COMMERZBANK

Insights:
Five drivers of sustainable trade

Understanding the magnitude of change

Financial Institutions: Partnership meets Expertise

In cooperation with

Oxford Analytica

The bank at your side

Contents

Foreword by Commerzbank

Dear reader,

Sluggish economic recovery, increased globalisation and the spectre of stricter regulation have all contributed to producing a global banking industry that is perhaps more competitive than ever before. Clearly, such a competitive landscape will force some market participants to focus on short-term survival and profitability rather than long-term strategy.

Not Commerzbank. As a bank, we have always focused on driving long-term partnerships with clients and stakeholders – our products, services and advice are designed to meet our promise of fairness, professionalism, responsibility and sustainability, and are audited against that promise. Our strapline "Partnership meets Expertise" is a perfect illustration of our approach.

This long-term philosophy is embedded in the very heart of the bank's operations. As such, we have become increasingly engaged with the topic of sustainability generally, and sustainable trade in particular. We believe that taking sustainable trade seriously is vital, not only to remain competitive in the banking industry, but also because some resources are now becoming scarce and inaction could put trade at risk in future. If banks and businesses want to continue trading with each other in the long-term, action needs to be taken in the present day. Indeed, Commerzbank has been focused on international trade for over 145 years, ever since it was founded by Hamburg-based traders looking to fund foreign trade transactions. And we are committed to staying around for another 145 years, and longer.

As such, we have, for a long time, been working with our partners to finance the trade of products and services in the fields of clean energy and clean technology – something we see as crucial to ensuring future global energy supply. Further, in all of the trade-related transactions in which we are involved, we include high standards of sustainability among our lending criteria, whether these relate to environmental, social or governance issues.

Christof Gabriel Maetze
Member of the Executive Management Board

Commerzbank is not alone in the financial sector in pushing progress on sustainable trade. Many other leading financial institutions, from Europe and elsewhere, are becoming engaged in similar ways. The combined impact of these efforts means that the financial sector is now playing a critical role not just in supporting sustainable trade by corporations, but in actually driving that sustainable trade.

At Commerzbank we feel that the financial sector's leading role in sustainable trade is perhaps not always noticed by policymakers, NGOs, consumers, and the media. This is because much of our work in this area takes place 'behind the scenes', for example in detailed discussions about compliance with sustainability criteria for loans. Moreover, the topic area of sustainable trade is so multi-faceted and fast-changing that it is difficult for anyone to understand what the current state of play is – and, more importantly, what the future holds for sustainable trade.

This is why we felt the need to produce this report. We hope it will contribute to a new, higher level of discussion among policymakers, businesses, NGOs and consumers about sustainable trade and how the global economy is likely to be transformed by it. We look forward to engaging with all our stakeholders, both to understand and to help shape future trends in this important topic area.

It marks the beginning of a deeper communications effort by Commerzbank on a topic area that is going to become increasingly central not just to our business, but to the financial sector in general. We hope you find this first report helpful and stimulating, and look forward to discussing its implications with you.

Foreword by Oxford Analytica

Commerzbank has partnered with Oxford Analytica to prepare this forward-looking report on sustainable trade. Oxford Analytica is a global analysis and advisory firm that draws on a worldwide network of experts to advise its clients on their strategy and performance. Our insights and judgements on global issues enable our clients to succeed in complex markets where the nexus of politics and economics, state and business is critical.

We are proud to partner with Commerzbank in the preparation of this report. In seeking to understand the present and future of sustainable trade, we have focused on what is driving it. We first conducted a brainstorm with members of our network of experts, establishing a 'long list' of 15 drivers of sustainable trade over the next 10-15 years. This list was discussed, and certain topics merged and refined, with Commerzbank, resulting in a focus on five key drivers: regulatory competition and protectionism; new patterns of global demand; supply chain trends; alliances, standards and labels; and innovative finance and the role of banks. This report provides in-depth analysis of each of these drivers, explaining why and how they are shaping the future of sustainable trade.

The report contains inputs from a range of members of our network of experts, most of whom are based at leading universities around the world and some of whom are former executives. Furthermore, we conducted interviews with five recognised thought leaders in the field of sustainable trade from the business and policy worlds: Edna Schöne-Alaluf, Member of the Board, Federal Export Credit Guarantees, Euler Hermes AG; Pascal Lamy, Honorary President of Notre Europe – Institut Jacques Delors and former Director General of the World Trade Organization; Arancha González, Executive Director, International Trade Centre; Martin Chilcott, Founder and CEO, 2degrees; and Kai Preugschat, Secretary General, Berne Union/International Union of Credit and Investment Insurers. We are very grateful to each of them for giving us their time to be interviewed, and for their valuable insights.

We look forward to continuing to support Commerzbank in shaping the debate on the future of sustainable trade.

Graham Hutchings
Managing Director, Oxford Analytica

Introduction: The rising role of sustainability

1. Historical differences between sustainability and CSR

There is growing significance around the sustainable trade agenda. But what activities does 'sustainability' connote and are these synonymous with corporate social responsibility ('CSR'): is there one trend, or are there various related ones? Will this agenda grow in importance and evolve, and if so, what factors will drive or affect this rise? This introduction assesses the answers to these questions with reference to the five drivers of sustainable trade analysed in this report: regulatory competition and protectionism; new patterns of global demand; supply chain trends; alliances, standards and labels; and innovative finance and the role of banks.

There is growing significance around the sustainable trade agenda.

While its roots can be traced back to the 19th century, today's sustainability agenda can be said to have originated in the Western European environmental movement, which involved the creation of 'green' political parties in the 1970s, some of which began to gain considerable traction from the 1980s onwards. Environmental conservation was at the heart of the movement, but its focus included a broader set of social and environmental concerns. About one decade ago, the term 'sustainability' was used fairly narrowly to mean environmental and energy efficiency issues, especially around carbon emissions and other forms of pollution or ecological footprint. At that time, CSR – which originated in the United States – referred instead to voluntary, charitable outward-facing activities undertaken by firms with the largely external (public and governmental relations) motive of improving or defending their image. These schemes were often in the form of one-off or programmatic social services directed towards benefiting host or labour-providing communities located near the business site. Extractive industry firms were the main proponents.[1]

Environmental conservation was originally at the heart of sustainability.

Relevant features of both sustainability and CSR schemes a decade ago were: relatively small-scale in financial commitment terms; distinct from employee conditions/labour rights issues; a tendency to be reactive, following particular problems; driven essentially by external pressures rather than internal initiative; and a fundamentally disconnected (especially for CSR) from the core business of the firm. Historically, CSR and even sustainability officers would generally complain about feeling on the periphery of corporate decision-making. If listed firms even had CSR or sustainability reports, these were generally published separately from financial reports, and seen as far less important.

[1] Extractive sector and plantation agriculture firms have a very long history (well before 'CSR' became a term) of social investment spending on local infrastructure and services. They did this mainly because they often operated over long project timeframes with entrenched local labour in remote areas, with few government services. That is, they had social programmes for clear operational reasons rather than for reasons of publicity, making these schemes closer to more recent trends.

2. Corporate sustainability today

Today, CSR is seen, among practitioners, as somewhat out-of-date. In the early 2000s the business discourse largely changed from referring to CSR to using the term 'corporate responsibility' (CR). The field of topics covered by CR is generally wider than that associated with CSR. It has come to represent the minimum standards expected of a firm by its customers, financiers and employees, irrespective of and in addition to its regulatory obligations. In this sense it has a negative, defensive, 'do no harm' meaning.

Sustainability today is a broad concept encompassing a firm's impact on overall environmental and social issues, as well as how it addresses questions of ethics and governance.

Meanwhile, sustainability has moved from having mainly environmental/energy/carbon connotations to being a much broader concept encompassing a firm's impact on overall environmental and social issues, as well as how it addresses questions of ethics and governance – not just within its own direct operations but throughout its supply chain. Hence, sustainable trade becomes a key issue. Social issues representative of CSR have thus become subsumed within this broader sustainability agenda.

Sustainable trade has, especially for consumer-facing multinationals, become increasingly about something far more positive, proactive, integrated and creative than the word itself suggests. In its business-world meaning it has become about how to go beyond merely 'do no harm' to instead find ways to build market share and valuation, to innovate, and/or to address potential non-financial risks and productivity inefficiencies throughout the supply chain.

Therefore, today, sustainability can be regarded as broader than CSR or even CR, even if these concepts sometimes are used interchangeably, and there is no single consensus definition of sustainability. In the corporate world, sustainability is increasingly referred to as corporate sustainability. For the rest of this report, corporate sustainability or sustainability are the terms that we will use when referring to issues that some might still classify as CSR or CR.

3. Sustainable strategy and operations

Corporations that have embraced sustainability speak in terms not just of ensuring integrity in their supply chain and operations, but of how to improve the firm's value proposition through integrating sustainability issues into core business strategy. For example, Daimler has introduced a car sharing business line, acknowledging that this is likely to reduce new car sales. However, the company expects its car sharing business revenues to exceed the loss of revenues from new car sales. If successful, this new approach will both make business sense and be more sustainable. This is also a good example of how the sustainability agenda drives innovation.

Corporations that have embraced sustainability seek to improve their value proposition through integrating sustainability issues into core business strategy.

Academic Michael Porter's phrase 'creating shared value' (CSV) has been taken up by many leading brands as the ideal corporate sustainability conceptual framework. Instead of being decoupled from core business considerations, this conceives of approaches driven by fundamental economic principles for long-term business success. This approach sees corporate sustainability as a vector for reducing cost and waste while improving the firm's overall value. It posits that businesses can combine success and address global problems by acting as businesses rather than as donors – by creating shared value for firms and society. This is in line with what often is termed the 'business case for sustainability'.

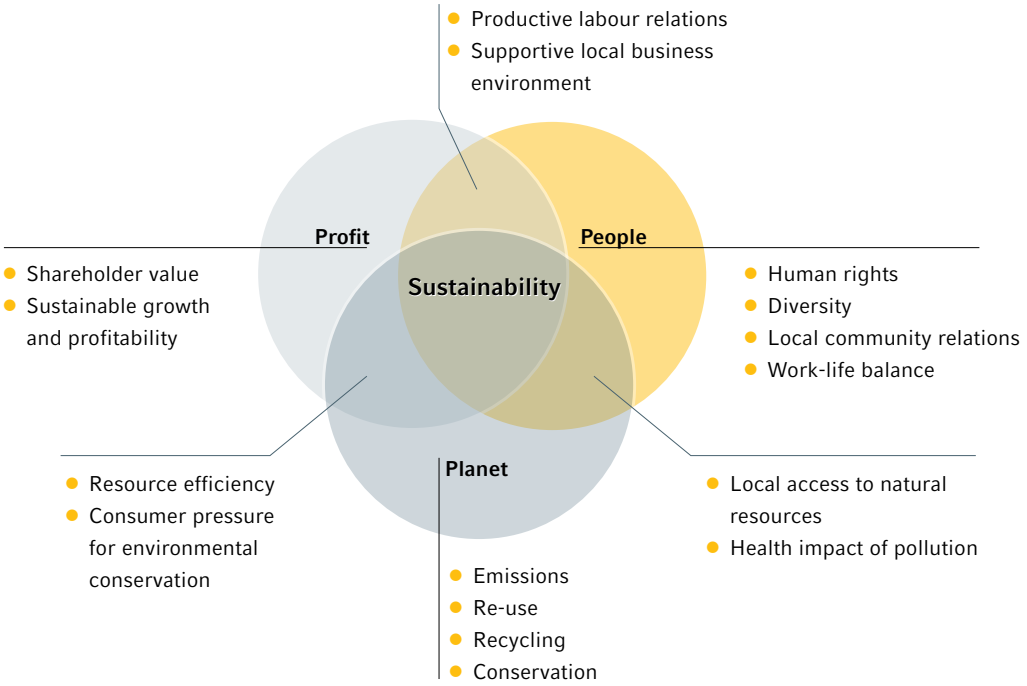
Another expression of firms embracing corporate sustainability is the full-cost accounting concept of the 'triple bottom line' ('people, planet, profit'). By this a firm assesses itself or is assessed not just by its financial bottom line (profit versus loss) but also by reference to social and environmental externalities affecting sources of social and natural capital that will in the long term affect business viability.

An extension of this is that integrated company annual reports are becoming more common, instead of separate sustainability reports. This reflects the greater and more proactive integration of sustainability issues into core business growth strategy. The trend is evident in corporate governance risk management approaches too, where sustainability issues ('non-financial risks') are increasingly integrated into risk modelling. These trends are so noticeable at least in Western listed big-name firms that the

"There is neither a general business case for sustainability nor one for un-sustainability. Whether a business case can be realised depends on how and when companies deal with sustainability issues. For example, a sewage plant causes costs whereas installing a closed-loop water system can reduce production costs while reducing sewage to the same extent. If the closed-loop water system is installed when an old non-closed-loop system needs replacing, additional investment costs compared to conventional systems might be very low or not exist at all. Companies need to anticipate and plan in order to actively create a business case for sustainability. Moreover, the business case for sustainability often does not depend on markets, politics or culture – for example, improved water efficiency is almost always beneficial."

Stefan Schaltegger, Professor of Sustainability Management and Head of the Centre for Sustainability Management, Leuphana University of Lüneburg

Figure 1. The 'triple bottom line'



Source: Oxford Analytica. Note: the lists of topics are examples only.

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The overall shift among firms is away from a more defensive, externally-driven posture that sees sustainability issues, like regulatory compliance, as a necessary cost. The shift is towards perspectives that relate to more positive concepts of profitability, opportunity-seeking, brand-enhancement and defining one's own market. This business logic explains why sustainability is growing in significance in global trade.

Nonetheless, the traditional 'defensive' factors remain highly relevant to why firms engage with this agenda. Publicity and image risk management continue to be major drivers, especially for brand-conscious consumer goods firms. This essentially defensive motivation remains powerful even though it is increasingly viewed through the positive lens of enhancing rather than just protecting a firm's image. Globalised retail media outlets and new social media trends mean that firms now have 'nowhere to hide' and proliferation of these new technologies will continue to heighten reputational risks as consumer awareness and concern about sustainability issues grows.

4. The role of business in society

There is a growing corporate consciousness of the changing public expectations of the role of business in society. This sentiment typically peaks following high-profile disasters (such as oil-spills) but received an arguably irreversible degree of momentum following the 2008-09 global financial crisis. In the Western world at least, this experience has resulted in some shifts in the underlying 'model' of capitalism, in that businesses are now expected to match the size of their influence with a corresponding degree of responsibility for addressing public goods and global commons. This intangible public sentiment factor will underlie the drivers of responsible business conduct in the coming 10-15 years.

Businesses are now expected to match the size of their influence with a corresponding degree of responsibility for addressing public goods.

This trend is reflected in the global aid effectiveness and development policy agenda, especially around the post-2015 multilateral process to replace the 2000-2015 UN Millennium Development Goals with the so-called Sustainable Development Goals for 2015-30. There is far more pragmatism from governments about the role that business can play in tackling sustainable development, and far greater urgency among business leaders to do so, with or without the cooperation of government. The greater high-level formal public policy recognition of business as a 'stakeholder' in global development partly reflects developed-world governments' recognition that they alone cannot solve global developmental problems and should harness the incentives, expertise, reach and resources of business.

For their part, large corporations are becoming far more proactive about the sustainable development agenda for reasons that have little to do with their public image but instead are directly informed by their own strategic long-term interest. Sustainability-related activities by large firms (acting in concert with others whose interests intersect along their supply chains, or together with competitors facing common problems) will increasingly seek to address developmental bottlenecks. That is, sustainability issues will become about addressing market failures, in cooperation with national or local governments, or notwithstanding incapacity or paralysis among governments. In an optimistic scenario, the alignment of corporate strategic interests with more proactively addressing under-development, fragility and vulnerability will generate greater innovation and momentum on sustainable development issues.

Leading consumer goods firms such as Unilever have understood this changing role for the private sector. Not only does Unilever set ambitious, explicit and public sustainability targets. Its approach is far more fundamental, aiming to revise its whole business model. Unilever has

Unilever has recognised that its value to society comes from the social utility of its products and the way in which they are made.

recognised that its value to society comes from the social utility of its products and the way in which they are made. Unilever's philosophy is that there must be alignment and integration of a firm's social utility proposition with its commercial value proposition. This approach reflects the idea that firms can succeed in shaping and dominating the market if they innovate in ways that help solve social needs and meet demands for more convenient, energy-efficient and responsible goods and services. It does not see addressing sustainability issues as a cost drain: it strategically engages with social problems so as to force itself to increase its productivity and efficiency, and to expand the market. This approach has helped Unilever become the leader, by some distance, of the ranking of the GlobeScan/SustainAbility 2014 Sustainability Leaders Report – an annual survey of 887 stakeholders from business, government, NGOs and academia from 87 countries.[2]

[2] www.globescan.com

5. Factors restraining sustainable trade

The proposition that market forces will drive a greater role for sustainability issues must be tempered by acknowledgement that global competition factors may cause firms to focus on short-term survival and profitability rather than long-term strategy. This can have implications for corporate sustainability:

"The challenge is that many companies act in a sustainable way only if it makes short-term business sense. This should not be the main driver of corporate sustainability."

Professor Richard Wilding OBE, Full Professor and Chair of Supply Chain Strategy, Cranfield School of Management

The strong business logic of 'shared value' and proactive sustainability approaches can obscure the need to recognise the lack of consensus, certainty and clarity about these trends. Considerable distance remains even among leading branded Western firms in terms of integrating sustainability issues into core business systems. The culture in Germany, for example, is generally very sustainability focused. But globally, there may be a need to temper optimism about the pace and scale of shifts in corporate sustainability practices.

There is still a lack of consensus, certainty and clarity about sustainability trends.

Considerable uncertainty remains among both policymakers and corporate leaders about the proper delineation of roles and responsibilities in relation to sustainability issues. This ongoing conversation will shape future sustainability activities. While business seems well placed to drive socially useful and sustainable innovations, corporations often are not good at addressing developmental bottlenecks. Many of the tasks required to address sustainability issues meaningfully will take firms out of their areas of core competency. For this reason, collaboration between corporations and NGOs is becoming more common.

Not all NGOs are in favour of collaboration with corporations. Some of the more radical activist groups, eg, grassroots organisations that have participated in the 'anti-globalisation movement', are wary of a more engaged sustainability stance by business, questioning its motives and expressing concern that this trend will only increase corporate influence in society. This scepticism can sometimes constrain the scope for cooperative and problem-solving approaches. Some less radical NGOs, eg, Human Rights Watch just do not accept corporate funding that might compromise their independence.

There is also uncertainty among corporations about the net costs of a greater focus on sustainability issues. In principle, this focus allows for waste and disruption to be avoided. However, the evidence is not beyond doubt. The great proliferation of schemes and initiatives related to business responsibility can raise the costs of even just voluntary compliance activities. These tend to favour larger businesses over smaller ones in ways that do not necessarily lead to greater overall sustainability outcomes.

There is uncertainty among corporations about the net costs of a greater focus on sustainability issues.

6. Main drivers of sustainable trade in the next 10-15 years

Figure 2. The five drivers of sustainable trade identified in this report

In this report, we identify five drivers that will shape sustainable trade over the next 10-15 years.

In this report, we identify five drivers that will shape sustainable trade over the next 10-15 years, as follows (their order does not indicate their relative importance):

A. The question of how the regulatory environment drives sustainability is of particular relevance in Europe, where regulation in this area is most advanced. However, sustainability issues are not removed from political ones. Considerable scope also exists for the abuse of sustainability concepts for reasons that relate more to market-distorting or protectionist measures than concern for 'people' and 'planet'. **(See Driver 1: Regulatory competition – and protectionism.)**

B. The context of urban population growth in emerging markets and pressure on global public goods means that firms and industry groups will be forced to prioritise efficiency

and sustainability in their operations. However, uncertainty exists around the degree to which there will be convergence, particularly between developed and emerging markets, in consumer pressures relevant to sustainability. **(See Driver 2: New patterns of global demand.)**

C. Leading multinational firms will increasingly need to be proactive about uncovering potential sustainability-related risks in their supply chains, and being transparent about these difficulties. Transparency is becoming increasingly critical given the growing 'monitoring' role being played by online mass and social media, NGOs and consumer groups. The sustainable trade agenda will also become ever more closely aligned with cost efficiencies and security of supply of inputs. This reflects recognition that weaknesses on sustainable trade issues (from human rights problems to corruption to pollution) often represent costs for firms. This consideration is particularly acute in terms of wasted energy and material inputs. **(See Driver 3: Supply chain trends.)**

D. Corporations will partner more frequently and openly with their stakeholders. There will be growing recognition that fundamental changes to products, services and processes are required. Minor changes, associated with 'green' labelling and backed by heavy marketing will be attempted less and less as consumers and business partners consistently demand fundamental changes. Open collaboration with NGOs, suppliers and consumers will increasingly generate ideas for innovation. At an advanced stage, corporate functions such as research and development (R&D) and marketing can increasingly be undertaken through such open collaboration. In addition, alliances of firms and other stakeholders will increasingly try to pre-empt the imposition of regulation by self-regulating on sustainability issues. As citizen awareness and concern for sustainable trade grows further, firms and industry groups will continue to see the need for proactive steps to shape the regulatory and pre-regulatory environment, and to avoid controversies that can lead governments to feel pressure to impose regulatory requirements. **(See Driver 4: Alliances, standards and labels.)**

E. The steady incorporation of non-financial risks into business systems of larger firms will increasingly be driven by their understanding that tracking and evaluating sustainability performance is not just something a 'good' firm does, but something all successful firms must do in order to obtain financing. The risk management mandates of banks and insurers will place increasingly stringent requirements on firms engaged in trade to demonstrate sound strategies for sustainability-related risk exposure. **(See Driver 5: Innovative finance and the role of banks.)**

These five drivers will be analysed in depth in the following five sections of the report.

Driver 1: Regulatory competition – and protectionism

1. EU leadership

Regulation on sustainability issues goes back several decades. An important early milestone was the 1987 Montreal Protocol on Substances that Deplete the Ozone Layer, which mandated reductions in the production of substances harmful to the ozone layer. During the 1990s, the EU assumed the mantle of ecological leader previously held by the United States. The EU and its member states have developed the most comprehensive sustainability legislation worldwide. It involves close to 600 texts that have been added to the European legal corpus (the so-called 'Community acquis') since 1972. The only existing study assessing the stringency of environmental legislation in an international perspective, which dates from 2005, places nine European countries and Singapore in the top ten[3].

The EU and its member states have developed the most comprehensive sustainability legislation worldwide.

The EU has jurisdiction over many aspects of environmental legislation, because issues such as pollution or air quality are trans-boundary in nature. Also, environmental policy in Europe has always been regarded as closely related to free trade of goods, fair competition and competitiveness, due largely to the single market. The concerns that national environmental measures could serve as obstacles to free trade and could distort competition between member states triggered the first EU integration effort in the environmental domain. About 80% of environmental law implemented by member states now comes from the EU.

Current environmental regulations are not only very ambitious and wide-ranging – covering air quality, climate change mitigation, noise pollution, chemicals, green labelling, and water quality, among other topics – but they are also strictly enforced by European authorities across the EU. The role of the European Court of Justice is critical in linking environmental policy to economic competitiveness.

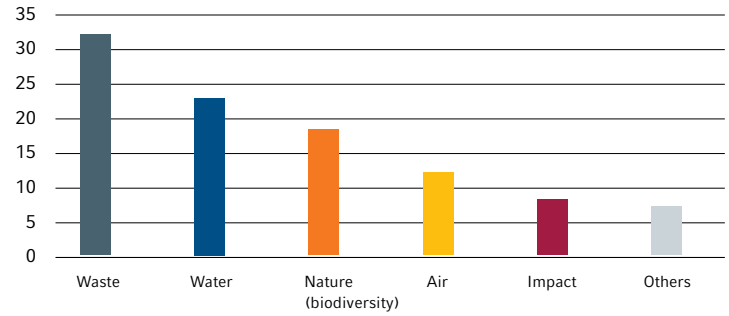
Environmental regulations are strictly enforced by European authorities.

One indicator highlighting the EU's willingness to enforce environmental regulation and hence its environmental credibility is the number of infringement procedures regarding environmental legislation.[4] According to the European Commission, during the first six months of 2014, the environment was the number one area in which infringements were assessed, with 22% of cases, ahead of taxation (17.5%) and transport (15%). Of the environmental infringements, waste and water are the main issues (see Figure 3). This breakdown is typical of recent years.

[3] Daniel C. Esty and Michael E. Porter, 'National Environmental Performance: An Empirical Analysis of Policy Results And Determinants', Environment and Development Economics, 2005. Esty and Porter develop a multiple indicator index, the Environmental Regulatory Regime Index, which quantifies the quality of regulation for a country. This index combines regulatory stringency, structure, subsidies, and enforcement.

[4] According to the European Commission, an infringement procedure is opened "when a Member State fails to comply with a judgement of the Court (EU Court of Justice) that found a failure to fulfill an obligation under EU law by that Member State. If the judgement is not finally complied with, the Commission would bring such a case back before the Court, which may impose fines on that Member State".

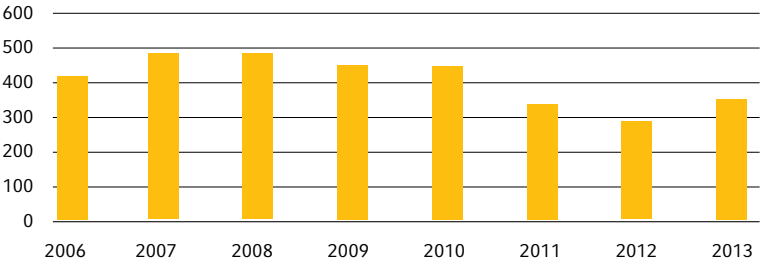
Figure 3. Environmental infringements by sector
% of total, 2013



Source: European Commission, DG Environment.

European member states have become increasingly compliant with the environmental legislative framework. Figure 4 shows that the number of infringement procedures has trended broadly downwards from its high point in 2008.

Figure 4. Number of infringement procedures opened by the DG Environment in the EU



Source: European Commission, DG Environment.

Several of the EU's progressive regulations, such as the Registration, Evaluation, Authorisation and Restriction of Chemical substances (REACH) regulation on chemicals, the Euro V standards on car emissions, and the Directive on Waste Electrical and Electronic Equipment (WEEE) have been adopted in countries as diverse as China, India and Australia, contributing to some levelling of the playing field for European companies.[5]

[5] DaeYoung Park, 'REACHing Asia continued' (Social Studies Research Network, 2009); Katja Biedenkopf, 'Hazardous substances in electronics: The effects of European Union risk regulation on China', European Journal of Risk Regulation, 2012; Mathieu Rousellin, 'But why would they do that? European external governance and domestic preference of rule importers', Journal of Contemporary European Research, 2012.

2. Reporting

Corporate reporting on sustainability issues aims to make companies transparent and accountable in their sustainability efforts. A KPMG study looking at the rate of sustainability reporting by region found that 76% of companies in the Americas[6] and 73% of companies in Europe[7] report on sustainability issues; 93% of the world's largest 250 corporations do so.[8] Within this group of 250, European corporations attain the highest average score for quality of sustainability reporting (71 out of 100), considerably higher than their American counterparts (54 out of 100).

The EU has adopted a new, ambitious directive on non-financial reporting.[9] The directive affects about 6,000 companies (listed companies and some unlisted companies) and groups in the EU with over 500 employees. According to the European Commission, "companies concerned will disclose information on policies, risks and outcomes as regards environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity on boards of directors." The text was formally adopted by the European Council in September 2015. Following adoption by national legislatures, reporting by companies is likely to begin in 2017. Companies will be granted flexibility to report according to various established reporting blueprints, eg the UN Global Compact[10] or the ISO 26000 standard of the International Organization for Standardization[11].

The EU has adopted a new, ambitious directive on non-financial reporting.

According to the European Commission, the new directive is estimated to result in an additional direct cost for large companies of less than 5,000 euros per year. Nonetheless, to ease the additional indirect burden (notably the increased amount of time required to comply) on the companies affected by the directive, the directive does not require comprehensive reporting on environmental and social issues (although the Commission certainly encourages it), but requires a description of the related policies, results and risks. Furthermore, disclosures may be provided at group level, rather than by each individual member company within a group.

[6] Brazil, Canada, Chile, Colombia, Mexico and the United States.
[7] Belgium, Denmark, Finland, France, Germany, Greece, Hungary, Italy, Netherlands, Norway, Poland, Portugal, Romania, Russia, Slovakia, Spain, Sweden, Switzerland and the United Kingdom.
[8] The 'KPMG Survey of Corporate Responsibility Reporting' provides a summary of current global trends in sustainability reporting. The survey covers 4,100 companies in 41 countries and includes an assessment of the quality of reporting at the world's largest 250 companies. The 2013 edition is available at: www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/corporate-responsibility/Documents/corporate-responsibility-reporting-survey-2013.pdf
[9] The directive is an amendment to Council Directives 78/660/EEC and 83/349/EEC.
[10] www.unglobalcompact.org
[11] ISO 26000 "provides guidance on how businesses and organisations can operate in a socially responsible way" – see www.iso.org/iso/home/standards/iso26000.htm.

3. Impact on competitiveness

Environmental regulation can spur innovation.

3.1. Overall impact

There remains considerable debate about the impact on the competitiveness of EU (and other OECD) companies of having to comply with 'best in class' sustainability regulation. Most studies point to a negative impact of environmental regulation on business performance. However, this impact is less negative than implied by the direct cost of the regulation itself. It appears that this is because some of the direct cost is counterbalanced by environmental regulation spurring innovation. Studies examining the link between environmental regulation (often measured as compliance costs) and innovation (measured as either R&D expenditure or patents) conclude that there is a positive link between the two, although the strength of the link varies.[12]

3.2. Small and medium-sized enterprises

A study published by the European Commission in 2010[13] found that the compliance cost is higher for small and medium-sized enterprises (SMEs) than for large corporations. SMEs are hugely important in the EU – there are 23 million (defined as companies with fewer than 250 employees) which, according to the European Commission, provide two-thirds of private sector employment and 57% of value added. In recognition of this, the EU has launched and developed an 'Environmental Compliance Assistance Programme' that should help to reduce their environmental compliance costs in the future, provided they can take advantage of this policy.

However, while many respondents to the aforementioned study believe these costs to be higher than they actually are, the actual cost to firms is fairly moderate. For the twelve sectors covered, most of which were in manufacturing, the annualised environmental costs are less than 2% of the total production value, according to the European Commission study.

3.3. Exporters

Stringent EU regulation on sustainability affects not only all companies operating within the EU, but also EU companies operating abroad or exporting. This is highlighted, for example, by the experience of the export credit sector in the EU, and applies more generally to this sector in the whole OECD. In its interactions with corporations, the sector plays an important role in driving sustainable trade at a global level.

OECD governments require corporations that request state export credit guarantees to conduct sustainability assessments of large projects. These requirements are in line with the OECD Common Approaches – a set of recommendations covering environmental and social considerations. The Common Approaches draw on the World Bank's Environmental and Social Safeguards Policies, the International Finance Corporation's (IFC's) Environmental, Health and Safety Guidelines and the IFC's Performance Standards. Adherence to the Common Approaches has worked well in levelling the playing field for corporations within the OECD.

However, a study of 15 German exporters suggests that the time needed for compliance with OECD sustainable trade regulations may give some degree of first-mover competitive advantage to corporations that do not adhere to similarly stringent regulations (ie, in a competitive situation outside the OECD involving an OECD-based company versus a non-OECD based company). Occasionally, compliance costs can also contribute to a loss of cost competitiveness for OECD-based companies.

[12] Stefan Ambec, Mark A. Cohen, Stewart Elgie, and Paul Lanoie, 'The Porter Hypothesis at 20: Can Environmental Regulation Enhance Innovation and Competitiveness?', Review of Environmental Economics and Policy, first published online in 2013.

[13] Constantinos Calogirou, Stig Yding Sørensen, Peter Bjørn Larsen, Stella Alexopoulou et al., 'SMEs and the environment in the European Union', PLANET SA and the Danish Technological Institute, published by the European Commission, DG Enterprise and Industry, 2010.

Nonetheless, the study finds that the overall competitiveness impact generated by firms applying the Common Approaches is relatively limited. Indeed, perhaps more significant than the potential loss of competitiveness are the potential gains associated with compliance. Implementing sustainable technologies can be a sign of the quality of the product, and compliance also acts as a safeguard against reputation risk.[14]

The time needed for compliance with OECD sustainable trade regulations may affect competitiveness.

"To understand the impact of sustainability compliance requirements implemented by the export credit sector, Euler Hermes AG commissioned a study comparing the experiences of German exporters with those of their Chinese counterparts[15]. The study found that the German companies, which were subject to stricter compliance requirements, had concerns about the costs of compliance and about the bureaucratic delays caused. For example, environmental and social impact assessments (ESIAs) for exports related to an infrastructure project can be costly and take a long time. If the project involves involuntary resettlement of a certain magnitude, the costs for resettlement of the affected people according to international standards can easily double the project costs. Not all project owners might be prepared to accept such costs, efforts and complexity – in particular where the local expropriation laws do not reflect the same high standards as in the OECD. We have experienced cases where, in the end, our involvement in a project failed on such grounds.

Nonetheless, in Germany (and, more generally, in the OECD), the export credit sector accepts that implementing high sustainability standards is a necessity. Moreover, adhering to these standards also makes good business sense for exporters, particularly for maintaining a good corporate reputation. Such reputational risks are especially clear in the business-to-consumer sector, but sometimes are less easy for firms in the business-to-business sector to become aware of.

Within the OECD, a level playing field already exists and there is close collaboration on establishing and implementing sustainability standards. The key concern is how quickly standards in non-OECD countries can be brought up to the level of the OECD. Attaining global standards for all export credit agencies to implement is the most important target; this is where the political focus should lie, even if aligning political considerations with different non-OECD countries is proving to be complex. Success in attaining this target would create strong global momentum for progress in sustainability."

Edna Schöne-Alaluf,
Member of the Board, Federal Export Credit Guarantees, Euler Hermes AG

[14] Stefan Schaltegger, Matthias Schock and Cathrin Buttscher, 'Nachhaltigkeit als Herausforderung für Exportwirtschaft und Exportkreditversicherung: Bedeutung und Rolle von Finanzierung und Umweltprüfung im B2B-Geschäft', Leuphana University, Lüneburg, 2009. The study assesses the experiences of German companies compared to their Chinese counterparts. Here, we suggest that the conclusions may also apply more generally to OECD versus non-OECD companies.

[15] Stefan Schaltegger, Matthias Schock and Cathrin Buttscher, 'Nachhaltigkeit als Herausforderung für Exportwirtschaft und Exportkreditversicherung: Bedeutung und Rolle von Finanzierung und Umweltprüfung im B2B-Geschäft', Leuphana University, Lüneburg, 2009.

4. Sustainability as protectionism

4.1. Political priorities

Politically, environmental concerns have often taken a back seat to the economic crisis in the last six years in Europe.

Politically, environmental concerns have often taken a back seat to the economic crisis in the last six years in Europe. One indicator of this relative decline of environmental preoccupations is the poor performance of green parties in the 2014 elections to the European Parliament (EP). Green EU MPs are no longer the fourth political force within the EP and have lost seven members. The failure to stringently implement the European Emissions Trading System (ETS), as well as a renewed interest in lignite as a source of energy in Germany, Poland and the Czech Republic, due partly to a desire to increase energy independence, are further indicators of a lack of political prioritisation of sustainability.

The composition of the new European Commission points to a weakening of the EU's environmental commitment.

The composition of the new European Commission, announced by the new Commission President Jean-Claude Juncker on September 10, 2014, also points to a weakening of the EU's environmental commitment. First, he has decided to merge the portfolio of the environment with that of fisheries. Second, he has also merged the portfolios of climate and energy. Aimed at removing the duplication and resulting inefficiencies of previous years, the latter merger also brings the risk of the subordination of climate policy to energy policy.

4.2. WTO framework

The WTO provides the general regulatory framework for sustainable trade. In addition to the trade agreements signed in Marrakech in April 1994 that gave birth to the World Trade Organization (WTO), ministers also signed a 'Decision on Trade and Environment', which states: "There should not be, nor need be, any policy contradiction between upholding and safeguarding an open, non-discriminatory and equitable multilateral trading system on the one hand, and acting for the protection of the environment, and the promotion of sustainable development on the other."

The WTO Charter tries to make this compatibility functional by combining a general regime of non-discrimination with granting exceptions on the grounds of environmental concern. The Charter states that protectionist measures "necessary to protect human, animal or plant life or health" and "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption" can be legal provided "that (they) are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade". These principles were re-affirmed by the WTO in 1998. In its judgement, the WTO explained that "Members are free to adopt their own policies aimed at protecting the environment as long as, in so doing, they fulfil their obligations and respect the rights of other Members under the WTO Agreement."

4.3. EU-US trade

WTO officials have warned of the risk of 'green protectionism' many times in recent years, for example arguing that governments might implement it in exchange for political support for more stringent environmental policies. This risk might be alleviated between the EU and the United States if the Transatlantic Trade and Investment Partnership (TTIP) is concluded. However, while TTIP enjoys the support of the US administration, many in the US Congress and key EU leaders, significant opposition to the agreement in Europe remains, making it uncertain that agreement will be reached in 2015.

WTO officials have warned of the risk of 'green protectionism' many times in recent years.

Climate protectionist measures are often discussed at the highest level in the EU and United States. The EU is regularly attacked by its trade partners and competitors for resorting to green protectionism, often framed as the disguising of protectionist measures behind a 'virtuous' commitment to sustainability. Examples are EU restrictions on the import of biodiesel, paper and pulp. The 'Renewable Energy Directive' adopted in 2009 by the EU has been considered by many in the United States as a disguised tax subsidy for the EU's agro-industrial sector. However, while the trade regime enforced by the WTO actually allows green protectionism to develop in a certain respect, and despite the above examples, such protectionism is for now limited.

In practice, green protectionism so far is limited.

4.4. OECD discussions

At the level of the OECD, there are ongoing discussions about the role that has been played by export credit agencies (ECAs) of some OECD members – most notably, Japan – in supporting their domestic corporations in doing business in sectors that have a poor sustainability performance. The current hot topic of debate in this area is whether OECD-member country ECAs should be providing credit for the construction of coal-fired power plants in developing countries. Some OECD members, including the United States, the United Kingdom and the Netherlands, are seeking to restrict this practice. Until rules are fully harmonised at the level of the OECD, companies from these countries may not face a level playing field compared to their counterparts in some other OECD countries. Arguably, this is a form of protectionism that exploits certain countries' more sustainability-oriented policy objectives.

5. Scenarios for regulation as a driver of sustainable trade in the next 10-15 years

In the next 10-15 years, a key regulatory question will be how far non-OECD regulation in the area of sustainability catches up with OECD, and especially EU, regulation. Scenarios A to E below provide summaries of how developments could unfold. The most likely outcome is a version of Scenario B, but this would not exclude elements of the more negative Scenarios – C, D and E – occurring in parallel.

BEST

A. Political success permits unexpectedly fast global progress
Political compromises involving sustainable trade regulation and other areas lead to a faster-than-expected catch up of such regulation in many non-OECD countries with OECD countries. This creates a more level playing field for companies engaged in global trade, and permits steady refinement of best sustainable trade practices globally. However, even in this most optimistic scenario, some countries will continue to try to permit their companies to gain competitive advantage by failing to implement or enforce best-practice sustainability regulation, for example in the continued provision of export credit to fossil fuel activities.

B. Regulation takes hold slowly and unevenly
There is steady but slow catch up of non-OECD sustainable trade regulation with its OECD counterpart. This is based on a growing global understanding that making trade more sustainable is in the interests of business, the environment and citizens worldwide. Even so, like today the playing field remains uneven; OECD companies are sometimes disadvantaged by costs of compliance, but increasingly they are able to use their adherence to stricter sustainability requirements to their competitive advantage.

C. Non-OECD stalling causes regulatory stagnation
The gap between the compliance costs (in terms of time and money) for corporations of sustainable trade regulation in the OECD (especially the EU) continues to grow compared to non-OECD countries, which largely fail to upgrade their regulation. The competitiveness of EU firms clearly suffers, and pressure rises on policymakers to backtrack or at least slow down implementation of new sustainable trade regulation. This leads to an overall stagnation of the sustainable trade agenda.

D. Global discord leads to increasing misuse of regulation
Climate protectionism takes hold as sustainable trade regulation is increasingly misused worldwide, ie protectionist measures are disguised behind a 'virtuous' commitment to sustainability. Many specific measures affect different sectors and slow sustainable and other trade in those sectors. This is a risk if the international community is not able to reach a global and binding agreement at the United Nations climate summit in Paris in December 2015.

E. OECD governments turn focus to domestic support
If the Paris summit in December 2015 does not yield a globally binding treaty, OECD countries could consider imposing 'blanket' protectionist policies to try to force a level playing field. For example, OECD countries might consider implementing border carbon-adjustment mechanisms (ie, border carbon taxes) to compensate for what they consider to be unfair carbon dumping from countries that are not bound by carbon regulation or pricing. This could lead to very tough tit-for-tat measures and a significant slowdown in sustainable and other trade. This would represent a substantial failure of sustainable trade regulation.

WORST

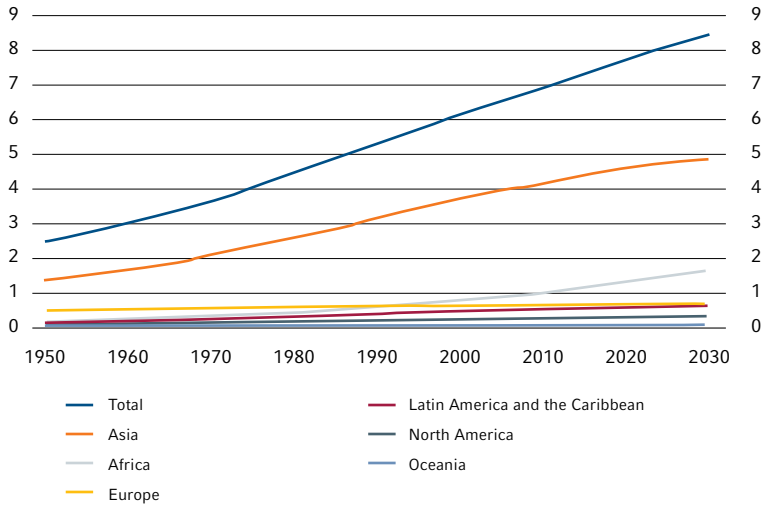
Developments in regulation will in part be a response to changing global consumer preferences, and how governments, corporations and NGOs react to these. In the next section, we analyse these and related topic areas in the context of new patterns of global demand.

Driver 2:
New patterns of global demand

1. Rising pressure on natural resources

Global demand for tradable products and services is likely to increase in the next 10-15 years: it is closely tied to the growing global population, which is forecast to exceed eight billion people in 2030, as well as to rising average income levels and an open world economy. These are the main determinants of overall trade growth.

Figure 5. World population by continents
in billion



Source: United Nations Department of Economic and Social Affairs, Population Division, Population Estimates and Projections Section.

An increased emphasis on the sustainability of trade will be an important part of the answer to the strains that will increasingly be placed on natural resources as a far larger part of the global population seeks to enjoy the quality of life currently experienced by middle classes in the OECD.

Pascal Lamy,
Honorary President of Notre Europe – Institut Jacques Delors[16] and former Director General of the World Trade Organization (2005-13)

"By 2030, the global middle class will encompass five billion people, compared to two billion today. Of these additional three billion members of the middle class, some two billion will be in Asia, and one billion across Latin America and Africa. Broadly, these new members of the middle class will have the same aspirations as middle classes in the OECD have today. This will place huge demands on corporate supply chains, which are simultaneously coming under increasing pressure from civil society to become more sustainable.

Accommodating the consumption preferences of the larger global middle class will require a reconnection of economics and society, in which it is widely recognised that current consumption patterns are not sustainable – and appropriate action is taken. This reconnection can happen top-down, through new regulation on sustainability imposed by governments. But it is more likely to be driven from the bottom up, by consumers, NGOs and corporate alliances.

International trade agreements will increasingly reflect this changing reality. Whereas in recent decades trade agreements have focused primarily on eliminating protection of producers, in the future, agreements will be required to protect consumers. It is unclear how fast such agreements will be put in place, because often public regulation lags behind 'private regulation', ie, standards established by consumer groups, NGOs or corporate alliances. Ultimately, if such private regulation is adhered to by corporations – and if consumers, suppliers and the environment benefit from it – then there may be little urgency for public regulation to catch up. Nonetheless, ultimately public regulation will be required, given that it is the best way to reflect what a society's collective preferences are."

[16] www.notre-europe.eu, a think tank based in Paris.

2. Consumption growth and patterns

2.1. Advanced economies

While the rapid growth of emerging economies is radically changing the structure of the global economy and patterns of demand, advanced economies are still likely to play the leading role in promoting global sustainable trade over the next 10-15 years. In absolute terms, advanced economy consumers will continue to have much more to spend than their emerging economy counterparts. While the distribution of income within countries also affects preferences, many advanced economy households will enjoy sufficient discretionary income to afford to pay the premiums sometimes associated with sustainably produced goods and services if they choose to.

Advanced economies are still likely to play the leading role in promoting global sustainable trade over the next 10-15 years.

Increasingly aware of global production conditions, consumers in advanced economies will demand more sustainable products, services and processes. However, sometimes consumer pressure can generate misleading debates. For example, the recent debate over 'food miles' (ie, the geographical distance that a food product travels from production to consumption) has sometimes involved confusing this measure with the overall environmental impact of the food product's lifecycle. Food miles are based only on the transport costs of food products and fail to account for total environmental costs, including production costs.

Nonetheless, in many advanced economies, governments as well as corporations are trying to respond to consumer pressure for increased sustainability. This is contributing to a shift in regulatory focus towards providing greater consumer protection on trade-related issues, which is also a response to the rising complexity of some new products and their supply chains.

2.2. Emerging economies

Over the next 10-15 years, consumer spending in emerging economies is likely to continue to rise fast as a proportion of global consumption. Ernst & Young estimates that by 2022 the number of emerging economy households with annual incomes in excess of 35,000 US dollars will be 200 million[17], larger than the United States (120 million) or the Eurozone (116 million). Therefore, a powerful, relatively new global middle class, much of it based in Asia, will be a key determinant of the outlook for global demand and trade – and for the prospects for sustainable trade.

[17] Ernst & Young, 'Growing Beyond – Rapid-growthmarkets: EY Rapid Growth Markets Forecast February 2014'

The priority for the growing middle classes in emerging markets is rapid catch up.

Sustainable trade will be affected not only by the rise of these emerging market consumers, but also by their profiles and opinions. The priority for the growing middle classes in emerging markets is rapid catch-up to their North American and Western European counterparts in terms of living standards. The 'American Way of Life' continues to be attractive for many of those who begin to be able to afford it, particularly younger generations. This raises some doubts about how high a priority such consumers will place on sustainability considerations in future.

Emerging middle class consumers tend to be younger on average than their advanced economy equivalents, are usually urban residents, and in many instances are first-time (or first-generation) buyers with little brand loyalty. They also tend to be technologically savvy and generally seek out the best 'value for money' – not necessarily buying the cheapest products. In some cases, this will benefit producers perceived to be trading high quality goods and services (including sustainably produced options), for example in food products – as consumers increasingly have the ability to pay a premium for such goods.

As income levels rise, demand will also shift away from essential goods (basic food, clothing and shelter) towards consumer durables, services and luxury goods. Already evident in emerging markets is the growing proportion of income allocated to prepared foods, personal care, entertainment, transport and services such as education and healthcare. When these shifts in preferences occur on such a scale and at such a pace as is forecast for the leading emerging markets, the impact on global demand and trade will be significant.

At present, citizens of countries such as China and India rank among the most sustainable consumers, according to the Greendex Score 2014.[18] However, to some degree these scores simply reflect lower income levels in these countries compared to OECD countries, and hence lower levels of consumption of resource-intensive products and services. As income levels in emerging markets rise, it is likely that these countries' rankings in this index will fall relative to OECD countries that have strong cultures of sustainability.

The pace of economic change in emerging economies in the coming 10-15 years may enable consumers to leapfrog some stages of technology and product offerings. To the extent that newer products are produced more sustainably than older models, upgrading is likely to be supportive of trade becoming more sustainable. There is certainly strong potential for increasing efficiency of resource use in emerging economies.

Emerging economies may leapfrog to more sustainable technologies.

Separately, as emerging economies develop, and incomes and costs rise, some types of production will shift to other more advantageous locations. Middle-income countries such as China will lose comparative advantage in low-skilled production in comparison to less developed countries. Therefore, one issue that is likely to remain an obstacle to growth in sustainable trade is that the manufacture of labour intensive products such as clothing, footwear and toys may continue to occur in some of the least regulated economies. This is likely to remain an obstacle for as long as global consumer demand for cheap, labour-intensive products remains high.

[18] National Geographic and GlobeScan, Greendex 2014.

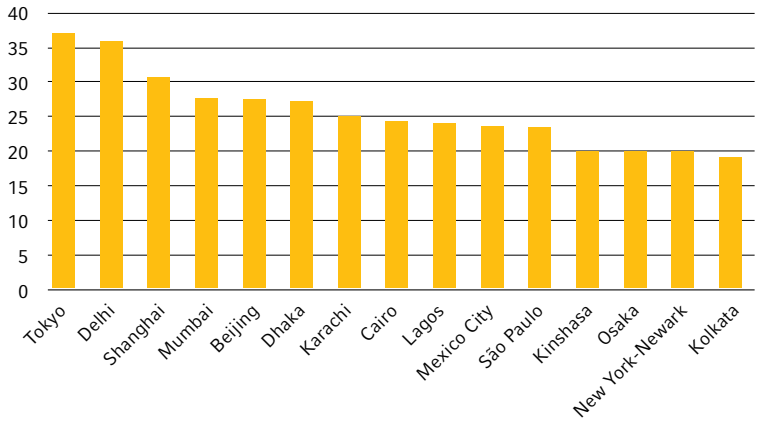
3. Urbanisation

Continuing rapid urbanisation is common to both advanced and emerging economies.

3.1. Rapid change and associated risks

Continuing rapid urbanisation is common to both advanced and emerging economies. While only 30% of the world's population resided in urban areas in 1950, this figure reached 54% in 2014 and is forecast to be 66% in 2050. Continuing population growth and the trend towards city living is expected to add an additional 2.5 billion people to the urban populace by 2050, with most of this increase occurring in Asia and Africa. Between 2014 and 2050, China is expected to add 292 million city dwellers, and India 404 million.[19]

Figure 6. Largest cities in 2030
population in millions



Source: United Nations, Department of Economic and Social Affairs, Population Division, 'World Urbanization Prospects: The 2014 Revision'.

[19] Data in this paragraph from United Nations, Department of Economic and Social Affairs, Population Division, 'World Urbanization Prospects: The 2014 Revision'.

Such rapid urbanisation may restrain growth in sustainable trade, at least until the overall sustainability of cities improves – as it goes hand-in-hand with rising living standards and increased consumption. Cities today account for over two-thirds of global greenhouse gas emissions and global energy use. Competing land use and internal migration will put additional strain on resources.

3.2. Opportunities for sustainable trade

Demand for sustainable technologies is likely to be strongest in the increasingly concentrated megacities of middle-income countries, most notably China. Cities are centres for innovation, some of which is tradable. For example, emerging countries such as China and India are generating 'frugal innovations' (ie, products or services that are low-cost, and usually eliminate any features that are not essential) in a range of sectors, ranging from solar energy to low-cost medical procedures.

Demand for sustainable technologies is likely to be strongest in the increasingly concentrated megacities of middle-income countries.

City governments worldwide will increasingly seek 'smart' transport systems and sustainable solutions to issues in water, energy and waste management. This is leading to a whole new subsector opening up relevant to sustainable trade: sustainable transport and resource solutions for cities. However, smart cities may become increasingly self-sufficient in energy needs, reducing trade in energy resources.

Also, as a larger proportion of the world's population becomes concentrated in cities, companies may develop a narrower geographical focus, reducing logistical inefficiencies related to serving rural areas. Marketing and distribution in overseas urban areas is often easier than in overseas rural areas, offering economies of scale for international businesses that focus on cities, and hence greater opportunities for sustainable practices.

4. Roles of governments, corporations, and NGOs

4.1. Governments

Governments worldwide have a significant educational role in promoting sustainability, which is related to the provision of public goods such as clean air and water, as well as in setting relevant policy and drafting relevant regulation. Their role is underpinned by the existence of positive externalities in sustainable activities. If a country has, for example, a clean natural environment, this can benefit a number of sectors, such as food production and tourism.

Government initiatives on sustainability can be of great benefit to corporations from that country.

Some OECD governments, eg, those of Denmark and South Korea, have driven national initiatives on sustainability. Such initiatives are supportive of business: They can help to strengthen corporate brands and market positions through enhancing positive 'country of origin effects'; this can lower the costs of attracting or retaining customers. A country's reputation for quality and integrity can facilitate entry and assist higher positioning in a market for companies from that country, eg, in sectors such as infant foods. Government initiatives in these areas may also help create first-mover advantages for its country's firms, as corporate sustainability itself becomes a source of competitive advantage, creating value propositions and increasing revenue.

Some emerging economy competitors may be constrained by domestic markets characterised by the greater availability of defective and fake goods, corruption and resource and energy inefficiencies. More fundamentally, these competitors can suffer from association with national governance systems that lack institutional supports such as an independent media, an impartial and consistent judiciary, and other forms of consumer protection that set a minimum quality level in the domestic market.

4.2. Corporations

Among corporations, global leadership on sustainability issues is still held mostly by North American and Western European firms. Arguably, this is a logical consequence of these firms having for decades been at the forefront of utilising natural resources worldwide for the production of goods and services. In the GlobeScan/SustainAbility 2014 Sustainability Leaders Report, eleven of the first twelve positions in the ranking are held by companies from these regions – Brazilian company Natura is the exception, coming sixth.[20]

Among corporations, global leadership on sustainability issues is still held mostly by North American and Western European firms.

However, as leading corporations from Asia, Latin America and Africa increasingly globalise, sustainable trade practices will almost certainly become more central to their strategies. Independently of companies' locations, sustainability programmes or processes are more likely to be implemented and maintained when companies initiating them enjoy a powerful position in global supply chains. For example, this is evident in the highly consolidated UK supermarkets sector.

[20] www.natura.com.br

4.3. NGOs

There is a wide spectrum of types of NGOs, ranging from those that are more 'fundamentalist' to others that are highly pragmatic. Overall, the profile of NGOs in the public arena has increased since the 1990s, as many of the more pragmatic ones moved from an operational role to having a greater involvement in policy design and implementation. In recent years, many of these NGOs have begun to refocus from exerting pressure on governments towards collaborating with them, as well as with corporations. NGOs can access vulnerable sectors of the population and remote geographical areas, partly through established links with local communities and knowledge of local conditions. They also have accumulated experience in certain fields, including aspects of sustainable trade, which the corporate sector or governments may lack.

Many NGOs have begun to refocus from exerting pressure on governments towards collaborating with them, as well as with corporations.

The more pragmatic NGOs have helped to bring concerns related to sustainable trade into the mainstream of debate, and are now playing a key role in corporate sustainable trade strategy. This has involved these NGOs working with corporations to overcome barriers that have sometimes prevented collaboration in the past, notably the different terminologies used by NGOs and by corporations. Efforts by both sides to 'translate' these terminologies for the other side appear to be working. A good example of corporations working with NGOs is the Forest Stewardship Council, a certification system for timber set up by an alliance of NGOs including Friends of the Earth and WWF, the timber industry and retailers.[21] Corporate-NGO partnerships such as this are likely to be a growing feature of sustainable trade in the next 10-15 years.

As regards collaboration between governments and NGOs, this is likely to continue to represent a rising trend – particularly in developed countries. Governments will respond to pressure for increased citizen participation in public affairs by creating more of the structures and processes needed to work more closely with NGOs.

[21] www.fsc.org

5. Scenarios for global demand as a driver of sustainable trade in the next 10-15 years

The pace of economic growth, and how it is distributed among advanced and emerging economies, will play an important role in determining how much, and how, global demand drives sustainable trade over the next 10-15 years. Stronger global economic growth would present a greater opportunity for Scenarios A or B below to take hold. However, even if economic growth is strong in emerging markets, there is a risk that Scenarios C and D could develop, which might slow global progress on sustainable trade.

BEST

A. Emerging economies leapfrog to sustainable trade
The rapidly growing emerging middle classes quickly assimilate global 'best practices' in terms of acquiring knowledge about sustainable trade practices and purchasing goods and services that are sustainably produced and traded. In emerging economies, governments, consumers and corporations are able to learn from unsuccessful, unsustainable trade practices of the past, and increasingly manage to push their economies to 'leapfrog' to more sustainable trade practices. Large and small corporations worldwide recognise that trading sustainably is crucial for retaining and attracting customers.

B. Consumer pressure encourages sustainable trade, but unevenly
The emerging middle classes show some interest in pressing for sustainable trade, but their main ambition is rapidly to increase their standard of living, whether this means purchasing sustainable products and services or purchasing non-sustainable ones. In advanced economies, consumer support for sustainable trade continues to strengthen, but a diversity of different consumer and NGO initiatives create some confusion.

C. Pace of urbanisation stifles progress on sustainable trade
Worldwide, the pace of urbanisation adds a layer of complexity to achieving sustainable trade ambitions. Governments, corporations, NGOs and consumers worldwide understand the need to push forward the sustainable trade agenda, but are confronted with a reality of urban problems that cannot be resolved sustainably within a 10-15 year timeframe. This is a particular problem in trade with the growing megacities of Asia and Africa.

D. Allure of 'American Way of Life' overpowers sustainability concerns

Economic performance is solid and emerging middle class growth is strong. However, this group of consumers shows little interest in pressing for sustainable trade, preferring to pursue the less sustainable 'American Way of Life'. The latter also remains the ideal for many consumers in advanced economies. Correspondingly, corporations that serve consumers worldwide have less incentive to trade sustainably in order to be successful, and pressure on governments to enhance sustainable trade regulation is limited.

E. Economic weakness diminishes sustainable trade momentum

Economic performance worldwide is worse than forecast. While in some cases this encourages more rapid uptake of sustainable trade practices by corporations in order to save costs, overall the volume of global trade stalls or even declines, which also diminishes momentum for sustainable trade efforts. Consumers worldwide start to lose interest in advocating sustainable trade, given that their overriding concern becomes their personal financial situation.

WORST

Global demand patterns will also have a major impact on supply chain trends, which is the subject of the next section. Supply chains are at the core of global trade and investment. Global economic integration, which facilitates growth in global demand, has led many firms to develop complex, geographically-extensive and cost-competitive supply chains. Increasingly, questions are also being asked about the sustainability of those supply chains.

Driver 3:
Supply chain trends

1. Sustainability and supply chain complexity

Global brand firms such as IBM, Apple, Siemens, Samsung, Toyota, Unilever and Wal-Mart have developed extensive sourcing and production facilities and operations in countries such as China, India, Mexico, Turkey and Vietnam. A principal driver of this trend was the low cost of labour in such countries, relative to advanced economies. Yet although these trends created jobs in emerging economies, the relative laxity of regulatory standards in many of these economies, and the sheer number of different suppliers in new supply chains, meant that offshoring was sometimes accompanied by negative environmental and social consequences. These were external to the advanced-economy firm, and viewed by such firms, their home-state regulators and the market generally as the responsibility of authorities in host states.

This situation has changed, mainly as a result of high-profile labour abuse and safety or pollution incidents in so-called 'sweatshops' supplying global brands. Ensuring social and environmental integrity among suppliers and subcontractors is now increasingly seen as part of a global corporation's responsibility. In addition, sustainability aspects of supply chain management are increasingly seen as integral to cost reduction, efficiency, commercial agility, and risk management – for example, related to the potential impact of weather-related disruptions, in addition to reputational profile concerns.

"Next generation sustainable supply chains will be leaner, greener and faster."

Jayashankar M. Swaminathan,
GlaxoSmithKline Distinguished Professor of Operations and Associate Dean, OneMBA and UNC-Tsinghua EMBA Programmes

Ensuring social and environmental integrity among suppliers and sub-contractors is now increasingly seen as part of a global corporation's responsibility.

2. Sustainability as a commercial imperative

Arancha González,
Executive Director,
International Trade Centre

"There are four drivers that explain why supply chains are becoming more sustainable. First, we are moving into an era of the 'conscious consumer'. Consumers in the growing global middle classes are starting to care more about the sustainability of supply chains. This is a global trend involving consumers from both the 'North' and 'South'. These consumers are demanding to know how products are produced; they care deeply about quality, especially of food – but also of many other items, such as medicines, electronics and vehicles. They also care about whether social and labour standards are being respected.

The second driver is climate change. This is already a significant threat to supply chains. It can be manifested, for example, as water scarcity or weather disruptions, such as floods or droughts. This driver is closely related to the third one, which is the complexity of supply chains. Many global firms have supply chains spread across different geographies, exposing them to risks that include the impacts of climate change, as well as location-specific social, political, health and other risks.

Finally, there is a fourth driver of supply chains becoming more sustainable: inclusiveness. Many supply chains are huge vectors for local economic activities, and therefore play an important role in local economic and social development. For example, a multinational corporation that sources tea from a country needs to work closely with tea growers there, helping to establish a local market and encouraging more sustainable production.

These four drivers are here to stay. The challenge is how best to organise supply chain sustainability in order to minimise social and economic costs and maximise the benefits for all those involved in the chains."

Ultimately, suppliers are much more likely to engage in sustainable trade practices if these have clear cost or efficiency benefits for their own operations. The challenge and cost of creating a supply chain that is risk-proofed in terms of sustainable practices is leading many firms to start questioning the global, over-extended nature of their supply chains, and some firms are already reducing the number of suppliers involved. For example, footwear brand New Balance has in recent years made efforts to reduce its supplier profile by 65%, instead focusing on strong partnerships with fewer existing suppliers to improve their sustainability performance.

The commercial benefits of offshoring to locations far from Western European or US markets may continue to decline if Chinese labour costs and global transport costs rise, diminishing the attractiveness of China as a location for suppliers of Western companies. Less developed, low-wage countries such as Vietnam, the Philippines, Indonesia and Bangladesh may remain attractive for some basic product manufacturing (eg, clothing, footwear and toys), but these smaller countries lack the capacity to produce on the same scale as China.

These risks and realities mean that the business case for rethinking complex and geographically extensive supply chains could grow further. By working to improve social and environmental standards and performance throughout a supply chain, and by rationalising complex supply chains, firms realise that they can reduce costs, minimise waste, conserve resources, find new efficiencies, and drive product innovation, while also displaying corporate commitment to social values.

The business case for rethinking complex and geographically extensive supply chains could grow further.

3. Supply chains in the broader operations context

It is possible to exaggerate some aspects of the supply chain sustainability trend. For instance, a report in 2014 showed 39% of respondents stating that corporate leadership was currently not providing the mandate, incentives or resources for action on supply chain sustainability. However, this does not necessarily reflect the wider trend, which is clearly towards greater focus on supply chain sustainability issues in future: 76% of respondents in the survey agreed that this would be the case.[22]

Re-examination by corporations of sustainability issues along their (external) supply chains needs to be assessed in the context of broader efforts to make sustainability improvements within their overall operations, ie, the overall business case for sustainability. For example, there is growing interest in the 'cradle to cradle' concept, according to which a product can be completely disassembled and recycled, without any waste being generated, or re-used without any loss of performance or quality.

There is growing interest in the 'cradle to cradle' concept.

Even if 'cradle to cradle' production can be difficult to attain, there is increasing alignment between basic cost and efficiency considerations, and demonstrating commitment to the global sustainability agenda for reasons of brand protection and enhancement. For example, Nestlé has developed an extensive sustainability programme. The firm decided to focus on reducing water wastage and energy consumption (in its processes and by working with partners), reducing overall water usage per tonne of product by 35% since 2005, and reducing overall energy consumption by 23% since 2005.[23]

In many cases, improving the sustainability of operations will simultaneously make commercial sense – especially on a long-term perspective, but often even in the short or medium term. Likewise, commercial reasons are the key driver for the current empirical trend whereby firms are monitoring and reassessing the social and environmental sustainability of their external global supply chains.

In many cases, improving the sustainability of operations will simultaneously make commercial sense.

[22] PricewaterhouseCoopers and APICS Foundation, 'Sustainable supply chains: Making value the priority', 2014.
[23] 'Nestlé in Society – Creating shared value and meeting our commitments', 2013.

4. Supply chain hot spots and new technologies

Companies are identifying and targeting supply chain sustainability 'hot spots'.

4.1. Identifying 'hot spots'

The opportunities for improving sustainability across supply chains vary considerably by sector and can involve different stages of the supply chain. Companies are identifying and targeting supply chain sustainability 'hot spots' where the business case for sustainability can be made most clearly. For example, Nokia identified materials acquisition as a hot spot, leading it to use more bio paints and recycled metals and plastics. Coca-Cola identified packaging as a hot spot. In response, it introduced a number of initiatives designed to reduce the weight of its products by 25-50%, generating cost savings of about 140 million euros over two years. Its 'PlantBottle' packaging, which is made partially from plants, has reduced CO_2 emissions by 100,000 tonnes since 2009.

4.2. Applying new technologies

Major firms will make smart use of 'big data' and systems harmonisation technologies to integrate information from diverse supply chains, with cost and sustainability benefits. Major factors in current and future rationalisation and greater sustainability improvements in supply chains relate to new technologies, especially for data management and analysis, as well as to improved implementation of existing technologies.

For example, trends in predictive analysis and point-of-sale 'demand signals' (rather than forecasts of future demand based on historic data) will enable firms to be more precise about replenishing stocks and avoiding overstocking, thereby reducing waste, saving costs and becoming more responsive to changes in consumer demand. For example, UK retail company Marks & Spencer uses 'second generation' radio frequency identification technology (RFID) both in its shops and across its supply chain. It has steadily increased its reliance on the technology since first testing it in 2001. RFID permits electronic tracking of goods, improving stock replenishment.

Although the relevant technologies themselves are continuing to be enhanced, a large part of the benefit for firms will come through improved implementation and management of the technology. For example, in order to be most efficient, all a firm's suppliers should use the same version of the technology, and report data in consistent, easy-to-use formats.

5. Relationships with suppliers

5.1. Cost sharing

Especially for products provided by a range of sub-contractors at various degrees of separation from the primary firm, suppliers can have a major impact on corporate sustainability efforts. According to the Carbon Disclosure Project, suppliers realised savings of about nine billion euros just from emission reduction investments in 2013.[24] However, realising the potential in supplier sustainability improvements is often difficult. In particular, there can be incentive mismatches between the buyer and the supplier.

Suppliers can have a major impact on corporate sustainability efforts.

Often when large firms mandate sustainability efforts from the supply base it is perceived by the suppliers as a cost increase or about 'passing the burden'. For example, Wal-Mart has asked suppliers in the fisheries sector to obtain Marine Stewardship Council certification to guarantee that their products follow sustainable processes and standards. However, this costs a supplier anywhere from 40,000-400,000 euros depending on the scale and extent of certification, and could take up to two years. This is a huge investment for the supplier and does not immediately translate into profits or efficiencies. It creates a dilemma for the supplier – should it invest to stay in business with the buyer, or is it better off working with another buyer that does not mandate such investment? When the buyer is important, the supplier is likely to certify, but there is a significant risk of suppliers seeking other, less demanding buyers.

This may encourage parallel production systems, with best practice companies diverging from less adaptive supply chains. Nonetheless, over the next 10-15 years, as more buyers subscribe to such requests, and if regulations become stricter, suppliers are likely to be left with fewer opportunities to avoid such costs by switching buyers. Conversely, buyers may face increasing concentration on the supplier side, with only large suppliers, able to afford sustainability-related investments, surviving. Fewer suppliers could lead to higher supplier prices, in the long term translating into higher prices for the consumer.

It may be that only large suppliers will be able to afford sustainability-related investments.

Even in cases where the buyer is important, the supplier might try to choose sustainability efforts that are more amenable to immediate efficiencies, while the buyer might be more interested in pushing to change the culture around sustainability at the supplier. The Carbon Disclosure Project finds that suppliers mostly want to work on process emissions reductions, product design changes, and energy efficient processes and building – while buyers are most interested in sustainability projects that involve behavioural change initiatives, and transportation and fleet investments. Overall, the evidence suggests that buyers are more advanced than suppliers in implementing sustainable business practices, notably in the area of climate change mitigation (see Figure 7 below).

Therefore, even when buyers and suppliers are interested in working together to improve sustainability within the supply chain, they may want to focus on different types of projects simply because of the way the cost and benefit sharing might work. And even after agreement is reached, buyers are likely to need to make substantial investments in ensuring that suppliers meet expectations, eg, conducting

[24] 'Collaborative Action on Climate Risk: Supply Chain Report 2013–14', Carbon Disclosure Project.

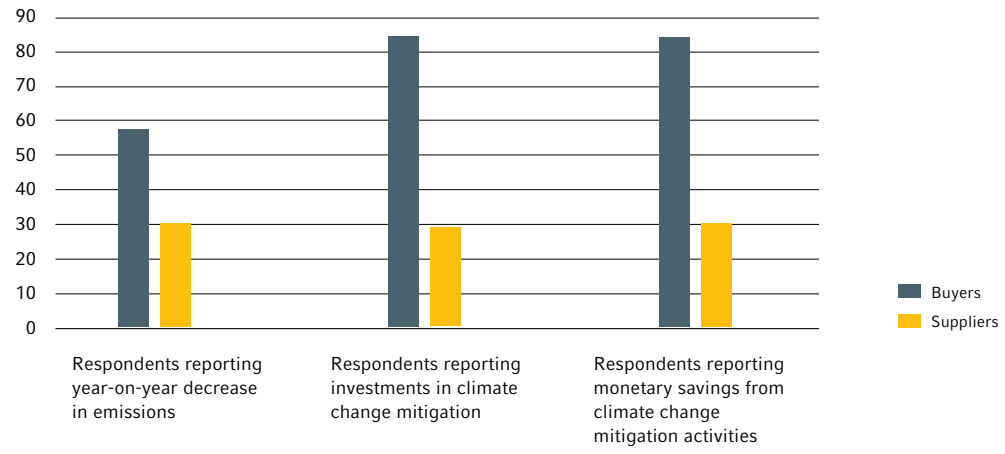
Buyers and suppliers may want to focus on different types of sustainability projects.

on-site visits and managing supplier training. Major buyers are paying increasing attention to building awareness and capacity among their suppliers around sustainability issues. For example, Hewlett-Packard has since 2006 run programmes to train suppliers in sustainability, and showcased best practice by some suppliers to others, to incentivise continuous improvement.

5.2. Compliance and oversight

Future global and national regulation is likely to pay increasing attention to social and environmental impact issues assessed on the basis of buyers' responsibility for their entire supply chain rather than their own core operations alone. For example, the 2011 United Nations Guiding Principles on Business and Human Rights[25] are clearly directed towards greater due diligence efforts by firms in relation to their suppliers and those within their influence. This trend of attributing responsibility will create significant pressures on firms, because it is accompanied by high expectations and often unfounded assumptions that global corporations can control closely all standards and behaviours in their extended supply chains. These corporations will increasingly struggle to make the case that responsibility lies with host state emerging economy governments for enforcement (among local supplier firms) of local health, safety, environmental and other standards.

Figure 7. Example of source of supply chain tension: Buyer versus supplier performance on climate change
in %



Source: Carbon Disclosure Project. Note: 64 buyers and 2,804 suppliers surveyed.

[25] www.ohchr.org/documents/publications/Guidingprinciplesbusinesshr_en.pdf

In many cases, regulatory measures and their degree of enforcement are different between jurisdictions. Yet any multinational is answerable to the general public, and sometimes to the regulations and standards in its own country as well as in the local country of operations. As a result, corporations need to take a range of actions with regard to their supplier base.

For example, Apple has faced difficulties (as have other electronics firms) relating to accusations of environmental damage caused by suppliers operating in China, including Foxconn, Pegatron and Catcher Technology. This is despite the fact that Apple has succeeded in reducing its overall net greenhouse gas emissions in recent years.[26] Apple is also a leader in efforts to educate and sensitise suppliers (perhaps partly in response to the problems it has experienced). Apart from training, it conducts site profile surveys, environmental assessments at supplier locations and audits of the supply chain. Even so, the ability of even a major buyer such as Apple to completely ensure the highest sustainability standards from its supply base has limitations. Like Apple, many corporations are now increasing the level of detail in assessing suppliers' sustainability practices; in some cases, these assessments are qualifying criteria for long-term supplier contracts. However, most firms still have scope for improving the level of detail in instructing suppliers on how to act on sustainability issues, including disclosure of accidents or other problems when these occur.

The ability of even a major buyer to completely ensure the highest sustainability standards from its supply base has limitations.

In terms of due diligence and reporting on sustainability issues along supply chains, firms face increasing complexity. There has been a significant proliferation of indicators and schemes for assessing and reporting on sustainable supply chains. This is becoming unmanageable for many firms and sectors: for instance, recent research has found 2,555 different metrics for measuring sustainability of supply chains; there were 76 different metrics just for water-related sustainability issues[27]. In the coming years, there is likely to be rationalisation of such reporting and monitoring. This will help such information management issues increasingly to align with core business processes relating to risk or other factors.

[26] Apple Environmental Responsibility Report (2014).

[27] Payman Ahy and Cory Searcy, 'An analysis of metrics used to measure performance in green and sustainable supply chains', Journal of Cleaner Production, 1 January 2015: http://www.sciencedirect.com/science/article/pii/S0959652614008270.

6. Collaboration among competitors

Informational and reporting burdens are fostering collaboration among competitors.

[28] www.eiccoalition.org/standards/assessment
[29] www.apparelcoalition.org/higgindex
[30] www.tfs-initiative.com

Informational and reporting burdens are fostering collaboration among competitors. In some sectors, groups of firms have developed common surveys to reduce the burden on suppliers of responding to a large variety of requests for information. An example of such an initiative is the Electronic Industry Citizenship Coalition (EICC) Self-Assessment Questionnaire, which establishes a process for consistency on auditing social and environmental performance, and related certification.[28] In the garment and footwear sector, the Sustainable Apparel Coalition has developed a performance assessment tool (called the Higg Index).[29] Some leading chemicals firms have formed the Together for Sustainability initiative for a supplier engagement programme to assess and improve sustainable production and sourcing practices.[30]

7. Scenarios for supply chain trends as a driver of sustainable trade in the next 10-15 years

Scenarios A to E suggest several ways in which sustainable supply chain trends could develop in the next 10-15 years. These are not all mutually exclusive, and it is possible that different trends could take hold among different corporations or in different parts of the world. Underlying Scenarios C, D and E is the potential for tension between cost savings, especially in the short term, and sustainability objectives.

BEST

A. Supply chain sustainability becomes core area for risk and strategy
The social, consumer and market pressures for proof of commitment to sustainable sourcing remain strong. However, for most global firms the business imperatives for greater attention to supply chain sustainability are compelling enough without these external pressures. Through this process, supply chain sustainability considerations become part of core risk management and strategic value-creation. Moreover, this becomes true for corporations worldwide – not just those in advanced economies.

B. Near-shoring takes off
The trend of 'near-shoring' gathers pace: that is, efforts to ensure less complex supply chains, preferably brought back into the same general geographical locality as the end-point manufacturer or customer. Generally, near-shoring enhances supply chain sustainability – but not always. Sometimes local production can be less sustainable overall, even if costs and resources related to transport are saved.

C. Agility is the major supply chain objective, not sustainability
Corporations remain conscious of achieving a lower carbon and eco-system footprint, and of social and ethical considerations related to their supply chains. However, overall these sustainability concerns take second place to 'agility': being able to be more responsive to supplying major markets in ways that are cost-competitive. Sustainability and agility sometimes are compatible, but sometimes not.

D. Global competition forces short-term focus
Many improvements to supply chain sustainability require a long-term strategic approach by corporations. However, the increasingly competitive global environment leads most firms to focus primarily on short-term survival and profit. Sustainability concerns are a factor in decision making, but are not corporations' main focus and so, globally, little progress is made on improving supply chain sustainability.

E. More countries actively compete to participate in unsustainable supply chains
Globally, progress on regulation encouraging sustainable supply chains falters. This permits many emerging economies to continue implementing lax regulation. Global economic weakness also allows those economies to keep labour and other costs very low. Therefore, the business case for supply chain sustainability becomes far less compelling than today. The world experiences a re-run of the 1990s and 2000s, as firms seek competitive advantage by sourcing from countries that offer 'the lowest price', independently of sustainability concerns.

WORST

There are a growing number of alliances among corporations, and between corporations and NGOs, that emphasise shared problem-solving around sustainable sourcing and supply. There has also been a proliferation of standards and labels for products and practices, many of which relate to the sustainability of supply chains. These topic areas are the subject of the next section.

Driver 4:
Alliances, standards and labels

1. Alliances

1.1. Types of collaboration

Alliances increasingly involve partnerships across the public, private and civic sectors. These are generally led by business and tend to reflect voluntary undertakings rather than regulatory requirements. In 2013, there were more than 110 national and international business-led sustainability coalitions, and several hundred industry- and issue-specific coalitions.[31] Some collaborative efforts follow product supply chains and engage suppliers involved in an end-product for a particular firm. Others are organised by a sector, which has decided to act collectively to address sustainability issues. This has happened, for example, in the trade of gold, jewellery, and apparel and footwear. In the latter sector, the 'Roadmap to Zero Discharge of Hazardous Chemicals' programme[32] sees apparel and footwear brands cooperating to improve environmental and business practices and standards for their industry, including pledges to eliminate various hazardous chemicals from production by 2020. It involves a wide range of global players, including Adidas, Nike, H&M, and Puma (and, since its initiation, others including Gap, Levi Strauss, and Benetton have joined). Other initiatives involve competitors coming together to achieve critical mass on a resource scarcity or image-related issue that concerns all of them – both in operational terms and in public image terms (for example, beverages firms in Africa working together to improve sustainable water supplies).

Alliances increasingly involve partnerships across the public, private and civic sectors.

In the coming 10-15 years, there is likely to be further proliferation and strengthening of all these sorts of collaborations. Although some have a publicity-oriented motivation, the strongest initiatives are driven by the shared interests of their participants in the sustainable trade issues to which they relate. Pragmatism and necessity will continue to drive firms competing in the same markets or sectors to cooperate on ensuring the reliability and quality of supply of non-renewable resources, and to promote sustainable trade in other ways. From the point of view of corporations, many alliances are fundamentally commercial.

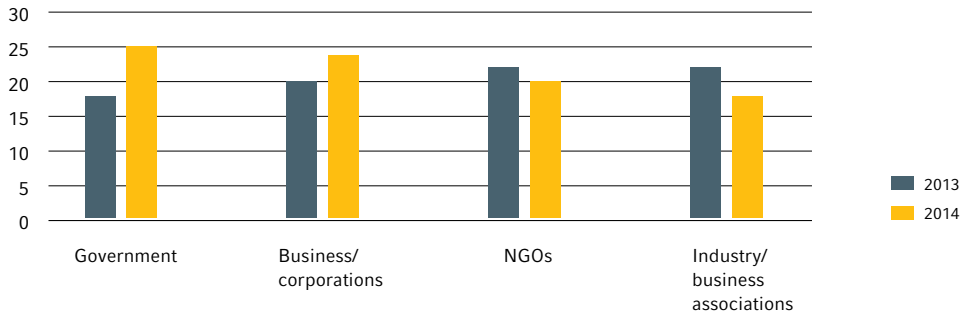
Increasingly, alliances will involve innovative partnerships with NGOs that both monitor firms and help them address issues (often along their supply chain) relevant to sustainable trade. Many firms are already in partnerships of some sort with global and local NGOs that have expertise in sustainable trade, impact assessment and mitigation.

Moreover, cooperation between corporate, NGO and public sector members of alliances is likely to grow for several reasons: firms are not necessarily good at improving sustainable trade outcomes and require help; consumer and environmental activists can benefit from working with (not against) firms; and governments need to foster such collaborative initiatives where these help to preserve or enhance public goods and services. A survey by Business for Social Responsibility (BSR) and GlobeScan shows that government is now regarded by businesses as their most important collaborator on sustainability issues, even more so than other businesses and NGOs.[33] This is a marked change compared to last year, when NGOs, businesses and business associations all ranked higher than government.

Pragmatism and necessity will continue to drive firms competing in the same markets or sectors to cooperate.

[31] David Grayson and Jane Nelson, 'Corporate responsibility coalitions: the past, present and future of alliances for sustainable capitalism', Stanford University Press, 2013.
[32] www.roadmaptozero.com
[33] 'State of Sustainable Business Survey 2014', BSR and GlobeScan, 2014.

Figure 8. Importance for collaboration with businesses
% of total responses



Source: 'State of Sustainable Business Survey 2014', BSR/GlobeScan, 2014. Answers from 700 professionals working in corporate sustainability to the question: "Which one of the following do you think is generally the most important for business to collaborate with in order to make substantial progress on a CSR and sustainability issue?"

1.2. Obstacles to progress

Business-led alliances for sustainable trade share some problems inhibiting their growth and wider uptake.

Business-led alliances for sustainable trade share some problems inhibiting their growth and wider uptake. Alliances are still limited to certain kinds of corporations in certain sectors and countries. This has explanations that go beyond simply the short time (last two decades) during which these alliances have been constructed. These constraints relate to enduring issues such as cost, convenience, and cautiousness on the part of many firms.

Enthusiasm for alliances is not shared by all business executives, nor by all NGOs, some of which are ideologically opposed to certain issues or practices (eg, oil sands or fracking) and have no interest in engaging in a meaningful dialogue with industry players. In part, there is also a problem of 'initiative fatigue'. This results from over-competition between initiatives and multiple overlapping schemes on the same issue

in the same sector. Organisations intending to drive cooperation on sustainable trade often lack resources or are seen as having limited utility and relevance to the business planning and operational needs of their members. It may also be the case that previous activity has mobilised most of those that could be readily mobilised – the maximum impacts have been achieved through this route – leaving a large, hard-to-engage segment untouched.

Designing, implementing, monitoring and evaluating the impact of alliances is complex. The scale of the challenges (eg, climate change) contributes to fatigue. Compounded by cost and cautiousness about future regulation or competition factors, many (especially smaller firms) may be taking a 'wait and see' approach to such alliances. Even large global firms cannot necessarily afford to repeat their involvement in schemes from scratch in each market in which they operate.

There is scope for considerable future streamlining, consolidation and merging of alliances.

This means that there is scope for considerable future streamlining, consolidation and merging of alliances. This consolidation process is very unlikely to come from top-down pressures or even inter- or intra-alliance consensus. It is far more likely that some groupings on particular topics or sectors will lead and other initiatives will follow or drop away entirely. Each alliance's resources, convening power, and relevance to business will determine the outcome. However, despite this consolidation, some niche alliances will flourish on the basis of particular issues or in particular places.

It is too soon to say whether the current collaborative spirit (business, NGOs and governments reaching out to each other to solve sustainable trade problems) will prevail. The gap between actual practice and expectations or aspirations in this area could lead to a period of more confrontation that is not conducive to dealing with sustainable trade problems, even if this raises reputational risks for business.

2. Standards

2.1. Proliferation of initiatives

A wide range of relevant standards and processes now exists.

Since the 1992 Rio Earth Summit, there has been strong momentum behind a so-called 'disclosure revolution' on the uptake and use by major corporations of sustainable trade-related, non-financial standards and reporting. A wide range of relevant standards and processes now exists, as evidenced by the production of reports-on-reporting, such as the annual KPMG Survey of Corporate Responsibility Reporting.[34]

Some sustainable trade standards and reporting schemes are sector-specific.

In addition to the ISO 26000 standard of the International Organization for Standardization, the leading and most widely-used generic sustainability reporting (SR) system is the Global Reporting Initiative (GRI).[35] In May 2013 it released its 'G4' (fourth generation) SR guidelines, with over 30 indicators.[36] The GRI scheme is shifting to emphasise 'subjective materiality' (firms monitor what they believe a reasonable investor would require to make an informed decision) rather than tick boxes of ever-greater numbers of indicators.

Other schemes such as the UN Global Compact and the OECD Guidelines for Multinational Enterprises incorporate the GRI scheme as best practice for monitoring compliance or implementation.[37] Bodies such as the International Integrated Reporting Committee drive the incorporation of SR into core corporate reporting practices.[38]

In addition to generic global systems, some sustainable trade standards and reporting schemes are sector-specific (such as the Kimberley Process[39] on conflict diamonds, the Rainforest Alliance[40], or the Extractive Industries Transparency Initiative[41]), issue-specific (for example the Carbon Disclosure Project) or product-specific. The latter relate to certifying and monitoring claims of sustainable sourcing, as is well established for example in the timber industry, or more recently in the palm oil industry. Such product-related standardisation and reporting is undergoing considerable innovation, for example through initiatives such as GoodGuide, which enables consumers to use smartphones to check sustainability ratings at the point of sale.[42]

A whole consulting and monitoring sub-sector now exists. This includes the large professional services firms such as KPMG, Ernst and Young and PricewaterhouseCoopers, firms specialised in inspection, verification, testing and certification, eg SGS[43], and many smaller firms.

Some stock exchanges have even introduced as a listing requirement mandatory sustainability reporting. The Johannesburg Stock Exchange has led on this, but the practice is also evident in Brazil and elsewhere. Major market players such as NASDAQ are trending in similar directions. Bodies such as the Sustainability Accounting Standards Board (in the United States) continue to develop mainly industry-specific metrics intended to become the basis of mandatory disclosures for companies.[44]

The drivers of SR standards and reporting trends are likely to remain fairly strong. They will remain directly commercial in nature: firms using sustainability-based approaches both to drive new value-creation and supply-chain or resource-use efficiencies, and to differentiate themselves in the market or adjust to market preferences. They will also retain indirectly commercial drivers, for example related to reputation. These drivers come

[34] The 'KPMG Survey of Corporate Responsibility Reporting'. The 2013 edition is available at www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/corporate-responsibility/Documents/corporate-responsibility-reporting-survey-2013.pdf
[35] www.globalreporting.org
[36] www.globalreporting.org/reporting/g4/Pages/default.aspx
[37] www.oecd.org/corporate/mne
[38] www.theiirc.org
[39] www.kimberleyprocess.com
[40] www.rainforest-alliance.org
[41] https://eiti.org
[42] www.goodguide.com
[43] www.sgs.com/
[44] www.sasb.org

together in relation to SR, as firms increasingly use the data they generate on sustainability for both external reporting and internal strategy purposes.

In a very limited set of countries, industry- and NGO-led initiatives on standards and reporting have attracted a legislative basis. For example, Sweden has made SR mandatory for all its state-owned companies (using the GRI system). As detailed under 'Driver 1: Regulatory competition – and protectionism' above, the EU has adopted a new, ambitious directive on non-financial reporting.

2.2. Need for consolidation

Big corporations complain about the huge quantity and variety of issues and schemes that they are now expected to track, engage in, or report on. Although there is a degree of harmonisation, there is discernible compliance fatigue in the sustainability area. As a result, reforms, convergence and consolidation in the area of standards and reporting are already taking place.

There is discernible compliance fatigue in the sustainability area.

Significant consolidation and clarification about standards has been established by the International Trade Centre's 'Standards Map', which includes details about over 150 "standards, codes of conduct and audit protocols" relating to supply chain sustainability.[45] This is of high value to businesses. However, the confusion, cost, and inconvenience associated with the existence of so many non-binding codes and expectations remains, and the pattern tends to benefit larger firms – while smaller businesses, which are vital in sustainability terms, sometimes cannot keep up.

Moreover, contrary to some big companies' experience of compliance fatigue, the fact remains that sustainability reporting (and all it signifies) is far from being universal even among large companies and organisations. A report by Chatham House on the uptake of sustainability reporting confirms this impression.[46]

Nonetheless, reporting on and disclosure of matters relating to sustainable trade will primarily remain the preserve of large listed companies even as it seeps into new or hitherto 'closed' business areas such as private equity. It is likely to play a significant and growing role in consumer sectors, in particular for large multinational companies that invest significantly in sustainability, such as Volkswagen. However, the market factors (especially cost and competition) that have inhibited greater uptake of this trend will continue to have a material impact on its prospects.

Reporting on and disclosure of matters relating to sustainable trade will primarily remain the preserve of large listed companies.

2.3. Ratings

There are now a large number of ratings (and indices and rankings), using different types of sustainability indicators. Examples of organisations providing such ratings include oekom research[47], which rates companies according to a set of indicators on employees and suppliers, society, corporate governance, products and services, environmental management and eco-efficiency; Vigeo[48], and MSCI Environmental, Social and Governance (ESG) Intangible Value Assessment[49], which rates companies' risks and opportunities in the ESG area. Large corporates are increasingly placing emphasis on performing well in these and similar ratings.

There are now a large number of ratings (and indices and rankings), using different types of sustainability indicators.

[45] www.standardsmap.org
[46] 'The Future of Sustainability Reporting', Paul Hohnen, Chatham House, 2012.
[47] www.oekom-research.com
[48] www.vigeo.com
[49] www.msci.com/products/esg/iva/

3. Labels

It is easy to exaggerate the importance of labelling for sustainability.

It is easy to exaggerate the importance of labelling for sustainability. In the last two decades there has been a proliferation of the number and types of labels on a wide variety of products. This has led to confusion, especially among consumers, and has devalued labels as an option for increasing sustainability. Moreover, many companies have misused labels for marketing purposes – making only minor product adjustments and then heavily marketing the label applied. This has generated widespread scepticism among consumers, who today tend not to pay much attention to particular labels – instead assuming that 'green is the new normal'.

Nonetheless, some of the most well-known consumer product labels remain widely respected, for example, WWF and Fairtrade. The latter, in particular, has contributed significantly to developing the discourse of 'fair trade'. In 1997, all national fair trade initiatives became represented by Fairtrade Labelling Organisations International (FLO) as a single certification for product categories. This system audits producer organisations to ensure they produce outputs in a socially just and sustainable way. It requires initial buyers wishing to use the certification mark to support this by providing up to 60% up-front credit where requested; engaging in long-term and predictable relationships; and paying a minimum guaranteed or market price (whichever is higher), plus a social premium that producers invest in projects deemed appropriate for business and community development.

The World Fair Trade Organisation (WFTO) has developed another fair trade accreditation system, under which – in contrast to FLO governance – whole organisations receive endorsement if they are considered to promote fair trade principles, which include: generating income for the poor; capacity building; providing fair prices and wages; gender equality; and environmental sustainability.

Martin Chilcott,
Founder and CEO, 2degrees[50]

[50] www.2degreesnetwork.com

"Labelling has become very widespread, but it is not a key driver of sustainable trade in the same way that climate change, security of supply, and reputational risk are. Some leading labels, such as Fair Trade or the WWF stamp do have an impact on the purchasing preferences of some consumers, but overall the field of labelling has become so crowded and confusing that most consumers have switched off from looking at sustainability labels on products. Moreover, consumers generally are not prepared to pay more for more sustainable products, nor do they want to have to choose among alternative sustainable products – they would like to trust a retail brand to make that choice for them.

Standards and alliances are a much more significant driver of sustainable trade than labels. The huge growth in the global middle classes is placing unsustainable pressure on

many natural resources, which are suffering the 'tragedy of the commons': they are not owned by anyone, so nobody takes responsibility for preserving them. This applies both to corporations and consumers. However, the tragedy is increasingly being addressed by collaboration and alliances among corporations (sometimes involving NGOs), or between corporations and their suppliers, that aim to manage natural resources sustainably. In turn, this collaboration can lead to the development of standards that are applied by whole sectors.

At 2degrees, we run large-scale, supply-based sustainability programmes: with the support of the corporate customer, we organise collaboration among the supplier base to identify and implement sustainability improvements in the supply chain, through innovation, and leading to reduced risk and costs. We are finding significant opportunities for improving sustainability. For example, with UK supermarket chain Asda, the results have been outstanding. It is clear that corporations that move early to adopt this collaborative approach with suppliers will gain a competitive advantage over corporations that move more slowly. Ultimately, following this approach will become unavoidable for all corporations."

4. Role of governments

Underlying business-led sustainable trade alliances, as well as market-led standardisation and reporting initiatives, is the decline in expectations about the potential of global governance institutions and the poor prospects (compared to the 1990s) for governmental consensus and action on a variety of relevant issues. The result of this general decline in expectations towards institutions and governments, together with the interest in influencing regulations before they become binding, will increase the willingness of business-led alliances to take the lead on issues such as sustainable trade.

Although business-led initiatives on sustainability are relatively new, the history of global business regulation shows clearly that the generation of standards has often derived from within sectors and markets, not from top-down legislative acts. For instance, maritime safety standards now incorporated in law began as the shared, self-regulatory, rational self-interest standards of London marine insurance guilds well before they were codified in legislation. Similarly, market initiatives appear far more likely than governmental ones to shape standard-setting on sustainability issues, even if some later become law. However, this increasing focus on what the private sector can do should not detract from the importance of enabling environments produced by government policies.

5. Scenarios for alliances, standards and labels as a driver of sustainable trade in the next 10-15 years

Scenarios A to E provide a spectrum of how the role of alliances, standards and labels could change over the next 10-15 years. A combination of Scenarios B and C is the most likely outcome. Underlying Scenarios C, D and E is the risk that further proliferation of alliances, standards and labels dilutes their importance and causes a loss of focus.

BEST

A. Normalisation of roles of alliances, standards and labels
In advanced economies, the roles of alliances, standards and a much-reduced range of labels are normalised. They are generalist (ie, economy-wide) when possible, or sector- and issue-specific when necessary. This takes place in parallel with some light regulatory steering and a shift in the onus such that firms without good disclosure or labelling profiles, or relevant alliance memberships feel excluded from the market altogether. Sustainable trade alliances become ever more linked to standards because monitoring, audit and reporting processes tend to improve the identification and rectification of trade practices that are unsustainable.

B. Broad integration of sustainability reporting and compliance with standards
Sustainability reporting is somewhat integrated over time into financial reporting, and sustainability labelling or certification becomes partly inseparable from conventional product information. This reflects widespread adherence to standards, many of which are generalist. However, confusion associated with the high number of standards and labels has not been fully addressed. This causes some firms to fail (or to be perceived as failing) in their sustainability efforts. SMEs suffer the most from this problem.

C. Increased fragmentation along sector- and issue-specific lines
Some of the most widely-used generalist SR initiatives, eg, GRI, continue to prove responsive in catering to particular sectors' needs. Nonetheless, this is insufficient to create accepted generalist standards and reporting system. Instead, sector- and issue-specific standards and reporting, and associated alliances, dominate – creating a fragmented system that leaves potential in this area partially unfulfilled.

D. Consolidation and progress are stalled
Cost, confusion, consumer apathy and inconvenience inhibit fast changes in consolidation of standards, sustainability disclosure, labelling and effectiveness of alliances. Among and within different stakeholder groups, eg, corporations, NGOs, consumers and governments, there is disagreement about the most appropriate alliances, standards and labels. Nonetheless, a variety of initiatives do succeed and some progress is made.

E. Alliances, standards and labels lose importance
Alliances, standards and labels lose importance as drivers of sustainable trade. This is caused in part by rising confusion about the proliferation of measures and mechanisms; a tendency to await governmental direction; and a general 'wait and see' approach that sees far more followers than leaders on sustainable trade outside of top brand consumer firms such as Unilever.

WORST

In terms of alliances among companies and the implementation of standards, one of the sectors that has undertaken important initiatives in recent years has been the financial services sector. In the next section we examine these developments, and more broadly detail why innovative finance and banking have the potential to be at the core of sustainable trade efforts in the next 10-15 years.

Driver 5:
Innovative finance and the role of banks

1. Strengthening sustainability trend

1.1. Reflection of broader corporate sustainability

Sustainable trade trends in the corporate sector are, in broad terms, mirrored in the financial sector. Indeed, some would argue that those entities that finance or insure corporate activity are the most significant drivers of sustainable trade within corporates. The banking sector probably has more impact on the uptake of sustainable business practices and strategies, on new markets for carbon-related issues, and on the fostering of new energy and other technologies, than any other sector. Banking practices will remain driven primarily by commercial considerations around risk and opportunity calculations, but sustainability issues have a growing weight in reaching those assessments.

The banking sector probably has more impact on the uptake of sustainable business practices and strategies than any other sector.

Sometimes, banks' involvement in sustainable trade involves financing sustainable projects and technologies, for example in relation to renewable energy or water. As the drivers of demand for, eg, viable clean energy and other clean technology projects strengthen, so the role of banks will rise. However, banking involvement in sustainable trade goes further, to include the application of sustainability criteria in financing trade by corporations. This reflects a newer role for banks, whereby they increasingly incorporate consideration of non-financial factors into their decision-making and lending criteria. This both mirrors the same trend within the corporate sector, and is increasingly responsible for driving that trend, given the influence that financiers' conditions can have on corporate conduct. This greater focus on sustainability issues in banking practices can have significant effects, shifting lending practices.

In terms of how strong the trend towards greater weighting for sustainability criteria in bank lending might become, and what is causing it, in most respects the factors are little different from those that explain corporate sustainability trends.

1.2. Factors behind the trend

It can be argued that there are four main factors that help to explain why sustainable banking is gathering momentum. They revolve around core considerations of risk and opportunity, both commercial and regulatory. They will probably continue to grow in significance even in the present climate of constrained capital availability.

There are four main factors that help to explain why sustainable banking is gathering momentum.

The first is the need to address or pre-empt new regulatory expectations, as indicated, for example, by the move in Brazil from voluntary efforts or 'guidance' to regulation, detailed below. The second factor is related to the first, and concerns attempts by individual banks to enhance their reputation and brand value (especially where they fund themselves from retail deposits). As a collective, the industry is also concerned to enhance its credibility on sustainability issues, especially following the 2008-09 financial crisis.

The third and most significant factor is around risk management and capital allocation. The perceived risks are mainly indirect, eg, the damage to infrastructure from extreme weather events caused by climate change. Some risks are direct, such as credit risks to clients' commercial prospects, derived from sustain-

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"For a long time banks have been involved in commercial project finance of sustainable energy projects, often becoming partners in developing sustainable energy markets. More recently, the banking sector (and financial institutions more generally) has been taking an even more proactive role on sustainability issues. Most significantly, trade finance has started to focus increasingly on how goods and services are produced and delivered. Many banks today place a lot of pressure on themselves to check trade-related transactions for environmental, social, governance and ethical considerations. Such considerations have become part of day-to-day practice in many leading banks. They have become almost as important as assessing the credibility of the borrower.

Climate change is also an important driver of these assessments of the sustainability of products and services. For example, many financial institutions no longer support coal-based investments, unless these are demonstrably 'clean'. Another example is regarding the application of ethical principles: a bank today examines whether local regulations applied to chicken farming in countries in which a transaction is taking place are as strict as those applied in the creditor's home country. If the answer is negative, a credit may be declined.

Numerous banks have signed up to the Equator Principles[51], which provide self-regulation on sustainability issues, by obliging institutions to report on these areas. These principles cover not just project finance, but all corporate activity. Most banks are deeply committed and are devoting considerable resources to better understand environmental, social, governance and ethical issues related to products and services. Fewer banks are willing to stay outside the Principles. Implementation of the Principles has already had a substantial impact – and once a bank has joined, it is difficult to get out, as that would risk a loss of credibility among shareholders and stakeholders."

ability-related events or issues. Banks are devoting resources to monitoring sustainability issues in client requests partly to be able to manage associated risks (by using conditionalities) and partly as a proxy for insights into how effective the client's planning and strategy processes are more generally, which can be indicative of their resilience to commercial strains apart from their sustainability exposure. Part of the risk is not just operational but regulatory, for example the risk that regulation in future could reduce the value of carbon-intensive assets.

The fourth driver is the prospect of new opportunities for value-creation by banks – new products and services that create or respond to new needs among corporate borrowers. This is reflected in, for example, the role of banks in establishing new markets for offsetting carbon.

1.3. Collaboration

The bank-corporate relationship can increasingly see the bank encouraging, assisting and/or requiring its client to pursue compliance-related efficiencies[52], for mutual benefit. Implementing sustainable technologies is a sign of quality and longer-term durability in some sectors, such as infrastructure. Another example is efficient collaboration in conducting environmental and social impact assessments (ESIAs). Collaboration between an exporting corporation and the institutions providing credit (and insurance) – all of which have a stake in an efficiently and correctly carried out ESIA – can substantially lessen the time needed to document compliance. This time reduction can itself provide a competitive advantage.

[51] www.equator-principles.com

[52] In the sense used here, 'compliance' refers to voluntary schemes as well as regulatory requirements.

2. Metrics and reporting

2.1. Financial institutions in the OECD

Sustainability concerns are thus already playing an important role as criteria in trade and project finance. More and more banks are rejecting financing trade activities or projects that do not attain acceptable sustainability standards, or that contain sustainability risks that the bank feels cannot be sufficiently mitigated through advisory support and/or conditions attached to the loan. Many financial institutions, at least in OECD countries, are integrating sustainability considerations into their routine operations. This trend will gather strength.

Many financial institutions, at least in OECD countries, are integrating sustainability considerations into their routine operations.

Many OECD banks adhere voluntarily to schemes such as the United Nations Environment Programme's Finance Initiative (UNEP-FI)[53], the UN Principles for Responsible Investment[54], or the 'Equator Principles'. Newer, narrower schemes include the Green Bond Principles (established by a group of thirteen investment banks in January 2014), which provide guidance to issuers of bonds for projects that have environmental benefits.

These schemes provide guidance for banks on implementing sustainability-related policies and processes (and managing associated risks). Most large banks are committed to one or more of the schemes, in terms of devoting resources to enable them to better understand sustainability issues related to their portfolios and lending profiles, and to their clients' activities across sectors. However, many banks' attention to these issues has been derived not so much from external schemes, but from their own internal approaches.

2.2. Financial institutions outside the OECD

The trend is not limited to OECD financial institutions; it is becoming increasingly noticeable in BRICS countries. For example, Brazil's national banking association (Febraban) has since 2009 had a voluntary 'Green Protocol' (Protocolo Verde), established together with NGOs, the government and banks, and covering areas such as the promotion of green/social financing, and awareness-raising. Since 2014, it is also subject to the central bank's socio-environmental policy that requires Febraban members to implement, by 2015, systems to mitigate losses on their books resulting from environmental damage. However, there has been some debate about whether the central bank's measures go far enough.

[53] www.unepfi.org
[54] www.unpri.org

Since 2007, the Chinese Banking Regulatory Commission has required environmental impact issues, in particular, to be integrated into loan application systems. In 2012, it issued 'green credit' guidelines, and in 2013 it instituted moves requiring banks to report how they were addressing sustainability issues in their portfolios.

2.3. No universal metrics

In this sense, globally the move towards mainstreaming these issues is partly among banks themselves, and partly being manifested in policy and regulatory frameworks (as in the above examples of Brazil and China). However, there does not yet exist a universally agreed metric for how financial institutions report on sustainability issues related to their trade finance, for example reporting on the volume or value of emissions associated with a financed export, such as a new power plant. In most cases, banks do not yet systematically report on the emissions generated by their loan and investment portfolios. However, progress is taking place: notably, Greenhouse Gas Protocol[55], in partnership with the UNEP-FI, is working on a set of guidelines to "better account for, report on and manage risks from financed greenhouse gas emissions"[56].

There does not yet exist a universally agreed metric for how financial institutions report on sustainability issues related to their trade finance.

The fact that sustainability issues are associated with real risks of business disruption or value impairment (either directly or indirectly, and sometimes cumulatively) continues to drive efforts to improve transparency around the sustainability aspects of credit extensions and investments. This is increasingly also seen as an important component of making the global financial system more resilient overall.

[55] www.ghgprotocol.org
[56] www.ghgprotocol.org/Financed_Emissions_Initiative

3. New products and services

3.1. Sustainable Shipment Letters of Credit

Some financial institutions are also promoting progress in sustainable trade of specific commodities, for example by supporting the development of the 'Sustainable Shipment Letter of Credit (SSLC)' initiative. This scheme, launched in January 2014, has been promoted by the Banking Environment Initiative (BEI), a group of banks working with their customers to incorporate pre-existing sustainability standards into letters of credit granted to companies that trade commodities internationally.[57] The SSLC initiative is using certifications from non-profit organisations such as the Round Table on Sustainable Palm Oil (RSPO) in order to prove the sources of goods, allowing trade finance institutions to distinguish between sustainable shipments and non-sustainable ones. The primary focus is on agricultural commodities whose supply chains have a particularly destructive environmental impact (soy, palm oil, beef and pulp/paper account for about half of tropical deforestation). Some of the world's leading purchasers of agricultural goods – including Unilever, Nestlé and Coca Cola – have stated the objective of achieving zero net deforestation in supply chains by 2020 through trading only in sustainably-produced commodities.

Some financial institutions are promoting progress in sustainable trade of specific commodities.

It is too soon to assess this particular scheme's impact, but it does reflect the trend towards innovative ways to incorporate sustainability issues into trade and to redesign familiar instruments of credit by reference to these considerations. This pattern can be expected to continue to strengthen and, over time, may expand from the above agricultural commodities to other products in supply chains. It should also move from Letters of Credit to other trade service products, such as Bank Payment Obligation (BPO) and open account finance offerings. It will be driven by the banking sector itself, rather than be a response to corporate or trading demands. Related initiatives include the extension of credit linked to energy efficiency targets set out in the instrument. These measures permit lenders to condition the conduct of borrowers so as to address risk factors that the bank sees as relevant either to the particular transaction (credit risk) or to its wider portfolio and brand integrity.

3.2. New forms of public sector credit guarantees

Alongside the role of bank finance are other sources of finance, including the extension of state credit. OECD governments require corporations that request state export credit guarantees to conduct sustainability assessments of large projects. The typical framework for such assessments is the OECD Common Approaches.

Alongside the role of bank finance are other sources of finance, including state credit extension.

International financial institutions play an important role. The European Bank for Reconstruction and Development's (EBRD's) Trade Facilitation Programme (TFP) guarantees political and commercial payment risk for trade transactions[58]. Similarly, the International Finance Corporation (IFC) provides credit guarantees under its Global Trade Finance Program (GTFP) to developing country exporters. According to the IFC, the GTFP has covered 25,000 trade transactions since its inception in 2005, for a total value of over 25 billion dollars.

[57] The Banking Environment Initiative's 'Sustainable Shipment Letter of Credit: A financing solution to incentivise sustainable commodity trade', University of Cambridge Programme for Sustainability Leadership, 2014.

[58] www.ebrd.com/work-with-us/trade-facilitation-programme.html

The IFC also has a growing role in providing trade liquidity assistance and in supply chain financing. Under the GTFP Climate Smart Trade initiative, the IFC may provide price incentives for products or projects covered under the GTFP if these have climate change benefits.[59] Many subsectors of energy efficient goods and renewable energy sources are included.

Banks play an important role in partnership with the IFC in establishing the climate change credentials of products or projects. When state credit guarantee agencies are involved, the sustainability assessments are transparent, which forces exporting companies to undertake a high degree of due diligence. Schemes such as the EBRD TFP and the IFC GTFP, as well as related initiatives to 'blend' public sector grants and guarantees with private sector investment or loans, are indicative of the facilities available alongside, and involving, the mainstream banking sector. These public sector initiatives can also provide the catalyst for private sector financial institutions to design new instruments relevant to sustainable trade.

Public sector initiatives can provide the catalyst for private sector financial institutions to design new instruments relevant to sustainable trade.

3.3. Leasing[60]

Purchasers often require innovative financing that helps to diminish up-front purchase costs. This is particularly relevant for large sustainability-oriented transactions, in which an up-front technology cost may be high for an importing company, but where such a cost will be compensated only several years later when sustainable operations begin to generate cost savings or higher revenues than non-sustainable technologies. One way of reducing the up-front burden is for buyers to lease rather than purchase the export product.

Under such a leasing agreement, the parties agree that the supplier will receive part of the flow of revenue from the product's operations once that revenue starts being generated. This transfer continues until the full cost of the product has been paid. This model works well if the product, for example a large infrastructure or power sector construction, exhibits a strong long-term business case for sustainability. That is, if over the long term the product generates higher revenues (and profits) than comparative products that use less sustainable technologies.

While there is increasing attention to such models in terms of supporting more sustainable practices, a risk of these financing models is that the business case for sustainability is eroded faster than expected. For example, the sustainability technology may work less well than expected or require high maintenance, or competing companies may implement similar or better sustainability technologies. In such cases, revenues or profits from the exported product may be lower than anticipated.

3.4. Non-bank financing of long-term investment

The European Commission in 2013 issued a Green Paper on 'Long-term financing of the European economy', which assesses the prospects for greater non-bank financing of long-term investments, including in the area of sustainability.[61] The Paper highlights scope for an increased role for public sector institutions in supporting or guaranteeing private sector investment, reducing risk faced by both large corporations and SMEs in investing in long-term projects. This is often relevant for major sustainability improvement projects.

[59] www.ifc.org/GTFP

[60] This section is based on analysis in Stefan Schaltegger, Matthias Schock and Cathrin Buttscher, 'Nachhaltigkeit als Herausforderung für Exportwirtschaft und Exportkreditversicherung: Bedeutung und Rolle von Finanzierung und Umweltprüfung im B2B-Geschäft', Leuphana University, Lüneburg, 2009.

[61] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52013DC0150

In line with the Green Paper, new European Commission President Jean-Claude Juncker is promoting a set of new investment funds, under which initial injections of cash from the EU budget or the European Investment Bank would help to cover the funds' downside risks, thereby attracting private monies of a much greater order than the initial public investment. The funds would focus on infrastructure, and would be likely to have some degree of sustainability criteria attached to them.

3.5 Capital-market based solutions for SMEs

As detailed under 'Driver 1. Regulatory competition – and protectionism' above, SMEs, in the EU, in particular, can struggle to meet the costs of compliance with sustainability regulation. In the current environment of constrained lending, they also face serious difficulties in accessing capital. This can be a major impediment to SMEs' contribution to driving sustainable trade – and given the huge economic importance of SMEs, it acts as a significant drag on the overall sustainable trade agenda.

SMEs, in the EU, in particular, can struggle to meet the costs of compliance with sustainability regulation.

There are many innovative proposals to give SMEs improved access to capital markets, several of which are detailed in a report in 2014 by Oliver Wyman.[62] The proposals in the report focus on improving the institutional set-up within which SMEs operate. Several of the proposals, including facilitating greater debt and equity market access, offer the prospect of access to longer-term financing than is usually available to SMEs. This is often critical to the implementation by SMEs of sustainable trade projects.

3.6. Sustainability investing

Banks operate alongside private equity, private foundations, corporate and public-sector pension funds and other institutional investors that are also interested in opportunities to finance sustainable energy and other projects, to integrate sustainability issues into routine investing, and to establish or contribute to pooled sustainable investment funds. As a result, access to capital is growing (at least in relative terms) for projects and operations that have either a direct sustainability dimension or that satisfy minimum sustainability criteria. Such sustainable investing could become an important component of overall financial system resilience, given that some of the risks associated with non-sustainable investments may gradually be eliminated.

Sustainable investing could become an important component of overall financial system resilience.

Like institutional investors, banks are increasingly seeking viable investment opportunities that also address global issues such as climate change mitigation and the transition to a low-carbon economy. These types of investment funds span asset classes across micro-credit funds, fixed income, public equities with sustainability screens, and social venture funds, among others. More generally, a greater range of financial products supporting sustainable trade is likely to develop in the future. This will involve close collaboration between banks, importers and exporters, and NGOs.

[62] 'Towards better capital markets solutions for SME financing', Oliver Wyman, 2014.

4. Scenarios for innovative finance and banking as a driver of sustainable trade in the next 10-15 years

The scenarios for innovative finance and banking as a driver of sustainable trade reflect broader aspects of the outlook for sustainable trade. For example, Scenario B reflects broader concerns about uniformity of metrics and reporting on sustainable trade-related topics. There is quite a strong likelihood of the most positive scenario – Scenario A – taking place, at least partially, over the next 10-15 years.

BEST

A. Both OECD and non-OECD financial sectors try to seize opportunities in sustainable trade
The OECD financial sector entrenches principles that embed more detailed sustainability concerns into trade and project finance, and devotes a greater share of financing to clean energy and clean technology trade. Moreover, non-OECD banks conclude that sustainability is a major factor in winning business related to global trade. Non-OECD banks and their host countries start modelling their sustainable trade norms and regulations on OECD best practices. Some innovative sustainable trade financing instruments become mainstream and provide a further boost to sustainable trade.

B. Lack of uniform metrics and reporting slows progress
Most OECD financial institutions and some non-OECD ones implement either internal sustainable trade principles and processes or ones related to the GRI or other schemes. However, progress is slowed by a lack of uniform metrics and reporting.

C. Doubts about commercial benefits of sustainable trade persist
Success stories of some banks that are not regarded as having strong sustainability credentials generate doubts in the global financial sector about the potential trade-off between engaging in sustainable trade and increasing market share or profitability. These doubts are deepened by the increasing complexity of regulations and norms related to financing sustainable trade, which slow the pace at which financial institutions can conclude business.

D. Fragmentation of sustainable trade schemes
There is disagreement within the global financial sector about the impact on competitiveness of adhering to sustainable trade norms. This causes a fracturing of some of the leading voluntary schemes that support sustainable trade financing, some of which had grown too fast and lost focus. Given that the regulatory environment has failed to keep pace with such schemes, a vacuum emerges and some OECD financial institutions (and many non-OECD ones) chart paths that are only weakly supportive of sustainable trade.

E. Broader decline in interest for sustainability affects finance
In the context of weak global economic growth, financing of non-sustainable trade booms relative to financing of sustainable trade. This reflects faltering interest in sustainability more generally among corporations and in society. Sustainable trade is seen as a niche area that rarely makes commercial sense for corporations or their financiers.

WORST

Outlook

There is growing consensus – in the OECD but also beyond – that sustainability is now a permanent feature of corporate life and thus international trade.

There is growing consensus – in the OECD but also beyond – that sustainability is now a permanent feature of corporate life and thus international trade. The majority of large global companies agree that pursuing a sustainable approach can be an important aspect of long-term strategy and operations. However, there is not yet global agreement on how this should translate into the practice of corporate sustainability and sustainable trade. In fact, there is wide divergence on what should or should not be implemented under sustainable trade. Recognition by companies of the importance of environmental, social, ethical and governance matters is not the same as actually doing something (or enough) about it. This lack of clarity around sustainability and sustainable trade is likely to constrain corporate commitment and action to some extent, and will almost certainly create challenges for governments wanting to put in place coherent, relevant regulation.

Improving the financial bottom line will remain the predominant concern of companies. Indeed, many sustainability practices to date have concerned short-term cost-saving measures with concrete returns. Businesses are more likely to engage in sustainability issues and sustainable trade when the immediate economic returns of such behaviour are apparent. This will continue, especially as efforts to quantify the impact of sustainability policies on companies' bottom lines improve.

The five drivers of sustainable trade analysed in this report underscore the potential magnitude of change that could take place.

But as companies pick the low-hanging fruit of sustainability policies – such as efficiency improvements and energy savings – future sustainability measures are unlikely to see the same kind of immediate financial return. The next surge of sustainability practices may include a review of employee working practices and benefits, or ensuring that all investments or consumer products are 'green'. Ultimately, leading companies in the field of sustainability will implement a holistic view across company policy and processes.

The five drivers of sustainable trade analysed in this report underscore the potential magnitude of change that could take place in global trade over the next 10-15 years. These drivers are powerful, but they also have to overcome substantial obstacles. It is conceivable that impetus on sustainable trade could stall, perhaps even resulting in a reversal of progress in some areas, for example if concerns about energy security and/or a further cheapening of fossil fuels reduces momentum for investment in renewable energy. As detailed, each driver offers a possible best-case and worst-case scenario. The table below summarises these. The actual path followed by sustainable trade in the next 10-15 years is unlikely to reflect either the set of best-case or worst-case scenarios, but rather some combination of the many outcomes that lie in between. Sustainable trade is still in its infancy; it is an area that will grow in the years to come, even if the pace and nature of that progress is uncertain.

In our next publication, we will draw on the ideas in the scenario below to articulate three comprehensive and plausible futures for sustainable trade. In building these narratives, we will assess the complex interactions among consumer preferences, business practices, macroeconomic developments, public policies, technological innovations and geopolitical concerns. The analysis will help to understand how the future of sustainable trade is closely linked to global developments, and how it can both drive and respond to macro dynamics over the next 10-15 years.

BEST	WORST
Political success permits fast global progress in deepening and harmonising regulation on sustainable trade: • Many non-OECD countries' regulations catch up with OECD countries. This creates a more level playing field for companies. • Steady refinement of best sustainable trade practices globally.	**Governments use sustainable trade regulation primarily as protectionism:** • For example, OECD countries might consider implementing border carbon taxes. • Tit-for-tat measures lead to a significant slowdown in sustainable and other trade.
Fast-growing emerging economies leapfrog to sustainable trade: • In emerging economies, governments, consumers and corporations are able to learn from unsuccessful, unsustainable trade practices of the past. • Corporations worldwide recognise that trading sustainably is crucial for retaining and attracting customers.	**Economic weakness diminishes sustainable trade momentum:** • Overall the volume of global trade stalls or even declines, which also diminishes momentum for sustainable trade efforts. • Consumers' main concern becomes their personal financial situation.
Supply chain sustainability becomes core area for risk and strategy: • The business imperatives for greater attention to supply chain sustainability are compelling. • Supply chain sustainability considerations become indistinguishable from core risk management and strategic value-creation.	**More countries actively compete to participate in unsustainable supply chains:** • Many emerging economies continue implementing lax regulation. • Global economic weakness allows those economies to keep labour and other costs very low.
Normalisation of roles of alliances, standards and labels: • Firms without good disclosure or labelling profiles, or relevant alliance memberships, feel excluded from the market altogether. • Sustainable trade alliances become ever more linked to standards.	**Alliances, standards and labels lose importance:** • Rising confusion about the proliferation of measures and mechanisms. • A tendency to await governmental direction.
Both OECD and non-OECD financial sectors try to seize opportunities in sustainable trade: • The OECD financial sector entrenches sustainable trade principles and devotes a greater share of financing to clean energy and clean technology trade. • Non-OECD banks and their host countries start modelling their sustainable trade norms and regulations on OECD best practices.	**Broader decline in interest for sustainability affects finance:** • Financing of non-sustainable trade booms relative to financing of sustainable trade. • Sustainable trade is seen as a niche area that rarely makes commercial sense for corporations or their financiers.

List of abbreviations

APICS: American Production and Inventory Control Society

BEI: Banking Environment Initiative

BRICS: Brazil, Russia, India, China and South Africa

BSR: Business for Social Responsibility

CDM: Clean Development Mechanism

CR: Corporate responsibility

CSR: Corporate social responsibility

CSV: Creating shared value

EBRD: European Bank for Reconstruction and Development

ESIA: Environmental and social impact assessment

EICC: Electronics Industry Citizenship Coalition

ETS: Emissions Trading System

EUAs: EU allocated emission allowances

FLO: Fairtrade Labelling Organisations International

GRI: Global Reporting Initiative

GTFP: Global Trade Finance Program

IFC: International Finance Corporation

NASDAQ: National Association of Securities Dealers Automatic Quotation System

OECD: Organisation for Economic Cooperation and Development

REACH: Registration, Evaluation, Authorisation and Restriction of Chemicals

RSPO: Round Table on Sustainable Palm Oil

SME: Small and medium-sized enterprise

SR: Sustainability reporting

SSLC: Sustainable Shipment Letter of Credit

WEEE: Waste Electrical and Electronic Equipment

WFTO: World Fair Trade Organization

WTO: World Trade Organization

WWF: World Wide Fund for Nature

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