. WHAT IS CORPORATE SOCIAL RESPONSIBILITY?

Although the concept of CSR has been developing since the early 1970s, there is no single, commonly accepted definition of CSR.[15] There are different perceptions of the concept among governments, the private sector, and civil society organizations. Depending on one's perspective, CSR may include the following: a company running its business responsibly in relation to internal stakeholders (shareholders, employees, customers, and suppliers); the role of business in relationship to the state, locally and nationally, as well as to inter-state institutions or standards; and business performance as a responsible member of the society in which it operates and the global community.[16]

What we can say is that CSR is voluntary and goes beyond existing regulations. Corporate social responsibility requires the integration of environmental issues into an organization's core business practices—for example, environmental management systems, labor standards, and fair consumer relations. Corporate social responsibility is neither charity nor philanthropy, and it is

---

Social Responsibility Rhetoric, 59 FLA. L. REV. 771, 773-75 (2007) (discussing how FedEx and other companies developed CSR policies in response to social and environmental concerns).

15. *See, e.g.*, Besmer, *supra* note 4, at 289 (opting to define CSR as viewing the corporation's actions in a "holistic mindset," but also mentioning several other accepted definitions of CSR).

16. *See* John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1, 11, 20 (2005) (discussing government and NGO concerns that corporations only enact CSR policies when pressured by home governments).

driven by the quest for a win-win scenario for business and its stakeholders.[17]

Importantly, CSR is a complement to, not a substitute for, regulation.[18] It can be encouraged and rewarded by effective regulation of the market. Companies that have excelled at CSR would note that it strengthens the bottom line, enhances brand value, helps penetrate new markets, and creates business opportunities.[19] CSR is smart business when fully integrated into business processes.

The view of CSR as morally driven, as opposed to business driven, is well documented, but produces dilemmas.[20] For example, how, at the enterprise level, can we navigate differing views on the morality of making profit from the private supply of affordable water or some other fundamental service, versus the morality of allowing corrupt or inept local governments to promise, but not deliver, free or cheap services?

I postulate that this conceptualization of CSR is a particularly western phenomenon—the idea that the private company is an embodiment of evil, while the public sector represents the good in society.[21] In societies where the dominant religious and spiritual traditions see evil as within—struggling with the good within each entity—a private firm is one expression of that society, some good, some bad.[22] Here in the west—where the dominant religious and

17. *See* Besmer, *supra* note 4, at 291 (discussing how CSR enhances profitability by using the example of "greening" techniques that reduce environmental waste and save money).

18. *See* Thomas McInerney, *Putting Regulation Before Responsibility: Towards Binding Norms of Corporate Social Responsibility*, 40 CORNELL INT'L L.J. 171, 172, 184-90 (2007) (noting that CSR is not a stand-alone solution, but instead should be part of a system of governmentally enforced self-regulation).

19. *See* Daniel Franklin, *The Next Question*, ECONOMIST, Jan. 19, 2008, at 8 (citing to a recent study which found a positive correlation between CSR and financial performance, but adding the caveat that the correlation was weak).

20. *See* Fairfax, *supra* note 14, at 779-80 (explaining how a sense of greater social responsibility drives companies to adopt CSR).

21. *See* STIGLITZ, *supra* note 2, at 187 (citing examples of irresponsible corporations, such as Exxon's oil spill and Nestle's infant formula scandal).

22. *See, e.g.*, Amelia J. Uelmen, *Forward to Symposium on Religious Values and Corporate Decision Making*, 11 FORDHAM J. CORP. & FIN. L. 537, 542 (2006) (describing how religious values shape corporate decision making, and specifically, how Jewish law requires Jewish business owners to prevent their businesses from doing harm).

spiritual traditions are often understood as positioning evil without externalizing it in some way—it is too easy for us blame the corporate world for all that is bad. In fact, that corporate world is as much a part of us as our aid policies. It includes inspirational success as well as embarrassing excess; but it is of us—our society, our regulation, our law, and our labor.

We are on much stronger ground if we discuss and use the drivers for good corporate responsibility that come from business and financial imperatives—effective regulation, including privatization and public private partnerships, competitiveness, profitability and shareholder/stakeholder value. Here, there is plenty of evidence that the alternative world described by Professor Stiglitz, where it always pays to pollute, is changing.

II. THE BUSINESS CASE FOR CSR IN THE FINANCIAL SECTOR AS DRIVER

What I have witnessed in the very short period of four years is a shift in drivers. The leaders have moved from fear of reputation, to effective integrated risk management, to a proactive strategy that captures value by seeking out well performing companies, to competing on how one financial institution can invest in the best company because it understands their risks as well as their opportunities better than any other institution. What this conveys to me is the beginning of the race to the top, not to the bottom.[23]

The reason for this shift is that value is being uncovered today and institutions are calculating that there will be even more tomorrow. This is a world where the Bottom of the Pyramid is the future market,[24] and where climate change will destabilize assets for many

23. *See* Debora L. Spar, *The Spotlight and the Bottom Line: How Multinationals Export Human Rights*, 77 FOREIGN AFF. 7, 9-10 (1998) (positing that collective action by multinational corporations, aimed at shoring up each corporation's reputation as globally responsible, can create a "race to the top").

24. *See* Dirk Matten, *Why Do Companies Engage in Corporate Social Responsibility? Background, Reasons, and Basic Concepts*, *in* THE ICCA HANDBOOK ON CORPORATE SOCIAL RESPONSIBILITY 3, 13-15 (Judith Hennigfeld et al. eds., 2006) (outlining the "bottom of the pyramid" concept, developed by C.K. Prahalad and others, which asserts that those at the bottom of the income brackets in developing countries represent an enormous untapped market, and will play an increasingly significant role in international commerce in years to come).

firms and currently provides a completely different framework for measuring long-term risk. Although socially responsible investors account for a mere fraction of the assets under management in the developed world, they raised many issues of concern and called for effective engagement by asset owners and managers which is producing a broader understanding of risk by the mainstream investment community. This enhanced understanding of risk is producing momentum that is incentivizing best-in-class companies across an ever wider spectrum to improve performance in financial, economic, environmental, social, and governance parameters.[25] As a result, financial institutions are seeking to understand not only their direct carbon footprint, but also ways to calculate their exposure to carbon at the portfolio level.[26] This is a world where global distribution channels built by leading brands can be used to deliver renewable energy lighting to the poor, as well as bouillon cubes and soft drinks.[27]

---

25. *See* Helena Buhr & Maria Grafström, *The Making of Meaning in the Media: The Case of Corporate Social Responsibility in the Financial Times*, *in* MANAGING CORPORATE SOCIAL RESPONSIBILITY IN ACTION: TALKING, DOING AND MEASURING 15, 26-27 (Frank den Hond et al. eds., 2007) (summarizing literature that views CSR as risk-management strategy, whereby corporations manage their reputation for social responsibility as a means of avoiding media and consumer backlash); Arno Balzer & Michael Kröher, *The "Good Company Ranking" of the Manager Magazin*, *in* THE ICCA HANDBOOK ON CORPORATE SOCIAL RESPONSIBILITY, *supra* note 24, at 369, 379-80 (ranking companies based on human resources, community service, environment, financial strength and performance, and communication and transparency).

26. *See generally* Erik Assadourian, *The State of Corporate Responsibility and the Environment*, 18 GEO. INT'L ENVTL. L. REV. 571, 593 (2006) (bemoaning the relative lack of enthusiasm by major financial institutions for CSR, but noting that Goldman Sachs has decided to both reduce its carbon footprint and lobby foreign governments to address climate change); *see also* GOLDMAN SACHS, GOLDMAN SACHS ENVIRONMENTAL POLICY FRAMEWORK 1 (2005) *available at* http://www2.goldmansachs.com/ideas/environment-and-energy/env-policy.html (stating that Goldman Sachs will work to ensure that their people, capital, and ideas are used to help find effective market-based solutions to address environmental issues).

27. *See, e.g.*, MICHAEL HOPKINS, CORPORATE SOCIAL RESPONSIBILITY AND INTERNATIONAL DEVELOPMENT: IS BUSINESS THE SOLUTION? 56-59 (2007) (providing an overview of the actions taken by the Royal Dutch/Shell Group of Companies, via their charitable subsidiary, the Shell Foundation, which include encouraging use of renewable energy in developing countries and facilitating the availability of financing for local industries).

For over three years, asset owners, managers, sell-side and buy-side analysts, banks, and others have gathered to examine why and how to integrate environmental, social, and governance factors into investment analysis. This conversation is not led by the socially responsible investment ("SRI") community with its $3.2 billion in assets in the United States alone—just 0.1% of which is emerging markets—but by large mainstream houses.[28] Three years ago, such practices seemed to be on the fringe and now SRI is making inroads into the mainstream. Many leading sell-side analysts are beginning to publish sector reports looking at sustainability performance.[29] Asset managers are looking for analysts that understand these risk issues, and increasing numbers of asset owners are looking for managers who can cover these issues for them.

The relationship between investors and firms is complex. Professor Stiglitz mentions in his most recent book that a mining company that skimps on environmental, social, health, and safety issues will automatically be more competitive.[30] The mining sector, in particular, having suffered across almost all of its business from enormous image problems and probably enduring the greatest barrage from stakeholders, has been forced into new patterns of

28. *See* Daniel Franklin, *Just Good Business*, ECONOMIST, Jan. 19, 2008, at 4 (noting that $1 out of every $9 under professional management in the United States constitutes SRI and that large mainstream investment houses such as Goldman Sachs and UBS are participants).

29. *See, e.g.*, ANGLO AMERICAN, A CLIMATE OF CHANGE - REPORT TO SOCIETY 1-2 (2006), http://www.angloamerican.co.uk/static/uploads/Report%20to%20Society%202007.pdf [hereinafter ANGLO AMERICAN REPORT] (discussing the company's efforts to achieve sustainability, including efforts to address climate change and water and energy conservation); ALCOA, 2006 SUSTAINABILITY HIGHLIGHTS 2-5 (2006), http://www.alcoa.com/global/en/about_alcoa/sustainability/pdfs/sustain_highlights06.pdf [hereinafter ALCOA 2006 REPORT] (outlining the company's broad approach to sustainability, which includes eliminating occupational hazards, understanding the communities in which the company operates, recycling aluminum, and reducing its environmental "footprint"). *Cf.* Daniel Franklin, *The Next Question*, ECONOMIST, Jan 19, 2008, at 10 (observing that numerous rankings and indices of corporate sustainability have been developed, such as the Dow Jones Sustainability index and the FTSE4Good, but that they typically "underperform" the market).

30. *See* STIGLITZ, *supra* note 2, at 194-95 (mentioning how mining companies in India, Papua New Guinea, Thailand, and Peru have used the shield of limited liability to shift the enormous costs of their environmental damage to the government, resulting in a substantial business advantage).

corporate behavior to protect the industry and improve shareholder value.[31] Now, the leaders within the industry position themselves as good homes for the long-term investor, precisely because they feel they can and do manage long-term environmental and social risk better.[32] Thus, necessity as the mother of invention would appear to be true in CSR as well as any other field. Whether CSR will be rewarded in the market is something we need to watch.

It is clear, then, that the financial sector has begun to integrate extra-financial risks into decision-making. Three initiatives in different spheres of the capital markets, discussed below, demonstrate this emerging concern with extra-financial risks. They are indicative of trends towards responsible lending and investing, and they run counter to the mantra that the public sector must regulate and the private sector must follow. In each case, private action has come from changes in the perception of risk, and it is the regulators that are observing and reacting.

A. PROJECT FINANCE: THE EQUATOR PRINCIPLES

In July 2003, ten of the leading commercial banks engaged in project finance launched the Equator Principles,[33] a set of

31. *See* Neil Gunningham, *Corporate Environmental Responsibility: Law and the Limits of Voluntarism*, *in* THE NEW CORPORATE ACCOUNTABILITY 476, 488-89 (Doreen McBarnet et al. eds., 2007) (regarding the mining industry as representative of business in need of improving its public image with respect to CSR, and advocating an industry-wide, rather than a company-by-company, approach).

32. *See, e.g.*, ANGLO AMERICAN REPORT, *supra* note 29, at 3 (reasoning that, because the company's investments are long-term, it has an incentive to conduct itself in a manner that promotes both stability and prosperity); ALCOA 2006 REPORT, *supra* note 29, at 2 (taking the view that environmental excellence, good governance, and social responsibility have the synergistic effect of long-term business success); NOVO NORODISK, 2006 ANNUAL REPORT 14 (2006), *available at* http://annualreport.novonordisk.com/images/2006/PDFs/Report%202006%20UK.pdf (discussing how the company's climate strategy minimizes long-term risk by aiming to make the company better prepared for a "carbon-constrained future" and less vulnerable to fluctuations in energy price).

33. Official Website of The Equator Principles, http://www.equator-principles.com/principles.shtml (last visited Mar. 22, 2008); *see* HOPKINS, *supra* note 27, at 215-16 (surveying the origins and the effectiveness of the Equator Principles, which began with 10 of the largest commercial banks, and has subsequently grown to include most similar banks).

environmental and social standards designed to manage risk. The Equator Principles are based on the International Finance Corporation's ("IFC") existing Safeguard Policies.[34] The Safeguard Policies were re-launched in July 2006 to follow the IFC's new Performance Standards.[35] By June 30, 2007, fifty-one financial institutions from around the world, including institutions based in emerging markets, had begun to apply the Equator Principles in project finance.[36] The Equator Principles account for nearly 90% of cross border project finance by number of projects and 88% by dollar volume.[37]

B. THE UNEP PRINCIPLES OF RESPONSIBLE INVESTMENT

In the period since the launch of the Principles of Responsible Investment[38] in April 2006, more than $4.5 trillion of assets owned by public and private pension funds have come together in search of outstanding assets in which to invest for long-term value.[39] Sustainability here is critical. There are many barriers to this, including substantial hurdles for these financial flows to seek best-in-

---

34. INT'L FIN. CORP. [IFC], SAFEGUARD POLICIES (1998), http://www.ifc.org/ifcext/policyreview.nsf/e11ffa331b366c54ca2569210006982f/1790644170c3547485256dfe0056243d?OpenDocument.

35. IFC, PERFORMANCE STANDARDS ON SOC. & ENVTL. SUSTAINABILITY (2006), http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/pol_PerformanceStandards2006_full/$FILE/IFC+Performance+Standards.pdf.

36. IFC, 2007 ANNUAL REPORT 20 (2007), http://www.ifc.org/AR2007 [hereinafter IFC ANNUAL REPORT] (noting that over 50 leading financial institutions have adopted the IFC Equator Principles, including several institutions from emerging markets).

37. *See id.* (stating that members of the Equator Principles together account for almost 90 percent of worldwide cross-border project finance).

38. U.N. ENV'T PROGRAMME FIN. INITIATIVE, PRINCIPLES FOR RESPONSIBLE INVESTMENT, http://www.unpri.org/files/pri.pdf (last visited Mar. 22, 2008).

39. *See generally* U.N. Env't Programme Fin. Initiative, *Principles for Responsible Investment Backed by USD 4 Trillion and Growing*, E-BULLETIN, May-June 2006, http://www.unepfi.org/fileadmin/publications/ebulletin/unepfi_ebulletin_200605.pdf (noting that, as of June 2006, the Principles for Responsible Investment was backed by groups with more than $4 trillion under management); INSIGHT INVESTMENT MANAGEMENT LIMITED, 2006 ANNUAL REPORT 3 (2006), http://www.insightinvestment.com/Documents/responsibility/Reports/Putting_Principles_into_Practice_FINAL.pdf (declaring that, by the end of 2006, the Principles of Responsible Investment had attracted more than 100 institutional investors, including pension funds, accounting for more than $5 trillion).

class firms in emerging markets, where most of the growth necessary for our demands on pension performance will be realized. Many of these asset owners are compelled to invest sustainably as a result of legislation or regulation regarding portions invested in so called SRI,[40] but drivers also include public expectations, risk management, and long-term financial performance.

The IFC's development mandate compels us to bring responsible investors together with the best performing companies.[41] We have begun to address the hurdles we face in forming these relationships by making our own investments in sustainability fund strategies in emerging markets—a demonstration that this can be done successfully—and by supporting investment research and creating emerging market indexes so that responsible investors know what the best performing companies are.[42]

C. MATERIALITY: THE PROOF OF THE PUDDING IS IN THE EATING

Is the materiality of environmental and social risk just wishful thinking? The evidence from the IFC's investment portfolio says no. When examining the environmental and social risk we attribute to projects in our own portfolio, in relation to our credit risk rating, it would appear that, at this very early stage of analysis, there is an emerging positive causal relationship between environmental and social performance on the one hand, and financial performance on

40. *See* Pauline Skypala, *Socially Responsible Investment "Better for the Long Term Good,"* FIN. TIMES, Aug. 6, 2007, at 4 (noting that in some countries there may be legal encouragement, or a legal requirement, to invest pension funds in a socially responsible manner); G. Jeffrey MacDonald, *Laws Target "Terror Stocks"*, CHRISTIAN SCI. MONITOR, Aug. 27, 2007, at 13 (reporting that public pension funds are increasingly becoming involved in "myriad social issues, from the environment, to labor conditions, to human rights in developing countries"); *see also* Simon Chesterman, *The Turn to Ethics: Disinvestment from Multinational Corporations for Human Rights Violations—The Case of Norway's Global Pension Fund*, 23 AM. U. INT'L L. REV. 577 (2008).

41. *See* IFC ANNUAL REPORT, *supra* note 36, at 104 (describing how the IFC's Articles of Agreement provide for investment in "productive private enterprise," and how the IFC applies "stringent tests of enterprise soundness, project viability, additionality, and developmental impact in determining the eligibility of projects").

42. *See id.* at 16 (reviewing how the IFC analyzes its investments using an index that takes into account financial performance, broader economic performance, social and environmental performance, and private sector development impacts).

the other. This indicates that a company that manages its environmental and social risks well performs better in the portfolio financially.[43] This is a potentially powerful argument that firms may present to their investors, as well as a powerful incentive for investors to demand good environmental and social performance.

However, in discussions involving CSR in global markets, the questions of the fast growing markets of India and China, among others, are quickly raised. Often the conversation paints CSR as western enlightenment and the behavior and growth of firms in the emerging markets as caricatures of corporate behavior from another century.[44] This debate is neither insightful nor accurate.

In China, India, Brazil, and South Africa, leading bankers discuss their concerns about the mechanisms they need to integrate environment and social risks into decision-making. These discussions range from the bank that wants to use environmental and social risk tools to weed out high polluters from their portfolio to the financiers that do not want to have the liabilities of firms that will cause social backlash from mishandling community relations on their books. In fact, in these emerging markets, the discussion is perhaps more pointed as private sector and financial sector leaders are perhaps closer to and feel more acutely the risks to their emerging nations of not managing these issues well. In China, for example, the People's Bank of China, acting as regulator, works jointly with the State Environmental Protection Agency to maintain creditor lists.

Professor Stiglitz asserts that fiduciary responsibility and environmental responsibility are in contradiction. The business case

---

43. *See* HOPKINS, *supra* note 27, at 10-12 (advancing nine reasons why CSR may "both improve the financial bottom line *and* help to resolve . . . under-development and poverty," including improving a company's reputation, access to finance, employee motivation, and risk management). *But see Ethical Capitalism: How Good Should Your Business Be?*, ECONOMIST, Jan. 17, 2008, *available at* http://www.economist.com/opinion/displaystory.cfm?story_id=10533974 (concluding that it is "[a]n inconvenient truth for advocates of CSR that the connection between good corporate behaviour and good financial performance is fuzzy at best").

44. *See, e.g.*, David Barboza, *Reform Stalls in Chinese Factories*, N.Y. TIMES, Jan. 5, 2008, at B1 (reviewing attempts by foreign corporations that invest in China to clean up their image, but concluding that "[t]here is little that any Western company can do about those issues, no matter how seriously they take corporate social responsibility—other than leaving China").

for responsible investment is the opposite: Environmental non-performance will destroy financial performance and, in turn, fiduciary responsibility. Indeed, the legislation regulating some of the largest pension funds is also helping redefine fiduciary responsibility to include issues of sustainability.[45] For example, PREVI of Brazil, the largest pension fund in Latin America, clearly states in its Code Of Corporate Governance Practices that it seeks companies that can act as agents of change for a better country as part of its achievement of value, seeing a long term link between the two and trying to minimize the gaps between private and social return through insisting that those with whom it invests exercise good corporate practices.[46]

Of these extra financial issues—environmental, social, and governance—governance is the easiest to measure and to prove material. Good corporate governance is, however, a proxy for many things: good financial, good environmental, and good social risk management, as well as creative future planning. That is why the character of the company's management and ownership, their vision of themselves and their company, is the most important element of due diligence in making any investment decision.[47] I could not agree more with the importance that Professor Stiglitz places on anti-corruption measures.[48] The role of the state is to create conditions in which responsible business practices can flourish. Corruption eats away at the heart of CSR.

45. *See generally* FRESHFIELDS BRUCKHAUS DERINGER & UNEP FINANCE INITIATIVES, A LEGAL FRAMEWORK FOR THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTMENT 117-51 (2005), *available at* http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf (providing an overview of legislative initiatives throughout the world that relate to socially responsible investing, including issues of sustainability).

46. PREVI, CODE OF CORPORATE GOVERNANCE PRACTICES 5, *available at* http://www.previ.com.br/pls/portal/docs/page/pg_previ/downloads/documentoseprogramas/cod_govern_ingl.pdf.

47. *See, e.g.*, Dan Fost, *Buffett Seals the Deal*, S.F. CHRON., Jan. 18, 2006, at C1 (quoting investor Warren Buffett as saying "a major criteria in all our investment decisions is evaluating corporate management").

48. *See* Joseph E. Stiglitz, *Guard Against Those Who Would Corrupt Fight Against Corruption*, BUS. DAY, Nov. 24, 2006, at 12 (S. Afr.) (crediting himself and the previous President of the World Bank with making the fight against corruption a Bank priority).

III. CONDEMNING EMERGING MARKETS TO REPEATING THE MISTAKES WE HAVE MADE

Looking beyond the OECD, we can perhaps find inspiration and ideas, not just anecdotes. PREVI's statement of purpose[49] would be appropriate for any pension fund in the developed world. Corporate social responsibility is a global dynamic, shaped by entrepreneurs and businesses across the developing world. They eschew the bells and whistles that CSR can become in the developed world, often because there is no domestic audience for the big headline or the philanthropic gesture, as is the case here. But the business case for CSR is real, and it is driving their business practices. CEMEX, a cement company, will become a leading sustainable energy services company that seeks to protect biodiversity.[50] Grupo Amaggi, a soy farming and trading firm, has become a steward of protected areas.[51] Manila Water became a social services organization.[52] EXIM Bank of Tanzania finances poor entrepreneurial women and grows its business while improving women's and their families' lives.[53] Cairn Energy Rajasthan provides AIDS services.[54] Why do they do it? Because they believe it will protect and enhance their business.

---

49. *See* PREVI, CODE OF CORPORATE GOVERNANCE PRACTICES, *supra* note 46.

50. *See* CEMEX, 2006 SUSTAINABLE DEVELOPMENT REPORT 30 (2006), http://www.cemex.com/ic/ic_re.asp (discussing the fact that the company rehabilitates quarries and mines that have come to the end of their life to create new habitats for biodiversity and prepare the land for agriculture or as a local amenity).

51. *See* Press Release, André Maggi Group, André Maggi Group Awarded International Environmental Certification (Nov. 14, 2007), http://www.grupomaggi.com.br/en/imprensa_materia.jsp?areaId=43&id=562 (noting that the company has obtained an ISO 14001 environmental certification which indicates that the company complies with all international standards required by ISO).

52. MANILA WATER CO., INC., 2006 SUSTAINABILITY REPORT 10 (2006), http://www.manilawater.com/sustainable-development/sustainability-report (lauding the company's "Tubig Para Sa Barangay" program, which has provided more than one million urban poor with a regular supply of drinking water).

53. *See* Press Release, Exim Bank Ltd., IFC Supports Women Entrepreneurs in Tanzania (July 8, 2007), http://www.eximfinancialservices.com/index.php?main_page=more_news&news_id=7 (announcing IFC's partnership with Exim which will allow Exim Bank to meet the financing needs of all its female clients, particularly those running small and medium sized businesses).

54. *See* CAIRN ENERGY PLC, 2005 CORPORATE RESPONSIBILITY REPORT 8 (2005), *available at* http://www.cairn-energy.plc.uk/annualreport2005/CairnCRR2005.pdf (recognizing the potential for the spread of HIV and working with

Now, a word must be said regarding the problem of differing environmental standards at home and abroad, which Professor Stiglitz cites as constraining good performance and enticing bad performance. The business rationale for one standard is that it increases efficiency and levels the playing field for competition. But it is increasingly dangerous to presume that OECD countries have the highest and best standards, for example, in the area of environmental and social performance. Across emerging markets, countries are setting high standards, sometimes very high standards, to drive the development they want to see. Emissions regulation in China is one example.[55] The issue is not solely with standards, but enforcement, and enforcement is often weak.[56] There is continued room, therefore, for voluntary standards as responses to early impulses from the market.

IV. ACCOUNTABILITY

Corporate social responsibility demands better accountability arrangements. Almost anything can be branded as CSR. Its test is materiality, measurement, reporting, and transparency. Transparency, I agree, is the best antiseptic.[57] From the examples of the voluntary arrangements in the financial sector that I cited before, the public and private initiatives such as the Extractive Industries Transparency Initiative,[58] and the Voluntary Principles on the use of Security

---

the IFC to implement a program to partner contractors in HIV awareness and prevention).

55. *See, e.g.*, Jim Yardley, *Beijing's Olympic Quest: Turn Smoggy Sky Blue*, N.Y. TIMES, Dec. 29, 2007, at A1 (stating that in order to become the host city for the 2008 Olympic Games, Beijing promised a "green olympics" and began implementing the highest vehicle emissions standards in China).

56. *See, e.g.*, Stephen L. Kass & Jean M. McCarroll, *Environment, Development and Human Rights*, 238 N.Y. L.J. 3 (2007), http://www.law.com/jsp/nylj/PubArticleFriendlyNY.jsp?hubtype=&id=1193303022948 (noting the lack of compliance with Beijing's environmental regulations). The Chinese government has not allowed lawyers and NGOs to challenge such environmental regulations in the courts and thus it has limited the scope of public discourse on the issue. *See id.*

57. *See* Erik Luna, *Transparent Policing*, 85 IOWA L. REV. 1107, 1164 (2000) (quoting Justice Brandeis as saying that transparency is "justly commended as a remedy for social and industrial disease").

58. *See* EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE, REPORT OF THE INTERNATIONAL ADVISORY GROUP 5 (2006), *available at* http://eitransparency.org

Forces,[59] we can see that the pressure for transparency in the private sector needs to be followed with effective and creative arrangements from regulators to embody this transparency for all. In the extractive industries, transparency of revenue payments from companies will need to be accompanied by transparency of decisions made at the state level on how those revenues will be used for development.[60] In many countries municipal and local authorities face enormous challenges in managing large flows of revenues that have come with the development of extractive projects in their midst.[61] Transparency leads to disclosure along the chain of custody of revenues.[62]

This issue goes beyond the normal attention afforded the oil and mining industries. Power purchase agreements, essential services tariff agreements, and other such fundamental agreements between the state and the private operator, if made transparent, will direct public and private attention at the correct locus for discussion on quality and price of services. The movement behind the Global Reporting Index[63] should be welcomed and congratulated. It is having an impact. A new generation of sustainability reports is increasingly focusing on the material and informative. But if CSR is to be fully integrated, reporting and regulation need to be integrated as well. Domestic regulators will need to require different reporting with a focus on specific material extra-financial issues.

/files/document/eiti_iag_report_english.pdf (requiring that there be transparency over both payments made by extractive companies and revenues received by governments in order to ensure that resources are well-managed).

59. *See* U.S. Dep't of State, Voluntary Principles on Security and Human Rights, Fact Sheet (Feb. 20, 2001), http://www.state.gov/g/drl/rls/2931.htm; Voluntary Principles on Security and Human Rights, www.voluntaryprinciples.org.

60. *See* EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE, SOURCE BOOK 18 (2005), *available at* http://eitransparency.org/files/document/sourcebookmarch05.pdf (suggesting that governments could promote transparency by providing legal protection to whistleblowers).

61. *See id.* at 32 (noting that this is particularly true in the mining sector).

62. *Id.* at 36 (offering to provide support for countries in managing their obligation to make revenue procedures transparent).

63. *See* GLOBAL REPORTING INITIATIVE, THE GRI'S SUSTAINABILITY REPORT JULY 2004-JUNE 2007, at 3 (2007), *available at* http://www.globalreporting.org/NR/rdonlyres/AEBDFCC1-8777-4B21-B86C-53C8145A3E96/0/GRISR20042007Finalversion.pdf (outlining the mission of the Global Reporting Initiative).

V. THE FUTURE

There are many actors on the move as the interrelationship between environmental and social risk and financial performance becomes better understood. The shareholder search for value and the stakeholder search for responsibility is beginning to converge, and we are beginning to understand more about how to signal what is important for company performance over the long-term, as well as how to assess the risks to that performance. Each of these actors is voluntarily developing the tools needed to reveal that value, to manage risks, and to focus on what is material.

I believe there are many reasons for optimism and that this race to the top is itself sustainable.[64] But we will need discipline and focus. We will need to produce continued proof of what is material, how it can be measured, by whom, and who should verify it. We must not project onto individual firms, or the private sector at large, solutions that we feel should be achieved; we must not mandate a particular method by which the private sector delivers the value inherent in CSR. Just as there is no room for romanticism in the debate on trade or aid, so is the case in the discussion on CSR and the role it can play in determining what good performance means and how it can be rewarded. We will need intellects the size of Stiglitz. But we need that intellect in its most incisive form, not wearing the cardigan of an armchair moral philosopher.

64. *See* JONATHAN E. BERMAN & TOBIAS WEBB, RACE TO THE TOP: ATTRACTING AND ENABLING GLOBAL SUSTAINABLE BUSINESS 1-5 (2003) (stating that "a majority of companies [participating in the study] reported that CSR issues are at least as influential as traditional considerations . . . in new venture assessment, and that this influence has grown in the last five years").