

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

Conference «Non-State Actors as Standard Setters: The Erosion of the Public-Private Divide» | February 8-9 2007 | Hotel Hilton Basel, Switzerland

## Environmental Standards Courtesy of Northern Financial Institutions – Insular Phenomenon or the Future of Standard-Setting in the South?

Marcus Schaper, University of Maryland, USA

*Please do not cite without author's permission.  
Contact: schaper (at) umd.edu*

### 1. Introduction

This paper examines the application of financial leverage in greening infrastructure development in developing countries. The establishment of environmental policies for multilateral development banks (MDBs), export credit agencies (ECAs) and private banks has attached green strings to the bulk of international financing available for large infrastructure projects. The consequence is that many infrastructure projects in developing and transition countries are now subject to environmental scrutiny before financing for such projects is granted – even if such environmental regulations are weak or absent in the recipient country. All three sets of policies share a common history and apply similar qualitative and quantitative standards for project evaluation. Arguably, environmental policies of the World Bank Group have spread to other providers of finance. This has occurred as a consequence of widespread concern about the environmental performance of such projects in the past. This move towards environmental rules for international finance has coincided with an expansion of private financing available for types of projects that were predominately financed with official development assistance (ODA) and by MDBs previously. Also implementation of ECA (public policy) and private bank standards (private-sector policy) is left to private-sector actors.

In previous papers, I have assessed differences in the implementation of these standards and the different manifestations of power in setting the standards. The first paper (Schaper 2006) assessed their monitoring and compliance systems. Purpose of that paper was to assess how substantially similar environmental standards can result in considerably different environmental policies when adopted by purely public, mixed private-public, or private financial actors. Especially the role of transparency provision as a basis for monitoring and enforcement as well as the resulting role of non-state actors in watching about the implementation of these rules was of concern. The second paper (Schaper 2005) traced differences in implementation to the diverging

nature of the actors setting them and to the power constellations which prompted their enactment.

This paper takes a Southern perspective. From such a point of view, the (i) legitimacy of such policies, (ii) the distribution of costs and benefits, as well as (iii) the impact on domestic-level institutions in client countries are of central concern.

All three sets of policies were mostly designed by Northern actors with little or no input from the client countries. Yet, these policies and standards almost exclusively affect environmental condition in client countries – even in countries with no applicable environmental policies of their own. Beyond the normative question of the desirability of such rules, one needs to ask under what condition the projection of such standards into a polity – which may have chosen not to enact such policies – is legitimate.

The benefits of managing reputational risks resulting from environmental and social risks associated with projects go almost exclusively to Northern providers of finance whereas the costs of bringing projects into compliance with environmental and social rules are borne by the Southern project sponsors and developers.

Finally, an important question is whether such rules can have lasting effects on client countries beyond the projects to which they apply. Can they diffuse into domestic-level institutions in the client countries? Do the consultation requirements for affected communities have an effect on civil society mobilization?

### 2. The Cases: Environmental Standards for International Financial Institutions

NGO campaigns aimed at greening international financial institutions have resulted in the current environmental standards for the World Bank Group, ECAs, and private banks. The first target of a campaign led by the National Resources Defense Council (NRDC), the National Wildlife Foundation (NWF), and the Environmental Policy Institute (later merged with Friends of the Earth) in the mid-1980s was the World Bank. Once the World Bank implemented considerable environmental policy changes

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

Page 2

by the late 1980s, the campaigns began to pressure other financial institutions, including other multilateral development banks, ECAs, and private banks. The result of these highly successful campaigns has been a proliferation of environmental policies among most financial institutions active in international project finance.

## *2.1 Regulation by international organizations: Environmental Policies of the World Bank Group*

The World Bank Group, consisting of the International Bank on Reconstruction and Development (IBRD), the International Finance Corporation (IFC), IDA, and MIGA, has long been the primary target of a NGO campaign aimed at “greening” international finance. The IBRD has been especially pressured to bring environmental concerns into its project loan operations. Starting with a lone environmental specialist in the 1970s, it has come a long way, having since developed a comprehensive set of environmental policies (see Rich 1994; Wade 1997; and Gutner 2002).

The environmental policies of the IBRD consist of a number of general and sector-specific policies contained in its operations manual. The Bank has also developed the *Pollution Prevention and Abatement Handbook* (PPAH), which provides both quantitative and qualitative information regarding acceptable pollution levels as well as mitigation strategies. Following U.S. pressure, environmental rules and procedures were designed to include broad transparency provisions and opportunity for public comment on projects and policy development. In addition to set environmental standards to develop and evaluate projects and “sunshine” as a greening agent, IBRD policies also provide stipulations for an independent inspection panel. The inspection panel acts on requests from the public, and investigates whether approved projects conform to the Bank’s policies.

Besides establishing these policies in response to pressure by NGOs and governments, the Bank has also assumed a leading role in further developing international environmental policies. The World Commission on Dams and the Extractive Industries Review are independent expert panels initiated by the Bank, and which have evaluated the Bank’s and other financial institutions’ involvement in these sectors, resulting in recommendations for future hydropower and mining projects. These recommendations now provide a reference point for such projects, and are likely to become the relevant international norms in these sectors.

Besides the IBRD policies, IFC environmental standards are also of concern, as they build the foundation of the Equator Principles, and ECAs also look to the IFC, as its business is most closely related to that of national ECAs. Initially, the IFC applied World Bank environmental policies, which did not match well with its different type of business highlighted by a controversial dam project in

Chile in the early 1990s. This led to the critical “Hair Report” on its environmental performance in 1997, and the subsequent adaptation of the Bank’s safeguard policies to IFC business (Park 2003). The IFC has recently replaced its safeguard policies dating from 1998 with new environmental and social standards. Its new policies represent a shift from a process-oriented approach to one focused on outcome. This change also represents a shift of environmental review responsibilities from the financial institution to the client – analogous to the ECAs’ and EPFIs’ procedures. Building on the previous safeguards, these standards were expanded to include labor rights, human rights, community health and safety, and even greenhouse gas emissions. IFC policies now also include expanded disclosure requirements, resulting in an increased transparency of IFC operations (see International Finance Corporation 2006).

MDBs were pressured into developing environmental policies by a NGO campaign that succeeded in teaming up with the U.S. government. These policies represent a delegation of a regulatory task by the U.S. government via the World Bank and its Executive Board to clients of the Bank. By using financing by the World Bank as a lever, these policies in effect regulate the environmental impact of development projects in client countries. Although they operate within the realm of state authority, they only appear legitimate when viewed from an perspective of intention-based accountability (Goodin 2003) or output legitimacy (Scharpf 1998).

The IBRD and IFC have both institutionalized compliance mechanisms and broad disclosure policies. These rules provide for monitoring of the institutions’ compliance with their policies from the inside and also enable external actors to scrutinize Bank operations. Through the IBRD’s inspection panel and the IFC’s Compliance Advisor/Ombudsman, both institutions provide the affected public with opportunities to trigger independent reviews of problematic projects. Thus, the Bank’s policies provide for internal as well as explicit outside compliance monitoring and enforcement.

## *2.2 Regulation by governments: the Common Approaches for Officially Support Export Credits*

Government-backed export credits and export credit guarantees play an important role in providing exporters with access to emerging markets in high-risk countries, especially in developing and transition countries. Transactions with firms in these countries often involve political risks that commercial insurers are not willing to cover at reasonable cost. Yet, most firms cannot afford to embark on such transactions without some insurance against non-payment to gain financing from banks. Governments fill this void by acting as a bank of last resort and providing domestic exporters with export credits, or by providing insurance against political and commercial risk in the form of export credit guarantees. The category of ECAs

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

Page 3

encompasses bank-type organizations, government-backed insurers, as well as combinations of these two ideal-types (Evans 2005; Walzenbach 1999).

Different types of ECA business can be roughly distinguished by the time frame for which support is granted. Short-term business includes transactions of up to one year, medium-term transactions are those of one to five years, and long-term business refers to transactions of five years or more. For the purposes of this paper, the long-term business is of interest, as this includes controversial infrastructure projects which have led to the establishment of the *OECD Recommendation on Common Approaches on Environment and Officially Supported Export Credits*, the international agreement establishing common environmental policies for ECAs. Similar to the Arrangement, the Common Approaches apply to transactions with repayment terms of more than two years. Its provisions require classification of projects in which individual ECAs have a share of more than 10 million SDR, or which are located in sensitive areas.

In 2003 total medium- and long-term export credits amounted to approx 43 billion SDR in 2003 for all OECD members combined. This is similar to the 1999-2003 annual average. More than half of this volume (58 per cent in 2003 and as much as 69 per cent in 1999) was support for exports to developing countries (OECD 2004: 3-4). Long-term business amounts to approx. 14 billion SDR (1999-2003 average), of which between 62 per cent in 2003 and 80 per cent went to transactions with developing countries (OECD 2004: 10-1). Within the long-term portfolio, the transport sector (particularly air transport) represents about half of 1999-2003 export credits, energy generation, and supply amounts for up to one quarter, and the industrial sector receives another quarter of long-term export credits (OECD 2004: 18). In 2003, 132 projects qualified as category A or B projects, requiring environmental reviews. These projects made up about half (7114 million SDR) of 2003 long-term business (OECD 2005a: 2).

As the availability of ECA support can “make or break” a deal by facilitating access to inexpensive financing, all major exporting nations have set up ECAs to assist their domestic supporters. It is not surprising that, in the absence of common rules on the conditions offered by ECAs, a competition over the conditions developed and led to outright subsidies of exports in an effort to help one’s own exporters a bit better off than the competitors. This subsidy race resulted in the establishment of common rules of finance in the *Arrangement on Officially Supported Export Credits* under the umbrella of the OECD. Since its inception in 1978, the agreement has continuously developed by squeezing ever more subsidies out of ECA terms and harmonizing the rules under which ECAs operate.

In the late 1990s, environmental requirements proved to be another harmonization challenge for the Export Credit Group within the OECD. The United States Export-Import Bank had established environmental standards in 1995 following a 1992 Congressional mandate, and thereby created a burden for U.S. exporters seeking support from the Export-Import Bank that their competitors in other countries did not have to deal with. After 5 years of negotiations, all parties agreed on the Common Approaches which require members’ ECAs to screen and classify all applications for cover exceeding 10 million SDR for their environmental impact and conduct environmental reviews of these projects if they fall within two of three categories of potential environmental impact. The Common Approaches do not contain quantitative or qualitative criteria for deciding whether environmental impacts can be considered acceptable or not, but they do reference a number of international standards, including World Bank environmental policies.

By making support conditional on the fulfillment of environmental requirements, ECAs enlist domestic exporters’ influence on project sponsors to bring projects into compliance with their environmental standards. This corresponds to what Gilboy (1998) calls “compelled third-party participation”: exporters becoming liable for the environmental performance of the projects to which they supply goods and services if these are to be covered by ECAs. Using ECA cover as a lever, the government has thus delegated this regulatory task via its ECA to the exporter.

The Common Approaches are a “gentlemen’s agreement” of a non-binding nature. Consequently, compliance procedures are rather weak and limited to reporting. Members to the Common Approaches report annually to the ECG Secretariat on their classification of projects and on which standards were applied in making cover decisions. Results of these national reports are published by the secretariat in aggregated form, making it impossible for outsiders to judge individual country performance. The review process enables peer monitoring, but it does not provide for external validation.

While the Common Approaches lack a formal compliance mechanism beyond mandatory reporting to the secretariat, transparency provisions in the environmental review process of individual applications empower the public to monitor ECA operations. These transparency provisions were promoted by the United States and haven proven to be a controversial element during the negotiation of the Common Approaches. The transparency provisions essentially provide for an implicit yet effective compliance mechanism by raising the reputational and political risks of non-compliance. At the same time, this outsourcing of compliance monitoring to non-state actors raises a number of questions (see below and Görlach, Knigge, and Schaper 2007).

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

## 2.3 Industry self-regulation: the Equator Principles

Initiated by the World Bank Group's International Finance Corporation (IFC) at a meeting in London in October 2002 a number of private banks including ABN AMRO, Barclays, Citigroup, and WestLB developed principles as a banking industry framework for addressing environmental and social risks in project financing (see Wright and Rwabizambuga 2006; Amalric 2005; and Martin in this collection). Equator Principles Financial Institutions (EPFIs) consider the Equator Principles a tool to manage the credit risk and reputation risk associated with financing development projects. In July 2006, the principles were updated and expanded from their initial 2003 version to include monitoring and reporting requirements among other changes.

By adopting these principles, financial institutions commit themselves to providing loans only to projects that adhere to the principles. These ten (nine in the 2003 version) principles are similar to IFC guidelines (see The "Equator Principles" 2006)

1. projects are categorized based upon the IFC environmental and social screening criteria;
2. for all category A (significant adverse environmental impact) and category B (less adverse environmental impact) projects the borrower completes an environmental assessment;
3. environmental assessments evaluate projects based on IFC environmental standards or host-country standards in high-income OECD countries;
4. for all category A and some category B projects an action plan and environmental management system is prepared;
5. for all category A and some category B projects stakeholders are consulted and are provided with access to the environmental assessments;
6. for all category A and some category B projects the borrower establishes a grievance mechanism for groups and individuals from project-affected communities;
7. for all category A and some category B projects independent experts review the assessment, action plan, and consultation process as well as assess compliance with the principles;
8. for all category A and some category B projects the borrower covenants to comply with the principles;
9. for all category A and some category B projects an independent environmental expert is appointed to verify monitoring; and
10. EPFIs report on their implementation of the principles at least annually.

Prior to the review in 2006, the principles applied only to direct loans for project financing of \$50 million or more. The threshold has since been lowered to \$10 million and also includes related services, e.g. advisory services for project finance. As with other voluntary industry stan-

dards, financial institutions choose to adopt the standards and are expected to integrate them into their operations. They need not to make a commitment to any authority or contracting party, and no provisions exist to ensure compliance. Yet the increased disclosure and transparency requirements in the 2006 version of the principles provide outside actors with the tools to enforce compliance through "name-and-shame" tactics.

Compared to the five years the ECG needed to agree on the Common Approaches, the Equator Principles were sketched out in very short time. Possible explanations can be found in the low profile nature of the initial principles, which prescribed no specific procedures and rules beyond requiring the classification of projects and subsequent environmental management plans for certain categories of projects. Combined with the complete lack of compliance mechanisms in their first version, adopting banks would only face minimal costs from the adaptation of the principles regardless of whether or not they intended to implement them. The revised principles, with their new monitoring and disclosure requirements, have raised the bar for EPFIs, as they are now much more open to scrutiny by an interested public.

The Equator Principles are an example of private regulation of the private sector, although they further policies established by public actors for similar purposes. The regulatory task of bringing projects into compliance with the Principles is delegated to the project developer under close supervision by the lead arranger. Thus, in the case of private banks, we witness the shortest chain of delegation among the three sets of policies discussed here. From a risk management perspective, requiring clients to minimize environmental and social risks that could potentially develop into reputational risks makes good business sense. Thus, implementing non-market standards in financial transactions does fit with Goodin's market-based accountability mechanism. However, a potential pitfall is that the EPFIs are likely to be judged based on their stated intention of improving environmental performance of their project loans. As a result, they may find themselves caught between their primary accountability regime (competition) and that of the third sector, based on intentions.

The lack of a secretariat and a formal compliance mechanism among the financial institutions underscores the importance of transparency in the Principles' implementation to enable the institutions to monitor each others' compliance, as well as to provide other actors with information needed to evaluate the financial institutions' performance. With regard to implementation of the principles on the ground, the 2006 Equator Principles equip the financial institutions with fairly strong monitoring tools. However, the formal accountability chain ends at the level of the individual financial institution. Similar to the Common Approaches for ECAs, the Equator Principles' disclosure and transparency requirements create an

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

Page 5

implicit compliance mechanism by raising the reputational risk of non-compliance.

### 3. Impacts of Standards Vary by Region

A crucial difference between environmental standards for access to finance and product or process standards is the leverage the rule-setter has over the regulatory target. When states or firms set product or process standards, their market leverage directly affect producers or suppliers decisions whether or not to conform with the standards: the larger the regulator's control over the market, the greater is his power over the regulatory targets. Environmental standards for access to finance, however, do not regulate access to a shielded market, but merely to support by a cartel of financial institutions. As long as the cartel does not have complete control over the finance market, any number of financial institutions not bound by the rules of the cartel can render them ineffective by providing alternative financing. With respect to ECAs and private banks, the cartels are imperfect: only OECD-member ECAs are bound by the Common Approaches allowing for an increasing role played by non-OECD ECAs such as the Chinese and Indian Exim Banks. The Equator Principles, too, have only limited membership, primarily representing North American and Western European financial institutions. But only in markets which are dominated by financial institutions bound by environmental standards can these be expected to carry much weight.

Regional variation exists within the reach of these standards. Christopher Wright and Alexis Rwabizambuga (2006) have illustrated regional limitation of the Equator Principles. Almost all EPFIs are headquartered in Europe and North America, and their project finance business is also limited in scope: while a majority of Latin American project finance loans are arranged by EPFIs, equator banks play a much smaller role in African and Middle East loans. None of the top ten arrangers of project finance in Asia has adopted the Equator Principles (Wright and Rwabizambuga 2006: 102-3).

Similar limitations apply to export credit standards while MDB policies apply to projects throughout the developing world. The Common Approaches and Equator Principles only apply to projects for which sponsors seek support from equator banks or OECD export credit agencies. Thus these standards only travel as far as there is demand for financing from these institutions. The effects of standards can be expected to be greater in regions in which the bulk of international financing provided is subject to such standards. The smaller the market share of Northern financial institutions, the smaller the likely impact.

In addition to variations in regional impacts one also needs to consider the overall relevance of these financial institutions. A study by the IMF notes:

*"Financial flows facilitated by official export credit agencies are large in comparison with official development assistance and gross lending by international financial institutions to developing countries" (Wang et al. 2005: 2).*

*"However, relative to total capital flows to developing countries or exports, export credits supported by ECAs in industrial countries have been on the decline. Preliminary estimates suggest that new commitments by official ECAs amounted to near 35 percent of total official and private lending plus foreign direct investment to developing countries in the early 1990s; the ratio declined to about 20 percent in 2000-02" (Wang et al. 2005: 7).*

*"New export credit commitments to low-income countries have been declining since 1995, and this trend has not been affected by the world economic cycle. The share of new commitments to low-income countries (excluding India) declined from 15 percent in 1995-96 to about 8 percent in 2000-03. [...] Indeed, a number of ECAs have remained off-cover in many low-income countries, even in HIPCs that have passed the completion point (thereby receiving irrevocable debt relief committed under the HIPC initiative" (Wang et al. 2005: 8-9).*

Table 1 illustrates the low relevance of long-term OECD export credits to Sub-Saharan Africa. Very few projects requiring environmental review under the Common Approaches are supported in Sub-Saharan Africa. Between 1998 and 2003 only six (out of 27) Sub-Saharan LDCs generated enough export credit business so that their annual portfolio exceeded \$10 million SDR for one or more years thus possibly triggering the Common Approaches' environmental screening process by volume (projects in sensitive areas require review irrespective of volume). Five OLICs, four LMICs, and three UMICs also generated enough business that it may have included projects subject to the Common Approaches. Due to the nature of ECG reporting it is not possible to identify the number or share of projects in Sub-Saharan Africa that actually received environmental screening. The OECD reports on environmental reviews are not broken down by recipient country or region.

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

Table 1 Long-Term Export Credits by Country Category (over five years) – (million SDR)

Income Group	1998	1999	2000	2001	2002	2003	2004
Least Developed Countries (LDCs)	59 (0.5%)	205 (1.3%)	169 (1.1%)	700 (5.1%)	156 (1.2%)	179 (1.2%)	48 (0.3%)
Sub-Saharan LDCs	29 (0.2%)	54 (0.3%)	146 (0.9%)	626 (4.5%)	128 (1.0%)	168 (1.1%)	4 (0.0%)
Other Low Income Countries (OLICs)	1,854 (14.9%)	1,495 (9.6%)	526 (3.3%)	638 (4.6%)	992 (7.6%)	1,936 (13.0%)	1,392 (7.5%)
Sub-Saharan OLICs	134 (1.1%)	186 (1.2%)	87 (0.6%)	36 (0.3%)	338 (2.6%)	109 (0.7%)	138 (0.7%)
Lower Middle Income Countries (LMICs)	5,585 (44.7%)	5,320 (34.1%)	6,471 (40.9%)	5,259 (38.1%)	4,767 (36.5%)	3,584 (24.0%)	6,790 (36.4%)
Sub-Saharan LMICs	25 (0.2%)	125 (0.8%)	2 (0.0%)	31 (0.2%)	7 (0.1%)	2 (0.0%)	26 (0.1%)
Upper Middle Income Countries (UMICs)	2,542 (20.4%)	4,280 (27.5%)	4,485 (28.4%)	3,608 (26.2%)	3,644 (27.9%)	3,472 (23.3%)	2,244 (12.0%)
Sub-Saharan UMICs	39 (0.3%)	188 (1.2%)	47 (0.3%)	264 (2.0%)	27 (0.2%)	127 (0.9%)	339 (1.8%)
High Income Countries (HICs)	15 (0.1%)	177 (1.1%)	222 (1.4%)	-	2 (0.0%)	77 (0.5%)	*
<b>All Developing Countries</b>	<b>10,054 (80.6%)</b>	<b>11,477 (73.6%)</b>	<b>11,872 (75.1%)</b>	<b>10,205 (74.0%)</b>	<b>9,561 (73.2%)</b>	<b>9,248 (62.0%)</b>	*
<b>All Sub-Saharan Countries</b>	<b>227 (1.8%)</b>	<b>553 (3.5%)</b>	<b>282 (1.8%)</b>	<b>957 (7.0%)</b>	<b>500 (3.8%)</b>	<b>406 (2.7%)</b>	<b>507 (2.7%)</b>

Source: (OECD 2004, 2005b); author's calculation of Sub-Saharan figures; classification of economies from the July 2006 World Bank List of Economies (<http://siteresources.worldbank.org/DATASTATISTICS/Resources/CLASS.XLS>; accessed 12/14/06); LDC classification from the United Nations LDC list (<http://www.un.org/special-rep/ohrls/lcdc/list.htm>; accessed 12/14/06); \*= cannot be clearly identified due to changes in OECD reporting.

While OECD ECAs engagement in Sub-Saharan Africa is limited, the Chinese Exim Bank – which is not party to the Common Approaches – is active in power generation, mining, and energy projects throughout Africa. Now among the top three ECAs by volume of new commitments, its lending volume has increased eight-fold from 1995 to \$8 billion in 2003 (Wang et al. 2005: 12). NGOs criticize the China Exim Bank for both its human rights and its environmental record.

*The Exim Bank's portfolio includes projects such as the Merowe Dam in Sudan, the Imboulou Dam in Congo-Brazzaville, the Tekeze Dam in Ethiopia, the Lower Kafue Gorge Dam in Zambia, the Yeywa Dam in Burma, and the Nam Mang 3 Dam in Laos. China Exim has also signed deals for projects in other countries with human rights problems, including Nigeria (Palantano and Omotosho power plants) and Zimbabwe (Zimbabwe Iron and Steel Company).*

*[...] One case in point is Merowe Dam, Africa's largest new hydropower project, which is currently being financed by China Exim. Located in Sudan, the project will create a reservoir with a length of 174 kilometers, generate electricity with a capacity of 1,250 megawatts, and displace 50,000 people. In spite of the project's large dimensions and potential social and environmental impacts, no independent environmental impact assessment was ever carried out. One of the companies involved in the project prepared a brief environmental assessment report. In viola-*

*tion of Sudanese law, the technical arm of Sudan's Environment Ministry did not receive a copy of the assessment, and was not able to review and clear the project. (Bosshard and Chan-Fishel 2005)*

Moss and Rose list a number of large pending projects which may involve support by the China Exim Bank:

- A possible \$1.2 billion in new loans to Ghana, including \$600 million for construction of the Bui dam;
- \$2.3 billion in total financing for Mozambique for the Mepanda Nkua dam and hydroelectric plant, plus another possible \$300 million for the Moamba-Major dam;
- A \$1.6 billion loan for a Chinese oil project in Nigeria;
- \$200 million in preferential buyers credit for Nigeria's first communications satellite;
- A \$2 billion line of credit to Angola, with the possibility of another \$9-10 billion;
- Reports of loans and export credits for other projects in Congo-Brazzaville, Sudan and Zimbabwe. (Moss and Rose 2006)

Clearly, the effect of the Common Approaches is limited in Sub-Saharan limited due to both the limited engagement of OECD ECAs in Africa. At the same time, the Chinese Exim Bank provides an alternative throughout Africa. Sudan, for example, is receiving US\$ 387 million in export credits from the China Export Import Bank for

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

Page 2

the construction of the Merowe Dam alone (Leadership Office of the Hamadab Affected People, International Rivers Network, and House 2007: 4) – more than 11 times as much as combined OECD export credits to Sudan between 1998 and 2005 (OECD 2007).

In addition to China's increasing role in providing export credits, India is also playing an ever more important role. The China Export Import Bank approved loans with a volume of \$20 billion in 2005 (Bosshard 2006). This ranks the Chinese ECA among its top three OECD competitors Korea (\$22 billion in 2005), Japan (\$20 billion in 2005), and Germany (\$19.5 billion in 2005) (see OECD 2007). "Between 1994/95 and 2003/04, the [Indian Export-Import] bank's loan disbursements grew almost 30-fold, from \$48 million to \$1.5 billion" (Wang et al. 2005: 12). India does not yet compete with the big OECD players in terms of export credit volume, but it already outpaces twelve smaller OECD ECAs such as those of Finland, Denmark, and Norway.

#### 4. Standard-Setting Process Impacts Legitimacy

A considerable share of international financing is now subject to environmental policies courtesy of the U.S. government and a NGO coalition concentrated in Washington, DC. Furthermore, these policies regulate environmental conditions inside polities which had little or no input into the development of these rules and may object to them. Finally, by employing transparency as an informal compliance mechanism, these policies rely to a large extent on non-state actors in monitoring compliance and enforcing the application of these environmental rules. All three aspects raise important questions relating to the legitimacy of these policies.

##### 4.1 *Pushed by a small NGO campaign*

The NGO campaigns have made a range of financial institutions accountable to the public. However, this means that these institutions are now subject to environmental mandates and public scrutiny even if this contradicts their primary missions. Private banks are profit-seeking institutions which are primarily accountable to their shareholders. Adding the interested public as an additional constituency to which banks are expected to be accountable to may conflict with their primary objective in maximizing profits for their shareholders. MDBs have a mandate which is more conducive to public input: they were set up by governments and receive funding from donor governments. Yet, only part of their business is in making grants. Where loans are disbursed, MDB banks operate similar to commercial banks when viewed from the client perspective. Yet, this non-concessional business is subject to the same environmental rules as their aid business, despite the self-sustaining nature of the loan business. ECAs are public agencies and thus should be most amenable to public control over their operations. However, the environmental mandate ap-

pears to be at odds with ECAs' primary mission of job creation through export promotion.

While public accountability in itself may be problematic for these institutions, the role of a small group of NGOs in bringing about such sweeping changes needs to be scrutinized. Both the ECA and the MDB campaigns received domestic legitimization through the involvement of the U.S. Congress and U.S. government in furthering the campaign objectives. While the Congressional endorsement does render U.S. government initiatives in these respects legitimate from a domestic perspective, the situation is not as clear internationally. Harmonization of ECA standards proceeded internationally with G7 and OECD ministerial council endorsements eventually leading to an international agreement under the umbrella of the OECD. Thus, these standards have been legitimized by the relevant international bodies. Environmental policies for MDBs were championed by NGOs and endorsed by Congress. However, different to the ECA standard-setting process, change came about through unilateral pressure exerted by the U.S. government. Viewed from a domestic perspective this was a legitimate and appropriate behavior; however, viewed from an international perspective, this behavior lacked legitimization through a relevant international body. Private banks finally were coerced into developing the Equator Principles by NGOs without government intermediation. Though a political act, this campaign took place entirely in the sphere of private politics. Given the lack of generally accepted accountability relationships among sectors outside the sphere of public politics, the legitimacy of NGO campaign on private banks is more difficult to assess. However, in corporate governance, the main accountability relationship is that of management to shareholders. Such a relationship does allow for shareholder activism, but it does put a question mark behind the legitimacy of activism by non-shareholders.

Applying output rather than input legitimacy would justify all three campaigns but this also raises the question for the most appropriate legitimacy concept. Similarly, an emphasis on intention-based rather than action- or results-based accountability would validate the MDB and private bank campaigns. Following Goodin's argument that NGOs primarily operate under an accountability mechanism based on intentions certainly validates the private bank campaign. However, such an argument becomes more difficult with regard to the U.S. government's role in pressuring the World Bank as the prevailing accountability mechanism for state actors is based on the legality of actions.

Thus far, I have equated concerns voiced by the NGO campaigns with those of the public at large. However, only a few of the NGOs involved in the campaigns have large membership bases who they can claim to represent. Most of the organizations in the networks are specialized advocacy groups with a small staff and no or

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

Page 3

small membership. While they can claim to work for the common good and to represent widely held grievances, they do not possess the input legitimacy for making political demands that groups with large membership have.

All three campaigns were predominantly funded by two foundations, the Charles-Stewart-Mott Foundation and the Wallace Global Fund (does not support BankTrack). The Mott Foundation's program area *Reform of International Finance and Trade Institutions* states that these must "become more responsive to environmental and social concerns [...]." The foundation "support[s] the efforts of non-governmental organizations to influence global policies and institutions [...]" (Charles Stewart Mott Foundation 2005). Similarly, the Wallace Global Fund's program areas include "shifting public and private financial flows out of environmentally harmful investments and into environmentally sustainable ones, by influencing multilateral lending and credit institutions and global trade mechanisms, and changing U.S. tax policies and corporate subsidies" (Wallace Global Fund 2004).

Those NGOs without a membership base of their own are ultimately only accountable to their funders. Which, in the case of these foundations, are organizations with a large capital stock and activist mission in their program statements who are only accountable to their boards. Adding Goodin's concept of intention-based accountability as an extra layer makes these NGOs accountable to others in the same network organized around shared norms and beliefs. Thus, NGO activities are legitimate as long as their intentions are in concert with the shared norms within the network.

## 4.2 ECAs: Transdomestic Regulation

Haufler states that financial sector "standards agreements are based on consensus among interested parties, and they are voluntary but widely accepted; they are a form of self-enforcing agreement" (Haufler 2005). This characterization applies to environmental policies only to a limited extent: private banks were coerced into establishing green policies by NGOs and sought to pre-empt government intervention; the World Bank was coerced into its environmental leadership role by the U.S. government; and ECAs did in fact establish consensus and rely on the self-enforcing nature of the Common Approaches. However, ECA rules are limited in their inclusion of "interested parties" in the agreement.

ECA standards are transdomestic in nature. These standards are domestic regulations that are aimed at domestic exporters. Yet, their impact occurs elsewhere: environmental conditions in another polity are being regulated. Furthermore, since the exporters need to make environmental impact information available to their ECA, project sponsors need to conduct environmental impact assessments, even if their domestic regulations do not provide for such a requirement. By means of these environmental standards, advanced industrialized countries project their environmental regulations into other polities.

In most states, these rules were devised without input from those polities in which the standards have the most direct impact. Similarly, the international negotiations on harmonization of these standards were conducted in the context of the OECD without consulting the recipient countries. Turkey is among the states represented in the OECD Export Credit Group because it operates its own ECA. Yet, Turkey is also recipient country of numerous ECA-supported projects. As such, the Turkish delegation was opposed to standards established in 2001 and in 2003. Both times it felt its interests as a recipient country threatened by them.

### 4.2.1 Transdomestic Regulation Explained

Traditional classifications of domestic, foreign, and intermestic policy are somewhat limited in dealing with a number of modern regulative phenomena that do not stop at national borders. Analysts have applied the labels of "domestic foreign" and "foreign domestic" policy. Yet, labels as such are oftentimes only applied in an ad-hoc fashion without considering the implications of policies beyond the domestic-foreign divide. In this section I lay out a way to characterize such policies and explore the theoretical and practical implications of these policies where the targets of regulation and policy-making processes are (deliberately) disjointed. This argument is not about domestic sources of foreign policies but rather about policies that are targeted into the borders of another sovereign and at the same time are formulated as domestic policies. In its simplest form, these policy types can be arranged in a 2x2 table (see Figure 1).

*Transdomestic policy* defies the traditional policy categories: policies appear to be domestic in nature, yet their deliberate effects occur within the borders of another sovereign state. This quality leads to unusual implications for state sovereignty. Little or no concerns exist for the state in which these policies are devised, and the state in which the policies will have their effect have little or no influence on the policy-making process. Infringement of state B's sovereignty comes at no cost to state A; state B meanwhile suffers from an infringement on its sovereignty with little or no means of remedying it. Whether it is foreign domestic or domestic foreign policy is a question of perspective: for A it is domestic foreign, i.e. domestic policy with effects elsewhere; for B it is foreign domestic.

Figure 1: Categories of policies

Impact Nature	Domestic arena	Foreign arena
Domestic	Domestic policy	Transdomestic policy (domestic foreign)
Foreign	Boomerang policy (foreign policy that targets your own domestic arenas)	Foreign policy (deliberately external)

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

Page 4

Furthermore, foreign people in state B have no voice in this domestic policy process unless they can forge transnational coalitions with domestic partners in state A.

*Boomerang policy* is targeted at regulating behavior at home. However, it is formulated and implemented as foreign policy. Policy-makers may pursue this option if traditional domestic regulation would come at high political cost, or if domestic veto players make it impossible to regulate in a purely domestic fashion.

The transdomestic nature of ECA environmental policies is what makes them appear unjust from the perspective of the recipient country: a foreign power intentionally targets its domestic politics. Thus, those aspects of ECA rules which go beyond recipient country regulations are likely to be considered illegitimate from the recipient country perspective. Though these rules are substantially similar to MDB and ODA conditions, the grant element of bilateral or multilateral aid makes such requirements less objectionable. ECA support, in contrast, is provided for commercial projects at market or near-market rates. Attaching environmental requirements to such expensive financing further increases project cost without off-setting the cost of compliance with these rules.

#### 4.3 EPFIs: Private Regulation

The Equator Principles' legitimacy is questionable from the same recipient country perspective which I discussed for ECA rules in the previous paragraphs. These rules are set by private actors without the input of recipient states, require compliance with rules that may exceed recipient country regulations, and assign the cost of compliance to the recipient country.

While ECA rules are at least sanctioned by the government of the exporting country, the Equator Principles have been devised and implemented beyond the reach of any state that could serve as a source of legitimacy. They are primarily a risk management instrument for its member financial institutions and are not intended to fulfill public functions. The congruence with MDB rules equips the content of these rules with some degree of legitimacy, but their format, nature of the regulator, and the lack of consultation in their creation challenge their authority.

#### 5. Uneven Allocation of Costs and Benefits

For many developing countries environmental concerns are secondary to the establishment of infrastructure. While it is generally accepted that donors have a say over what is acceptable or unacceptable in terms social and environmental externalities of development projects, this does not apply to ECA supported projects. By definition, ECAs provide support at market or near-market conditions and supported projects are usually of a commercial nature or they are funded with little or no aid

involved. As such it is not surprising that project sponsors and recipient country governments are concerned about their loss in autonomy and control if the exporting countries' ECAs require environmental impact assessments and potentially costly modifications to the projects' design despite compatibility with the recipient country's regulations. After all, costs that result from the compilation of assessments or from modifications to the projects are borne by the project sponsor or the recipient country.

Similarly, environmental assessments required by EPFIs and mitigation of environmental externalities in projects subject to the Equator Principles are being paid for by project sponsors. The cost of improved risk management for the Equator banks is externalized to their clients.

All three sets of rules are dominated by the interests of the providers of finance and only consider the interests of receivers in terms of providing for a better environment as an unspecified common good. Material interests of the receivers (e.g. costs associated with preparing environmental assessments or providing mitigation measures) are externalized. In all three cases, establishment of the policies was possible because of diffused costs and concentrated benefits. The reputational benefits of having implemented environmental policies go exclusively to the providers of finance, whereas the costs generated by these policies are borne by the receivers.

In the case of ECAs this required the establishment of common environmental rules among ECAs because unilateral environmental measures would have upset the cost-benefit balance by creating domestic costs in the form of foregone export opportunities. The transdomestic nature of ECA standards facilitated the establishment of ECA rules. Rules with domestic targets, such as environmental standards imposed on exported goods are even more likely to hurt domestic exporters and are politically more visible, rendering agreement to such policies more difficult. While regulating the access to financing for exports may have the same effects on exports as setting product standards for exports the indirect nature of this strategy may be politically less costly.

#### 6. Diffusing Good Practice into Target Countries?

All three policies rely on transparency provisions as compliance mechanisms. While this mirrors the U.S. approach in NEPA in which these policies find their common root and was championed by NGOs as well as the U.S. government, it places a considerable responsibility and burden on non-state actors.

Effectively, these policies are policed by NGOs utilizing the transparency provisions to flag problematic decisions and projects. With the existence of an inspection panel or ombudsman, the capability burden on these organizations is limited as they can initiate a review process with

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

Page 5

little impact on their own resources. However, where such a mechanism does not exist –most ECAs and all Equator banks – the only way to enforce these policies is by researching violations and making them public. In the absence of explicitly delegated authority to assume this function and no compensation for such services, the role of NGOs in this area is problematic.

Furthermore, faithful implementation thus depends on the existence of active civil society to monitor institutions' conduct. As a consequence, thoroughness of implementation may vary by civil society capacity. At the same time, the combination of problematic projects and a transparent decision-making process may serve as a catalyst for NGOs to form around opposition to projects. While it may be too early to assess the diffusion of these international rules for finance into recipient countries, it is clear that these policies can improve the environmental performance of supported projects in countries where the government lacks either the capacity or the political will to implement similar policies. By making project sponsors directly responsible for the environmental impacts of their projects, ECA standards and Equator Principles also avoid the involvement of public authorities that may be potentially ineffective in countries with lacking regulatory capacity.

## Bibliography

- Amalric, Franck. 2005. The Equator Principles: A Step Towards Sustainability. *Working Paper* 01/05. January 2005. Zurich: Center for Corporate Responsibility and Sustainability at the University of Zurich.
- Bosshard, Peter. 2006. *Export Credit Agencies and Environmental Standards: An Invitation to Join the Dialogue*. International Rivers Network, updated December 2006 [cited 3 February 2007]. Available from <http://www.irn.org/programs/finance/index.php?id=061220exim.html>.
- Bosshard, Peter, and Michelle Chan-Fishel. 2005. Western Banks Financing China's Export Import Bank: A Case of Environmental Money Laundering. 21 July 2005. Berkeley, CA: International Rivers Network. Available from <http://www.irn.org/programs/finance/pdf/050721exim.pdf>.
- Charles Stewart Mott Foundation. 2005. *Reform of International Finance and Trade Institutions* [cited 16 November 2005]. Available from <http://www.mott.org/programs/env-reform.asp>.
- The "Equator Principles" - A Financial Industry Benchmark for Determining, Assessing and Managing Social and Environmental Risk in Project Financing. 2006. July 2006. Available from <http://www.equator-principles.com>.
- Evans, Peter C. 2005. International Regulation of Official Trade Finance: Competition and Collusion in Export Credits and Foreign Aid. Dissertation, Department of Political Science, Massachusetts Institute of Technology, Cambridge, MA.
- Gilboy, Janet A. 1998. Compelled Third-Party Participation in the Regulatory Process: Legal Duties, Culture, and Noncompliance. *Law & Policy* 20 (2):135-55.
- Goodin, Robert E. 2003. Democratic Accountability: The Distinctiveness of the Third Sector. *European Journal of Sociology* 44 (3):359-96.
- Görlach, Benjamin, Markus Knigge, and Marcus Schaper. 2007. Transparency, Information Disclosure and Participation in Export Credit Agencies' Cover Decisions. In *Participation for Sustainability in Trade*, edited by S. Thoyer and B. Martimort-Asso. Aldershot: Ashgate.
- Gutner, Tamar L. 2002. *Banking on the Environment: Multilateral Development Banks and their Environmental Performance in Central and Eastern Europe*. Cambridge, Mass.: MIT Press.
- Haufler, Virginia. 2005. Finance: Actors and Agents of Change. Paper presented at the ISA Workshop Finance as Power: The Second Wave, 17 November 2005, Philadelphia, PA.
- International Finance Corporation. 2006. International Finance Corporation's Policy on Social & Environmental Sustainability. 30 April 2006. Washington, DC: International Finance Corporation. Available from [http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/pol\\_SocEnvSustainability2006/\\$FILE/SustainabilityPolicy.pdf](http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/pol_SocEnvSustainability2006/$FILE/SustainabilityPolicy.pdf).
- Leadership Office of the Hamadab Affected People, International Rivers Network, and The Corner House. 2007. Memorandum on the Merowe Dam Project - Sub-

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

Page 2

- mitted to His Excellency Zhang Dong, Ambassador of the People's Republic of China to Sudan, At the Occasion of the Visit of President Hu Jintao to Sudan. 29 January 2007. Berkeley: International Rivers Network.
- Moss, Todd, and Sarah Rose. 2006. China ExIm Bank and Africa: New Lending, New Challenges. November 2006. Washington, DC: Center for Global Development. Available from [http://www.cgdev.org/files/11116\\_file\\_China\\_and\\_Africa.pdf](http://www.cgdev.org/files/11116_file_China_and_Africa.pdf).
- OECD. 2004. 2003 Report on Export Credit Activities. TD/ECG(2004)16/FINAL. Paris: Organisation for Economic Cooperation and Development.
- . 2005a. Export Credits and the Environment: Information on Category A and B Projects Reported for 2004. TD/ECG(2005)11/FINAL. 11 July 2005. Paris: Organisation for Economic Cooperation and Development.
- . 2005b. Statistics on Export Credit Activities (up to and Including the Year 2004). Tables 1 to 12 from TD/ECG(2005)13/FINAL. Paris: OECD.
- . 2007. Statistics on Export Credit Activities (up to and Including the Year 2005). Paris: OECD. Available from <http://www.oecd.org/dataoecd/30/35/37931024.pdf>.
- Park, Susan. 2003. 'Greening' the International Finance Corporation: Transnational Environmental Advocacy Networks and Sustainable Development. Paper presented at the Australasian Politics Studies Association Conference, 29 September - 1 October 2003, at University of Tasmania, Hobart.
- Rich, Bruce. 1994. *Mortgaging the Earth: The World Bank, Environmental Impoverishment, and the Crisis of Development*. Boston: Beacon Press.
- Schaper, Marcus. 2005. Applying Financial Leverage to Green Infrastructure Development: Environmental Policies of the World Bank, Export Credit Agencies, and Private Banks. Paper presented at the Conference *Global Governance and the Power of Business*, 8-10 December 2005, Wittenberg.
- . 2006. Delegated Delegation: Environmental Rules for Project Finance. College Park, MD.
- Scharpf, Fritz W. 1998. Demokratie in der transnationalen Politik. In *Politik der Globalisierung*, edited by U. Beck. Frankfurt: Suhrkamp.
- Wade, Robert. 1997. Greening the Bank: The Struggle over the Environment, 1970-1995. In *The World Bank: Its First Half Century*, edited by D. Kapur, J. P. Lewis and R. C. Webb. Washington, D.C.: Brookings Institution.
- Wallace Global Fund. 2004. *Program Areas: Natural Resources* [cited 16 November 2005]. Available from [http://www.wgf.org/natural\\_resources.html](http://www.wgf.org/natural_resources.html).
- Walzenbach, G.P.E. 1999. Export Promotion: Gaining Advantage through Credit and Insurance. In *European Industrial Policy and Competitiveness: Concepts and Instruments*, edited by T. C. Lawton. New York: St. Martin's Press.
- Wang, Jian-Ye, Mario Mansilla, Yo Kikuchi, and Siddhartha Choudhury. 2005. *Officially Supported Export Credits in a Changing World*. Washington, D.C.: International Monetary Fund.
- Wright, Christopher, and Alexis Rwabizambuga. 2006. Institutional Pressures, Corporate Reputation, and Voluntary Codes of Conduct: An Examination of the Equator Principles. *Business and Society Review* 111 (1):89-117.