

# Chapter 7

## Investigating the Relationship between Foreign Direct Investment and Corporate Social Responsibility: Central Bank Independence and Inflation

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### ABSTRACT

*Should regulatory incentives which incorporate the lowering of environmental and labor standards, generate life threatening and environmental repercussions, as well as those resulting in moral hazard and excessive risk taking levels, be encouraged? This chapter not only investigates whether central bank independence is positively correlated with inflation, but also highlights other variables which could impact the relationship between Corporate Social Responsibility and Foreign Direct Investment. It will highlight why a continuous need for updating of data is necessary given the inability to capture data specific variables and why the introduction of complementary standards would serve to bolster measures aimed at promoting financial stability and encouraging investors – rather than incentives aimed at diluting such standards. In so doing contributes to previous and current literature on the topic – by way of reference to investigations and studies which have revealed concerns in the ability to adequately capture data – particularly in light of the recent 2008/2009 Financial Crisis.*

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## INTRODUCTION

The recent introduction of Enhanced Supplementary Leverage Ratios in several jurisdictions, despite arguments related to the burdensome nature of requirements and conditions attached to their implementation, as well as competitive advantages or disadvantages, not only underlies the importance of these regulations in aiming to avert disastrous consequences which could arise where systemically relevant institutions are threatened, but also highlights the importance of sending appropriate signals to foreign investors that the jurisdiction is relatively stable in terms of financial stability and regulatory measures.

The OECD Guidelines highlight the fact that:

- The ability of multinational enterprises to promote sustainable development, is greatly enhanced when trade and investment are conducted within the context of open, competitive and appropriately regulated markets (OECD, 2008).

Why should standards which have the potential to facilitate the realization of CSR goals and objectives be relaxed as a means of accommodating and attracting foreign investment?

Should cost benefit considerations apply where such standards are so crucial to the realization of CSR goals? Should economic and profit considerations supersede those relating to ethical, and legal obligations?

Does this necessarily mean that jurisdictions with less stringent standards – such as those pertaining to Basel III Leverage and Supplementary Leverage Ratios, have greater potential to attract foreign investment than those jurisdictions which have imposed more stringent requirements? (Ojo, 2014, 2015)

A financial environment which operates with the optimal level of regulatory requirements, which are crucial in facilitating a business environment built on trust, confidence – such that investors are able to rely on information being generated by the management and directors of an enterprise or business, as well as an environment which facilitates transparency, disclosure, should generally constitute incentives for investors to be attracted to such an environment. Further, as rightly, indicated in OECD Guidelines, a competitive market environment, should also serve as an engine which fosters growth and development.

Why is it then the case that foreign direct investment in certain jurisdictions does not necessarily translate to propellers of growth and development in such jurisdictions – whether these are developed, emerging or developing economies?

Whilst UNCTAD statistics reveal dramatic growth in certain jurisdictions, this cannot be said of others.<sup>1</sup>

One plausible reason can only be that certain jurisdictions have failed to consider the benefits of fully implementing or complying with regulatory, environmental or ethical standards, or are encouraging investment incentives which whilst aimed at encouraging growth and development, are not necessarily facilitating the generation of benefits which full implementation of certain regulatory and ethical standards would have facilitated.

It is definitely a trade game where you either implement the standards at a level such that costs of such implementation are minimal – whilst compromising certain Corporate Social Responsibility goals. Further, the environment within which such standards are supposed to be implemented may be negatively influenced by political, institutional and legal impediments, such that it warrants little effort to fully implement or even introduce such standards. In other words, profits dominate the firm or MNEs' corporate goals and objectives given such negative external influences.

According to UNCTAD (2014),

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