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# Foreign Direct Investment and the Environment[1]

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1. Foreign direct investments play a critical role in shaping the future of our planet. Without significant flows of private capital into developing countries, poverty will continue to be one of the principal underlying causes of environmental degradation worldwide. But at a time when the earth's natural resources are already dangerously overexploited (WWF's Living Planet Index reports that a third of our natural wealth has been destroyed in the last 3 decades), international investment also poses a major threat to sustainable development. This is on top of the fact that FDI often fails to return basic economic benefits expected. Poverty alleviation is not happening fast enough. Income disparities are growing and technology transfer and economic development are often distant hopes. Today, policymakers are rekindling debate over proposed new agreements to help open borders to private investors. We need to refocus this debate by giving serious attention to promoting conservation and sustainable livelihoods for people and not just to protecting corporate profits.

2. Research by WWF shows that the interactions between FDI and sustainable development are complex. FDI can boost the economic growth of a country by increasing its total productive capacity, creating positive spill-over effects (transfer of cleaner and more efficient technology, knowledge, skills) as well as spurring competition and innovation. However, these positive impacts depend on a number of factors including having strong domestic regulation. A number of cases exist where investment has taken place at such a scale and pace that it has overwhelmed host country regulatory capacity, resulting in inefficient production and irreversible environmental destruction.

3. The negative impacts are most prevalent in the natural resource sectors such as forestry and mining and in export zone manufacturing that form the largest proportion of investment flows to developing and least developing countries. These investments are often located in remote areas, and thus their impacts have not received wide attention in the host countries or internationally. Moreover, these activities frequently have few linkages to host country economies- they extract

[1] This presentation is drawn largely from the papers written by Richard McNally on FDI and environment and the draft investment and environmental governance paper written by Tony Zamparutti which was commissioned by David Schorr, WWF, US.

and export raw materials contributing little to long-term development. There is not much real priming of the development pump (problems of leakage of profits, lack of technology transfer, anti-competitive practices, etc).

4. While governments have devoted extensive efforts in a global competition to attract foreign investors, their support for environmental governance has lagged behind. Environmental governance is defined as mechanisms, processes and institutions through which citizens and public interest groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences. Attributes of good governance process are that it is participatory, transparent and accountable. Formal elements of governance include but are not limited to, the development of national environmental laws and institutions, as well as mechanisms for public participation and the use of environmental impact assessments.

5. Many countries have established essential laws and institutions for environmental governance- but implementation remains difficult. For example, in many countries, environmental institutions lack the necessary funding, staff and equipment to carry out essential environmental protection work. Progress has been 'chilled' by the fierce competition among countries for investment flows. Indeed in many countries, economics and other ministries loathe to co-operate with environment authorities and to encourage the development of environmental requirements. In some countries, domestic economic interests may also be encouraging this 'chill'. This lag is an obstacle to sustainable development and ongoing environmental degradation has brought high economic and social costs.

6. In Costa Rica- deforestation, much of it due to land clearing for cattle ranching cost the country at least $4b in the 1980s, and where included in national accounts would have reduced economic growth by 20% a year. The cost of environmental degradation in Nigeria is estimated over US$5b a year, which is more than 15% of its GDP. This estimates merely focus on national and local costs. If we look at the implications of resource degradation at a global level, then we have examples of deforestation contributing to the worldwide loss of biodviersity and through forest fires and the loss of potential carbon storage aggravates climate change.

7. Curioulsy to solve this problem, the main prescription offered to developing countries are more investment. Developed country political and business leaders have repeatedly claimed that FDI is actually the solution: investment will bring economic growth, they assert. As countries grow wealthier, they will start to address their environmental problems. Behind this rhetoric lies an economic theory, the environmental Kuznets curve, which contends that 'grow now, clean up later' is a standard path for development. This theory rests in weak evidence at best and provides dangerously wrong lessons for development.

8. *Both the methodology and the message of Kuznets curve are flaw*ed. The hypothesis has been tested only for local airborne pollutants. Studies claim that pollution increases up to a turning point and declines thereafter- between USD 5000-8000 per capita as turning point.

   *The Kuznets curve suggests that a clean environment is only for the wealt*hy.
   Even is we accept this simplistic correlation, it will take many years of accelerated environmental degradation with potentially large catastrophic and irreversible effects before they could reach the turning point. The fact that 1/3 of our natural wealth has been destroyed in the last 25 years makes one wonder where these resources will come from. The turning point of USD5000-8000 is way above the income of most of the world's inhabitants

   *Kuznets curve also ignores the cost of environmental problems and their global dimension.*
   The assumption that the environment is merely a luxury good and one with national dimensions if a central problem for the Kuznets curve argument. The global biodiversity loss, global warming, spread of toxic pollutants show no evidence of following the EKC.

9. There is no ‘market solution – and the challenge of environmental governance must be addressed directly. However, governments, particularly in developing countries have been concerned that, improving environmental governance will prove expensive and will divert resources from other necessary development needs, and moreover, stronger environmental requirements will deter investors.

10. The costs of many elements of better governance are relatively low, in particular to the costs of environmental degradation. Production and economic growth are not locked in a zero-sum trade-off with environmental impacts. For factories, there are many opportunities for low-cost pollution prevention, some of these indeed reduce pollution costs and improve quality; and modern production methods can often cut pollution levels. For natural resources, there are a host of methods provided that can protect natural values and provide long-term revenues: Forestry Stewardship Council has guidelines for sustainable forestry, international initiatives are underway to identify best practices in mining. Moreover, effective environmental governance is more than a set of rules imposed by governments, and instead involves interaction of citizens and local communities, business and markets, and government agencies.

11. Furthermore, better governance should not deter foreign investors as many corporations have committed themselves to high environmental performance. Studies indicate that society has accepted market capitalism in exchange for deepening and broadening the standards of accountability to encompass the environmental, social and economic dimensions of corporate activity. In addition, in many cases, companies have found that better environmental performance has indeed improved profits, through pollution prevention approaches that improved production efficiencies. In countries, with strong environmental liability, lawsuits from pollution victims have forced companies to pay high fines. There also a number of developed consumers that are prepared to pay for a premium for ‘green products such as MSC, FSC and increasingly shun products from companies associated with major environmental problems.

12. Environmental governance is not an obstacle for FDI flows. The low cost of environmental governance –compared to costs of environmental degradation suggests that it will not drive away investment but could even attract. Within Europe for example, national and regional investment promotion efforts often highlight positive environmental conditions related to the quality of life, innovative government programmes and strong corporate environmental performance.

13. Today, proposals for new investment rules are driven mainly by international business and by governments who increasingly believe- for one reason or another- that freer flows of international capital will help their nations prosper. But today’s vision of prosperity to often ignore the need for sound environmental stewardship. With FDI growing at unprecedented rates and despite the slight dip last year, governments have not fully made the case for pouring diplomatic resources into new rules to promote investment.

14. In the mid 1990s, OECD countries were unable to complete negotiations for a proposed MAI- in part because of fears raised by some governments about the impact the MAI would have on their ability to pursue legitimate public policies. Meanwhile, the investment chapter of NAFTA has generated a rash of cases brought by private parties seeking to use NAFTA in ways not intended by its drafters, as a tool to resist domestic environmental and other regulations.

15. Unfortunately, the lessons of these experiences have not been fully learned. In a significant setback for the environment, WTO ministers in Doha agreed to expand WTO rules on investment. WWF considers that negotiations towards an investment regime within the WTO should not be pursued. Until the international debate seriously addresses the relationship between the basic needs of conservation and sustainable development, all international investment negotiations will be premature. This WTO decision promises to increase the already heated controversy over international investment rules.

16. WWF believes that better international investment can bring substantial benefits, especially to developing countries. However, this positive outcome will only occur inside a regulatory framework that actively promotes sustainable development and ensures that environmental limits are preserved.

17. Creating the right regulatory framework to harness investment to support sustainable development will be challenging and will require a variety of actions at all level. This framework should provide host countries with the flexibility and ability to control investment flows that undermine their pursuit of sustainable development. Basic elements of the framework would include the following:

- Developing integrated policy packages- liberalisation in the context of policies for conservation and sustainable development
- Close governance gaps by providing development assistance that support recipient country efforts to develop good environmental governance, including capacity building and knowledge, skills and technology transfer; allocate financing to monitor and enforce environmental standards; impose disclosure requirements.
- Encouraging corporate accountability and best practices, including through adherence to OECD MNE guidelines and minimum binding environmental regulations in key natural resource sectors.
- Developing balanced investment rules by ending hostility to legitimate domestic regulation, forbidding competitive deregulation, avoiding potential conflicts with MEAs, promoting returns to LDC economies through technology transfer, integration
- Promoting transparent and accountable institutions and mechanisms- provide mechanisms for ensuring and strengthening stakeholder/civil society consultations, participation and activities related to investment decisions that affect them.
- Providing incentives for sustainable investment (ending perverse subsidies, promoting private 'green investment 'mechanisms
- Conducting impact assessment (look before you leap)
- Implementing debt service commitments by developed countries and effective special and differential treatment for developing countries to address current imbalance in the international trade and investment policies and practices.

12. The above is a long list and entails changing the way governments work. However, there are political decisions that are practically and realistically within reach now. WWF urges governments to:

- Insist that the Doha Ministerial Declaration does: (a) not mandate an automatic start to negotiations on the Singapore issues after the Fifth Ministerial Conference; (b) mandate the continuation of a study process on these issues; and (c) require that any decision to launch negotiations on these new issues must be made AFTER the Fifth Ministerial Conference and must be on the basis of, but not be determined by, a decision made at the Fifth Ministerial Conference by the Members by explicit consensus regarding the modalities for such proposed negotiations on new issues.
- Fix NAFTA and other existing agreements
- Reorient regional and bilateral negotiations with governments explicitly declaring their intention to adopt a new and more balanced approach to investment agreement negotiations. More specifically, governments involved in such negotiations should detail how new agreements will address each of the basic elements of the new approach discussed above. Of particular importance is the clarify the need for an integrated policy package approach, including developing flanking measures and for establishing investment rules that balance private rights with public needs
- Undertake stakeholder-oriented sustainability assessments (look before you leap).