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Workshop 1: Policy and Institutional Issues

**THE ENVIRONMENTAL IMPLICATIONS OF FOREIGN DIRECT INVESTMENT:
POLICY AND INSTITUTIONAL ISSUES**

DRAFT

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Introduction

1. Since the beginning of the decade, private capital has surged in importance as a source of finance for emerging market economies. In 1990, it accounted for less than half of the US\$44 billion in international capital that came to developing countries. In 1996, this share rose to 86 per cent, amounting to some US\$244 billion of private capital flowing to developing countries that year (French, 1998).
2. Almost half of the private capital inward-bound to the developing world consists of foreign direct investment (FDI). FDI can be distinguished from more volatile private capital flows, such as portfolio investment or bank lending, in that it is usually for the long term. The investing transnational corporation (TNC) aims to enhance its competitive value by entering into new markets, obtaining access to new resources, or achieving efficiency gains.
3. Most private financing flowing to the developing world has focused on a small group of high-performing countries (UNCTAD, 1998).¹ In an effort to attract a larger share of this capital, many countries are in a race to liberalise their regulatory regimes. In 1997, UNCTAD tracked 151 changes made by 76 countries in their laws governing FDI. Some 90 per cent of these changes were aimed at creating a more favourable climate for FDI, *e.g.*, streamlined approval procedures, special trade and investment zones. Some 36 countries introduced new investment incentives
4. The growing importance of FDI in the global economy has engendered considerable debate among policy makers and activists concerning the implications of this trend for the environment, on the macro as well as micro levels. The “big picture” concern is that this increasing reliance on FDI and on the investing TNCs will spread the consumerism of the advanced market economies, and the accompanying excessive use of resources, to the rest of the world. This could counteract efforts to build a sustainable global economy.
5. On the micro level, the concern is how a particular investment will affect a host country’s environment. This depends *inter alia* on the industry and sector involved, the reason for the investment, and the environmental controls in place. In certain circumstances, FDI can bring about significant environmental improvement. For example, much of the FDI that has recently flowed into Central and

Eastern European (CEE) manufacturing facilities has gone for upgrading of technologies and remedying of past environmental damage (PED). Investors have brought capital and know-how, introduced more efficient methods of production, and demonstrated the link between good environmental practices and profitability (Goldenman, 1997).

6. Other types of FDI, particularly investments into resource extraction industries such as mining and logging, have frequently led to serious and at times irreversible environmental degradation. Some of these cases have drawn international attention, *e.g.*, environmental pollution from oil exploration and drilling in Nigeria (RAN/PU, 1998) and non-sustainable exploitation of forest timber resources in Southeast Asia (Dixit, 1995). Negative environmental impacts from FDI are more likely in countries where property rights are poorly defined, and few safeguards are in place to ensure proper attention to the matter of environmental protection.

7. This paper considers some of the policy and institutional issues that arise in the effort to protect the environment from adverse impacts related to FDI. It focuses on government in the belief that the state remains the institution best placed to set in place effective controls over activities carried out within or from its territory. At the same time, it recognises some of the limits to reliance on state action in this area, *e.g.*, when governments lack the economic power, technical capacity or political will to set conditions with respect to a particular investment.

8. The first part of this paper examines the role of the state with respect to FDI, including its power to set in place and enforce the operable rules of the game. In particular, it explores the role of host countries in developing and implementing coherent policies in order to ensure environmental-friendly investment. In doing so, it draws on some recent Central and Eastern European (CEE) experiences in this area.

9. The second part takes a critical look at some of the instruments available to the state for bringing about more sustainable development. These range from national plans and programmes to tools for controlling impacts from individual investments, including environmental impact assessment and environmental auditing.

10. The third section considers the roles of other key stakeholders, including international financial institutions (IFIs), source countries and non-governmental organisations (NGOs), in developing transparent structures for holding investors accountable for the environmental impacts of their projects. The paper concludes with some reflections on directions for future actions to ensure that the growing phenomenon of FDI does not overwhelm the effort to bring about sustainable development.

The Role of the State in Ensuring Environmentally Sound Investment

11. Over the past decade, the global economy has experienced a number of fundamental shifts, including the collapse of centrally planned economies in Central and Eastern Europe and the former Soviet Union, and the crisis in the “miracle” economies of Asia. These developments have led to a fresh appreciation of the role of the state in economic development, and the benefits and limits of state action.

12. Today, markets and governments are seen as complementary. The state is needed to set in place the appropriate legal and institutional framework for well-functioning markets, while stable markets and long-term investment are fundamental to the effort to achieve economic development and alleviate poverty.

13. Globalisation of the marketplace has set governments on a race to see which country can attract the most FDI, in an effort to spur maximum economic growth. The amount of FDI flowing into a given country is determined by a number of factors, including (1) the host country's regulatory framework for investment, *e.g.*, trade liberalisation and/or privatisation, (2) the ease of doing business; and – most important – (3) prospects for long-term economic growth (UNCTAD, 1998).

14. Investors are particularly concerned that rules be predictable and applied consistently and without discrimination to all investors. This desire for predictability extends to a country's environmental rules. Investors polled in 1992 concerning environmental issues with respect to investments in Central and Eastern Europe (CEE) reported that they were less concerned about the stringency of environmental regulations than about incomplete or inconsistent regulations that created uncertainties with regard to their environmental responsibilities (Klavens and Zamparutti, 1992).

15. Given the above, a first principle for host countries should be that it is never appropriate to encourage investment by relaxing or waiving domestic health, safety or environmental measures or their enforcement (OECD, 1995).

16. A more difficult task is to set in place measures to ensure that investment contributes to a process of sustainable development aimed at achieving environmental and social as well as economic goals. In a few countries, investment guidelines have been developed with some consideration of potential impacts, including environmental, of various types of investment. For example, China's 1998 guidelines for foreign investment list some 200 industries in which incoming foreign investment will be encouraged via *inter alia* favourable ownership rules and tax regimes. The overall thrust of the guidelines is to encourage the entry of up-to-date technologies. However, a few industries have been included with a view to their environmental importance, *e.g.*, planting of forest trees, recycling technologies, and coal-fired power stations adopting clean combustion technology.

17. The real challenge is, of course, to integrate environmental and social considerations into strategies and plans for national development, especially in those sectors having a significant environmental impact such as transport and energy. In most countries, this effort is still more of an aspiration than a reality, with economic policies set with little or no involvement on the part of environmental specialists.

18. This can be the case even in those countries where special efforts have been made to integrate major environmental concerns into development policies and investments. For example, all of the World Bank's 49 IDA borrowers have been required to prepare National Environmental Action Plans (NEAPs) as a precondition for financial assistance (World Bank, 1996). An internal Bank review of the NEAP process in six countries found that the NEAPs had had a discernibly positive effect in just two countries, mainly with respect to building more effective environmental protection institutions. Only a few government officials involved with Bank-financed projects in the other four countries knew about the NEAPs, and even fewer felt that it informed their work.

19. A more recent effort by many countries is the establishment of national mechanisms to oversee the implementation of the agreements made at the 1992 UNCED conference in Rio, usually in the form of National Councils for Sustainable Development (NCSDs). Though considerable efforts have been made to ensure that these mechanisms are participatory, bringing in all affected stakeholders, it is still too early to assess their effectiveness in bringing environmental issues into national economic development planning.

20. The experiences with the World Bank-mandated NEAPs reveal some of the difficulties in getting economic policy makers to take environmental concerns seriously. One reason put forward for the failure of the NEAPs to become integrated into the work of the governments for which they were prepared was a profound lack of co-ordination between those working on the NEAPs and officials working on economic development issues. This can be partly attributed to the fact that ministries of environment are often among the weakest institutions in the executive branch, overshadowed by more powerful ministries dealing with economic concerns. Environmental officials have difficulty making their cases for integrating environment into economic policies, while many government officials working on economic issues still believe that taking account of environmental considerations will impede development.

21. One of the lessons emerging from Central and Eastern Europe (CEE) is that this gap of understanding can be considerably narrowed. During the initial years of economic transition, conflicts between environmental and economic development officials were not uncommon. Environmental officials and NGOs tended to consider foreign investors either as outsiders who would bring polluting industries, or as “deep pockets” -- sources of financing for cleanup of the region’s sometimes massive environmental problems. Privatisation officials were reluctant to deal with environmental problems for fear this could slow down the process of economic reform and keep out investment.

22. Inexperience concerning how to address environmental problems in privatisation led to costly negotiating mistakes in some early CEE transactions. In some cases, investors insisted on unlimited indemnification for environmental clean-ups. In one oft-cited case, an investor built a containment facility for a hazardous waste deposit using stringent Western European standards, without informing authorities that this clean-up approach would cost nearly as much as the facility itself, and then insisted on full reimbursement according to the contract. Or they backed away from pending deals out of fear of incurring liability for pre-existing environmental problems.

23. At the end of the 1990s, recognition of the potential costs if environmental issues are not properly addressed has increased within the CEECs. Most CEE and many NIS countries have developed at least some administrative and technical measures for addressing environmental problems in privatisation, and in some countries co-operation between privatisation and environmental officials has been institutionalised. In Poland and Hungary, for example, environment units have been set up within privatisation agencies. These units provide expert assistance in deciding how to deal with an enterprise’s environmental problems, including past environmental damage (PED), at the time of property transfer.

24. Those CEE countries that have addressed investors’ concerns about environmental problems related to a particular investment have seemed to have more success in attracting FDI. Even more remarkable, CEE environmental officials and NGOs are now more comfortable concerning foreign investment. In fact, a consensus has emerged that foreign direct investment has been an important element in bringing about concrete environmental improvements in the region.

25. The mostly positive experience of CEE governments in integrating environmental concerns into privatisation indicates that there is indeed room for the state to take a strong position with respect to the environmental implications of a particular investment, and still remain attractive to other investors. The next section looks more closely at some of the instruments that can be used towards this end.

Policy Instruments for Ensuring Environmentally Sound Investment

26. An important element in the CEE success in bringing in outside investment has been the development of stronger regulatory frameworks, thereby building investor confidence. This has included a

new generation of environmental legislation, modelled after Western European standards. Also important has been the development of technical capacity for evaluating the environmental problems of industry and for building reasonable environmental conditions into operating permits.

27. The regulatory tools used in CEE investment negotiations have been the same as those used in other property transactions and applications for development consent around the world: the environmental impact assessment (EIA) and the environmental audit. The environmental assessment or EIA is also a key part of the multilateral development banks' procedures for taking decisions on proposed projects (see below).

28. The EIA is not intended to stop development, but is aimed at identifying and minimising the adverse environmental and social consequences of a proposed project. In determining a proposed project's potential impacts, it ensures that government officials are fully informed when deciding whether to grant or deny permission for the project. The EIA can also provide important information for determining whether to place conditions on the project's operation, if development consent is forthcoming.

29. Though some variances are found from country to country, an essential element of the process is the preparation of a formal document. The document is usually required to describe at least the following:

- the proposed project, including information on its site, design and size;
- the main effects which the project is likely to have on the environment;
- the main alternatives studied by the developer and the reasons for the choice made, taking into account the environmental effects;
- the measures envisaged in order to avoid, reduce and/or remedy significant adverse effects that are unavoidable if the project is implemented.

30. In recent years the concept of environmental impact assessment -- especially with regard to large infrastructure projects -- has expanded to include social impacts such as disruption of land use of vulnerable indigenous peoples or forced resettlements. This is in addition to the specific risks associated with certain types of operations, *e.g.*, accidents during transport of oil via pipeline in seismically active areas, as well as impact on the environment *per se*.

31. In most instances it is the project proponent, *i.e.*, the investor, that is responsible for commissioning the EIA. In order to offset any concerns about possible bias, the document is often reviewed by environmental authorities for adequacy. Another essential element is the requirement that the affected public be informed about the proposed project and its likely impacts, and have an opportunity to voice their views. Finally, the authorities taking the decision as to whether to grant permission for the project are usually required to take account of public comment.

32. In recent years, awareness has grown concerning the importance for governments to assess the environmental impact of their policies, plans and programmes. This is the basis of strategic environmental assessment (SEA), whose application is growing. It could be particularly advantageous to undertake strategic planning based on an assessment of possible environmental and social impacts, in determining the design and allocation of concessions for resource exploitation, including mining. For example, the concept of biodiversity or cultural "hot spots" has been broached as a possible development constraint.

Public participation and FDI at Slovakia's Slovalco aluminium smelter

For more than three decades, toxic air emissions and groundwater pollution from a large complex of state-owned smelters and aluminium plants in central Slovakia caused significant damage to local ecosystems and to the health and safety of thousands of employees and residents. In 1985 the state aluminium company started a programme to expand production by replacing its out-dated smelters with state-of-the-art technology developed by Hydro Aluminium, a subsidiary of Norsk Hydro. Slovak and international environmentalists charged that the plans for expansion would add to Slovakia's pollution problems and increase electricity demand.

In the early 1990s, Slovalco asked the European Bank for Reconstruction and Development (EBRD) for financing. An independent environmental impact assessment (EIA) of the proposed investment and an environmental audit of the company's current operations indicated the project would lead to concrete environmental improvements by enabling closure of the existing plants. An EBRD loan and equity participation was approved. Hydro Aluminium also invested in the company. A number of environmental conditions were attached to the investments, including an Environmental Remediation Programme financed by designated cash flows from the company.

To address public concerns related to Slovalco's environmental impacts, a citizen-based Monitoring and Advisory Group (MAG) was established. The MAG's seven-member steering group (including company managers and local environmentalists) meets every five to six weeks in meetings open to the public. Larger public meetings take place every quarter. The MAG has facilitated more open communication with the company's management and enabled the local population to become actively involved.

By 1998, the company had complied with most of the environmental conditions. Closure of the old smelters has significantly reduced emissions of pollutants. Despite a doubling of smelting capacity, the new plant consumes only 10 per cent more energy than the original complex.

33. The EIA process can encourage consideration of less environmentally harmful alternatives, or identify ways in which a project could be altered to have a lesser environmental impact. Successful use of the EIA to prevent environmental damage may require close co-operation between economic development and environmental protection authorities in order to ensure that mitigation elements are built into the design of the project.

34. In a growing number of investment projects around the world, the EIA procedure has become a focal point of controversy, rather than a constructive process of building a societal consensus about a project's environmental impacts. Its effectiveness depends on the competence of the bureaucrats and environmental professionals involved, and whether rule of law and an open society is in place, along with an educated and knowledgeable public. However, it may lead to unsatisfactory results or be subject to abuse in countries where the political system is closed or where informed participation of local people is not possible.

35. One aspect of the EIA process often overlooked is the need for ongoing monitoring and oversight of the project, once it is under way. This is important to ensure that all agreed-on mitigation measures are carried out. In some countries, independent and community-based panels are increasingly used to assist authorities in this oversight task, and to address community concerns on an ongoing basis.

Chad-Cameroon oil pipeline

A consortium comprising Esso, Shell and Elf petroleum companies is seeking to construct a pipeline to bring oil from oil fields in Chad through Cameroon to a port on the Gulf of Guinea. The governments of Chad and Cameroon are also participating in the consortium in the hope that construction and exploitation of the pipeline will create job opportunities and provide revenue for their economic problems. The World Bank has been asked to provide part of the project's financing in order to reduce financial risks associated with investing in the project. The project is estimated to cost 20 times the national budget of Chad.

The pipeline, which will traverse some of the continent's last remaining rainforests, is opposed by a global coalition of some 70 NGOs from the United States, France, Switzerland, Germany, Cameroon and other countries. An environmental assessment carried out in order to qualify for World Bank funds has drawn fire for *inter alia* failure to carry out adequate consultations with local indigenous communities, including pastoralists, who face displacement by the project.

An independent review of the EA by a Netherlands commission pointed out a number of gaps. It raised concern about local capacity to monitor project implementation and recommended establishment of an international advisory group (IAG) to assist in this regard. In particular, it noted the need to monitor compliance with the Bank's internal operational directives and policies on environmental assessment and management, poverty alleviation, resettlement issues, indigenous people, forests, natural habitats and public participation in the project.

36. Another important tool when FDI is intended for an existing operation is the environmental audit. A pre-property transfer environmental audit is part of a buyer's due diligence efforts. It is used to identify and quantify the environmental liabilities at a site, including any past environmental damage (PED), *e.g.*, soil or groundwater pollution from past operations. An integral part of the environmental audit is determining whether the facility meets with and satisfies all government requirements and regulations in this area, including conditions of operating permits.

37. Once environmental problems are identified, the investor (and environmental authorities) must decide how to control any risks of future harm. Risk assessment is a method for determining the type of harm that might result from the problem and the probability of that harm occurring. It can be useful for setting priorities for remedial action.

38. The environmental audit enables the buyer and seller to agree on a fair price for the property, including how to allocate responsibility for the environment-related problems. If the seller is the state, as in privatisation, it can be possible to structure specific environmental solutions into the deal itself.

39. In several CEE countries, notably Romania and Bulgaria, environmental audits are now mandatory whenever an industrial property changes ownership. It is increasingly common in the region for the sale of assets to a private investor to be made contingent on a package of social, environmental and investment commitments. As in the EIA process, the schedule of agreed environmental measures may become an integral part of the plant's operating permit.

40. The tools to control environmental risks from FDI described above often require technical expertise that may be hard to find inside environmental protection agencies. In several CEE countries, the demand for local experts to carry out environmental audits and environmental impact assessments created a number of new employment opportunities in environmental consulting.

MDK Copper Smelter in Pirdop, Bulgaria

The MDK Copper Smelter in Pirdop, Bulgaria has been the source of a range of environmental problems, including during its years of operation under state ownership. The plant's past operations left millions of tons of tailings and slag contaminated with heavy metals and stored without precautionary measures. The most critical environmental threat is posed by a large settling pond brimming with semi-liquid wastes contaminated with heavy metals. An overflow or break of the unstable dam could spew arsenic-contaminated sludge into a river feeding the drinking water supply of Plovdiv and other large towns. In addition, the plant needs considerable investment to address current pollution problems.

Bulgaria's Privatisation Agency (PA) looked for a strategic investor to modernise the plant. Since national privatisation legislation indemnifies buyers of state-owned property from liability for past environmental damage (PED), the PA also wanted clarity concerning the state's possible liability for PED. In accordance with Bulgaria's environmental legislation, an environmental audit was carried out during preparations for privatisation, to establish the extent of PED and related liabilities and to identify necessary measures to address existing environmental problems.

The successful bidder, Union Minière of Belgium, sought assurance that the Government would cover the cost of any necessary clean-up. The World Bank helped facilitate the deal by structuring an arrangement for PED clean-up that reduced risks for both the investor and the Government and that will result in larger overall revenues for the Government than previously expected.

The Government endorsed an environmental management plan prepared for MDK-UM that committed the company to taking a number of measures and investments to improve the company's environmental performance and bring it into regulatory compliance. After reviewing the environmental audit, the Ministry of Environment issued a Decision obliging MDK-UM to implement the recommended PED remediation plan and established a schedule for improving the plant's environmental performance. The Decision became a condition of the plant's operational permit.

Total cost for emergency remediation of the unstable sludge pond and for clean-up of critical PED was estimated at US\$25 million. This amount was set aside from the purchase price into an escrow account. A World Bank loan to the Government provided further assurance that money would be available for clean-up. The National Trust EcoFund (set up on the basis of a debt-for-nature swap with the Swiss Government) provided some grant financing and agreed to provide ongoing oversight and technical support for the arrangement, on behalf of the Government.

The MDK-UM is responsible for carrying out the clean-up itself. It pays contractors up front and submits invoices to the escrow agent and the NTEF, for reimbursement from the escrow account. Funds from the Bank loan are released to the Government as the remediation work proceeds.

The agreement specifies that World Bank public procurement procedures must be followed. These procedures -- though considered cumbersome by MDK-UM -- are aimed at protecting the Government's interest by keeping clean-up costs down. The remedial work now under way is expected to cost less than the amount in the escrow account. All unspent funds will be returned to the Government after satisfactory completion of remediation.

41. The introduction of Western-style permitting of industrial installations based on an evaluation of the technical feasibility of various pollution reduction measures also requires specific expertise. Environmental ministries may need to develop considerable technical capacity, including familiarity with industrial processes, in order to understand the environmental problems faced by existing industries and to determine appropriate conditions for operating permits.

42. There is in this regard a need for internationally recognised standards for use by both FDI source and host countries to provide potential private sector investors with predictable, consistent and clear rules concerning their environmental responsibilities. One important effort in this area is the World Bank Group's *Pollution Prevention and Abatement Handbook 1998: Toward Cleaner Production*. Another significant international effort is UNEP's efforts to develop internationally recognised guidelines on best environmental practices for various industrial sectors.

43. Also needed are more guidelines on how concessions for resource exploitation can be based on principles of sustainable development. The Forest Stewardship Council's certification scheme for sustainably produced wood products is worthy of note in this regard.

44. One rule of thumb concerning the level of standards with respect to investments is that all new "greenfield" investments should comply with internationally recognised environmental standards for that sector, in view of the fact that retrofitting a plant is more expensive than designing and building it right in the first place.

45. A more difficult question concerns the level of standards to apply to existing plants undergoing upgrading of technology. In some low-income countries, local investors have sought to bring in "dirty processes", e.g., used or outdated technologies no longer in compliance with home country standards. In such cases, government decision makers need to weigh the potential cost of any pollution that may occur, including public discontent if pollution is excessive. In Phuket, Thailand, for example, an IFC and private bank-financed tantalum smelter under construction was burned to the ground by local residents concerned about the smelter's possible impact on the local environment.

46. In certain instances, and especially where the risk of environmental damage is significant, investors may be asked to put up performance bonds or other guarantees that remedial steps will be taken, should damage occur. Clear rules concerning private responsibility for damage to the environment from economic activities will also send a signal that investors will be expected to operate without causing unacceptable harm to the environment.

47. TNCs that do not take care in their overseas operations may find themselves in trouble in home country court systems. Lawsuits have been filed against Texaco by rainforest Indians from Ecuador and Peru, joined by the Ecuadoran Government (Appleson, 1998). The Indians claim that a Texaco subsidiary dumped an estimated 30 billion gallons of toxic waste into their environment while extracting oil from the Ecuadoran Amazon between 1964 and 1992. If Texaco loses, clean-up costs, compensation for devastation to the rainforest, and alleged increased cancer risks could lead to a claim exceeding US\$1 billion.

48. Finally, given the importance of transparency and public participation in ensuring environmentally sound project design and operations, host countries should consider measures to ensure a supportive legal environment so that NGOs can act as constructive and independent partners in the effort to achieve sustainable development.

Management of Environmental Risks Incurred in Financing FDI: The Role of IFIs and Home Countries

49. The fast pace of globalisation, the competition for FDI, and the sheer size of many TNCs can make it difficult for a host country acting alone to set in place adequate environmental controls over incoming FDI. Pressure is therefore mounting on other stakeholders, including investors' home countries and international actors, to take a larger share of responsibility in this area.

50. One argument for this is that many types of FDI do not occur without some form of governmental, bilateral and/or multilateral co-financing, risk insurance and guarantees. In particular, most large infrastructure projects are structured on a “non-recourse” basis: private commercial banks approached for financing do not have access to the parent company’s assets in the case of project failure and loan default. Such private financing is often not available unless parts of the project’s financial risk are covered through publicly financed export credit and investment insurance agencies, and/or through private sector support provided through international financial institutions (IFIs).

51. On the international front, the IFIs have been in the forefront of taking account of the environmental impacts of their project development and lending activities. Today virtually all have environmental guidelines in place for helping to assess environment-related risks prior to determining which projects to finance.

52. For example, the World Bank requires all proposed projects to be screened to determine their potential environmental impact. This includes private sector projects financed through the Bank’s International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA). Environmental assessments are required for projects identified as posing significant environmental risk. The result of the EIA may lead to mitigation efforts being built into the project deal, as well as support for developing the home country’s institutional capacity for environmental protection.

53. The scope of home countries’ responsibility if a TNC’s activities abroad cause environmental damage is a more-debated issue. Some home country governments have argued that any unilateral measures would be patronising and impinge upon the sovereign right of host countries to take their own decisions concerning FDI.

54. Still, a consensus has emerged over the years that governments of home countries do have certain responsibilities if commercial activities originating on their territory could cause environmental problems in another country’s territory. An example of this is the Basel Convention obligation that countries of origin must repatriate shipments of waste that cannot be safely handled or disposed of in the country of destination.

55. In recent years, attention has focused on the role of national export credit agencies in providing capital for home country investors seeking new opportunities abroad. Total annual commitments of export credit agencies have quadrupled over the past decade, from some US\$26 billion in 1998 to US\$105 billion in 1996.² In other words, the role of export credit agencies (ECAs) in catalysing private sector finance is even greater than that of the multilateral development banks. Unfortunately, very little is known about the amounts of financing covered by ECAs on a project by project, sector by sector, or even country by country basis. Most countries’ ECAs operate without transparency or accountability, and with little input from national development assistance agencies and ministries, let alone environment ministries.³ Only a few have environmental guidelines similar to those in place in the IFIs.

56. International pressure is mounting for development of common environmental assessment policies, guidelines and standards. The aim is to ensure that FDI will be adequately assessed for environment-related risks before government credit or guarantee schemes are used to support private sector project financing. The OECD’s lead in this effort should be recognised.⁴

57. So far most ECAs have resisted taking action in this area, maintaining they do not have the technical capacity to conduct environmental reviews or to evaluate common standards, and that adding technical capacity will make the review process too cumbersome, bureaucratic, or politically impossible. But capacity already exists within national environmental and development assistance ministries that

could be tapped via interagency co-operation. In any case, without a common approach, one or more ECAs could be put at a competitive disadvantage if they institute more rigorous, comprehensive environmental assessment.

58. Even where ECAs have taken decisions in view of the potential or actual environmental impacts of an investment, the actual leverage exerted on the investor to follow better environmental practices may be limited. For example, in 1996, the US Overseas Private Investment Corporation (OPIC) suspended risk insurance for the US mining company Freeport McMoRan's gold mine operation in Indonesian New Guinea citing the "unreasonable" major environmental, health and safety hazards created by the company's operations, including the dumping of over 120,000 tonnes of toxic mine waste into local rivers every day (Project Underground, 1997). Shortly after the insurance had been reinstated, Freeport cancelled all of its insurance by both the World Bank and the US government rather than face an independent investigation into its activities in Indonesia.

59. One additional proposal is for home countries to encourage foreign investors to use more stringent home country standards, wherever they operate in the world. Since many TNCs have already instituted a uniform environmental management system throughout their global network, a home country policy of this nature could build on and extend this experience.

60. International attention to a project's environmental aspects is particularly important where a host country's framework of environmental rules and capacity for enforcement is still rudimentary. A number of IFIs and bilateral donors are willing to assist host countries in building the institutions and expertise necessary to effectively manage the environmental impacts of economic activities.

61. Driving the effort to ensure that home country and international institutions act responsibly with regard to FDI and its impacts is an emerging global civil society based on the same cross-border flows of information that are transforming the global economy. The increasing use of international coalitions of NGOs, parliamentarians and unions to focus attention on the environmental impacts of a proposed or ongoing project gives evidence to this.

62. This prospect of a global public concerned about the environmental consequences of foreign and domestic investment and the adequacy of opportunities for participation in decision making by those affected is an interesting development. One effort has coalesced around the proposed Chad-Cameroon oil pipeline, where a coalition of environmental NGOs from North America, Europe and Africa has come together to raise questions about the validity of an EIA process where the affected public is unable to participate effectively because of *e.g.* low literacy rates.

63. If governments and investors react to restrict information and access to decisions, the consequence may be more blockage of investment projects. A more enlightened response will be to ensure free flow of information and transparency of decision making, and to hold investors in both manufacturing and resource extraction industries to high international environmental standards, wherever they operate.

Conclusions

64. Governments -- both in the host country and the source country -- have a critical role to play in controlling the environmental impacts of FDI. However, most examples of integrating environmental concerns into proposed investments cited in this paper were the result of pressure from IFIs and citizens groups, and not from national officials. There are still problems with getting host country officials responsible for economic and investment policy to take environmental concerns seriously.

65. At the same time, environmental officials are often inexperienced or otherwise reluctant to effectively push their concerns into national debates on economic policy. In short, more needs to be done in this area. In particular, more attention needs to be paid to the building of regulatory frameworks and development of the necessary institutional capacity so that host countries can hold investors accountable for the environmental impacts of their activities.

66. The regulatory tools at hand for addressing environmental concerns in the development process are useful, but not a panacea. To be effective, the EIA process must be carried out at an early stage in the project's development, when changes in the project or investment design are still possible. It must also be carried out under conditions of transparency and accountability, so that affected stakeholders can understand the implications of a proposed project and have an opportunity to comment in the confidence that their views will be taken into account. When the EIA process is subverted or curtailed, public opposition may raise new obstacles to the project.

67. One of the most interesting developments of recent years is the growing role of other stakeholders -- including IFIs and global coalitions of NGOs -- in bringing pressures for more transparency and accountability. Multinational investors that do not adequately address environmental issues in investment decisions may find themselves the targets of concerted global actions from either of these groups.

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NOTES

- ¹ In 1995, 75 per cent of private capital flows went to just ten countries.
- ² Boote & Ross, *Official Financing for Developing Countries* (Washington DC: International Monetary Fund, Feb. 1998), p. 13. *Cited in Rich, ibid.*
- ³ Ironically, almost all OECD countries' bilateral development assistance agencies have environmental assessment procedures already in place. The fact that most national ECAs do not carry out environmental assessments is a striking inconsistency.
- ⁴ In 1998, the OECD Working Party on Export Credits and Credit Guarantees agreed to address environmental concerns in its deliberations.