Ethics, Security, and International Investment: New Rules for a New Global Order?

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**Ethics, Security, and International Investment:
New Rules for a New Global Order?**

In the aftermath of September 11th, new questions are also being raised about the role of global investment and financial markets in enhancing or undermining global peace and security. Concerns about the transparency and accountability of global capital markets, long the preserve of environmental and social groups, have entered the mainstream lexicon. Moreover, a more just and equitable global economic order must be part of any effort to build lasting international peace and personal security.The International Sustainable and Ethical Investment Rules Project aims to build support for a new approach to global market governance which rejects the paradigms of both 'free market' and 'anti-globalization'. A collaboration of four agenda-setting NGO research institutes, the Project has two aims. First, it seeks to articulate an investment rules framework which balances private rights with social responsibilities. Second, it aims to help stimulate a network of influential leaders from business, government, labor and NGOs to advocate for the framework.The Project collaborators are the Nautilus Institute, the International Institute for Sustainable Development, the Singapore Institute for International Affairs, and ECOS Fundacion Uruguay. All have worked extensively on trade and sustainable development in institutions spanning the WTO, APEC, NAFTA and Mercosur. All are preparing 'thinkpieces' to articulate key substantive and strategic issues.A central question for the Project and for the Strategic Consultation is "where?" Which institutional vehicle(s)-global, regional, or bilateral--are the best options for a global strategy aimed at implementing new rules? Most efforts to promote better investor performance have focused on voluntary approaches, such as ethical investment and corporate social responsibility. How will rule-making on investment unfold over the next ten years and what does that imply for the potential to develop sustainable and ethical investment rules? These are central questions for the Strategic Consultation.

'Stuck in the Mud'-Global Investment Without Global Responsibilities

Private international investment flows are the predominant source of capital in the global economy. Between 1990 and 2000, Foreign Direct Investment (FDI) outflows grew almost fivefold, from about $200 billion to nearly $1 trillion. FDI flows to emerging markets in 2001 are expected to be nearly US $130 billion. In the next decade, the governance of these investment flows will remain a hotly contested issue among policymakers and civil society. Unlike trade, no overarching rules-framework currently governs international investment.

Recent attempts to create an investment regime, notably the ill-fated Multilateral Agreement on Investment (MAI), articulated only the rights of foreign investors, especially the right of equal and non-discriminatory access to investment opportunities. The failure to address the ethical and social dimensions of investment drew intense opposition from human rights, labor, development, and environmental NGOs throughout the world.

Rather than articulating and expanding common social purpose, the current trend in the governance of investment is to provide access to foreign investors through liberalization as well as a set of unprecedented rights for investors to challenge states' regulations as barriers to investment. NAFTA's Chapter 11 provision, which gives private investors standing in disputes against national and sub-national governments, has generated enormous controversy.

The currently formulated rights provided in investment agreements, such as Chapter 11, allow investors to arbitrate whenever a foreign corporation feels it has not been treated "fairly and equitably. Perhaps unintentionally, Chapter 11 has allowed foreign corporations to challenge local environmental and health regulations on the grounds that they undermine profit and markets. Rather than "polluter pays," court settlements "pay the polluter". A prime example is California's ban of the gasoline additive MTBE, a groundwater polluter, which has been challenged under Chapter 11 by the Canadian Corporation Methanex.

Beyond rights, a 'sustainable and ethical' framework should articulate the responsibilities of private investors.

Why should international investment rules explicitly embrace social purpose, a terrain traditionally occupied by national governments? Many countries, especially in the OECD, have national systems of social and environmental regulation which apply equally to domestic and foreign investors. However, large gaps exist between regulatory regimes at a global level. Most countries in the developing world lack adequate regulation and/or enforcement capacities. Competition among international investors for lucrative investment opportunities in developing countries-as well as among developing countries for highly sought-after foreign dollars-keeps a lid on standards.

Moreover, even within the OECD, there is intense competition for FDI, both among and within countries. In the high tech sector, for example, a new, billion-dollar semiconductor fabrication plant offers huge local economic benefits in the form of direct jobs, tax dollars or other contributions to local infrastructure, and a stimulus to local suppliers who will become integrated in a global supply chain. Little wonder that government officials, from New Mexico to Ireland to Costa Rica, compete intensely to lure high tech investment-and that they are reluctant to place 'onerous' social or environmental requirements on them.

In the aggregate, international investment may not directly cause environmental and social standards to fall absolutely in a 'race to the bottom'. It may even push standards up incrementally by disseminating better technology and or management practices. But the system-wide effect of competition for investment without common norms is to create something of a policy low-pressure zone, keeping standards from rising as much and as quickly as both scientific information and social demand would indicate. This 'stuck in the mud' problem of not being able to move much unilaterally is a classic prisoner's dilemma situation. The only way to overcome it is to collectively set common norms.

A set of clear principles and common responsibilities is needed not only for FDI but also for portfolio investment, which is the fastest growing type of finance flowing to developing countries.

In the wake of the financial crisis which hit Southeast Asia in the late 1990s, NGOs targeted "speculative investment," such as currency and derivatives trading, as the focal point for regulation of the global financial architecture. Aside from that effort, however, civil society has barely grappled with the need for regulation of the international capital markets to ensure transparency and to promote the flow of capital to environmentally and socially sustainable enterprises. Indeed, one of the issues emerging from the rubble of September 11 is the urgency of pressing for transparency and accountability from the global financial services industry.

The underwriting and trading of portfolio securities is mostly the preserve of large financial institutions such as Goldman Sachs and Morgan Stanley. These institutions mobilize huge amounts of capital and channel them (inter alia) into energy, water and other huge infrastructure projects and other corporate activity in developing countries. There is no common requirement, say as a condition of underwriting, to exercise social or environmental due diligence and to assure investors through mandatory reporting and disclosure that such projects will not generate environmental or social harms-for which investors might even be liable.

In China, for example, the World Bank and the Asian Development Bank turned down investment in the Three Gorges Dam Project because of environmental and social impacts. The Chinese government turned to private capital markets, notably a handful of U.S. investment banks. These underwriters were not required by law to disclose the project's environmental and social risks to potential investors. Despite an ongoing shareholder campaign, the financing for Three Gorges and other sensitive infrastructure projects continue.

There is also the crucial issue of equity in global access to investment capital. The lion's share of international investment, both FDI and portfolio, goes to rich countries. Africa, the poorest region of the world, receives about one and a half percent of global FDI. As a whole, developing countries get about 20 percent of global FDI-and of that, China alone receives about two fifths. A 'sustainable development' framework for investment should help to increase the flow of FDI to the countries where it is most needed.

Common environmental and social norms for investment would provide a 'level playing field' for corporations and financial institutions alike. Depending on how such norms are designed, many in the business community would potentially support them. Common norms would help multinational corporations navigate the uneven regulatory terrain of the global economy, and the increasing demands put upon them to be 'socially responsible'. In the US, Canada, Europe and Japan, a growing chorus of NGOs, human rights, labor, consumer and development groups are pressing corporations and financial institutions to recognize their responsibility not only to shareholders but to a much wider set of stakeholders.

These campaigns typically target a single company or group of companies based at home (e.g. in the oil sector). Companies protest, with some justification, that if they unilaterally raise standards, they will lose competitiveness vis-à-vis companies who are less responsible, especially in lower-standard countries. In the Caspian Sea area, for example, US oil companies protest that raising the bar on human rights would mean that the regional governments would award contracts to French and other companies. A 'level playing field' for all investors, host and home governments, could raise the bar for all.

The Opportunty: Private International Investment and Demands for Social Responsibility

NGO campaigns have aimed, with some success, to bring social and environmental norms into the governance of public sources of international capital, including at the World Bank, regional multilateral development banks, bilateral aid agencies, and most recently, export credit and investment insurance agencies. These government institutions can set the pace for the governance of investment, providing signals about social expectations to the private sector. Moreover, they control or influence a significant amount of international investment, especially in developing countries.

The time is now ripe to extend this work by developing and pressing for a set of principles and rules to guide private international capital flows. This is so for three reasons.

First, private investment remains the primary source of capital in the global economy. According to UNCTAD's World Investment Report, FDI inflows grew by over 30% per year in the second half of the 1990s and reached nearly a trillion dollars in 1999 alone. The primary players in FDI are large multinational corporations such as General Electric, Royal Dutch Shell, Ford, and IBM. Portfolio investment, underwritten by a handful of large financial institutions such as Goldman Sachs and traded by retail and institutional investors such as Fidelity and CALPERS, has also grown rapidly. In 2001, portfolio investment to emerging markets is expected to reach $16 billion, surpassing traditional bank lending as the preferred way to raise capital.

Second, international investment rules are on the political agenda. In Seattle, European and Japanese delegations pressed to have investment included on the WTO agenda and have done so again in the lead-up to Doha. In both cases, the U.S. was lukewarm, largely because of differences in the U.S. and European scope for investor protection. The U.S., pushes hard for access to investment opportunities, while the Europeans focus only on protecting investors from various forms of exprorpriation after they have occurred. Following adoption of the Agreement on Trade Related Investment Measures (TRIMS) as part of the Uruguay Round accords, a Working Group on Trade and Investment was established-the first step in typically a 2-3 year process leading towards global negotiations. The European approach rests on a 'rights without responsibilities' framework, much like the MAI.

Moreover, with a high level of uncertainty around global talks, a flurry of bilateral investment treaties (BITs) and several regional investment agreements are in the works. These regional agreements and BITs could set the precedent and generate momentum for the design of global investment rules in 4-5 years. Unless NGOs, business, and other citizen groups articulate and press for the inclusion of responsibility rules, the regional agreements and BITs will look like mini-versions of the MAI. On the other hand, if pressed to include social and environmental responsibilities, the BITs and regional investment agreements could help to build ethical global investment rules 'from the bottom up'.

Third, in the post-Seattle era, there is a much greater acceptance-including by business--of the idea that social and environmental issues are part and parcel of global economic governance. In addition, a wide range of groups are working via a variety of channels and strategies to encourage corporations and financial institutions to voluntarily embrace a commitment to social responsibility. Methods include shareholder activism, socially responsible investment, and direct engagement of private banks. These efforts all point in the same direction and will help to build acceptance for a 'sustainable and ethical' approach to investment rules within the business and policymaker communities.

Common global norms for investment would likely fall into three broad categories:

1) Substantive social and environmental standards: Commitments to maintain and enforce a common, minimum but improving set of substantive social and environmental standards, including standards to protect human health, maintain environmental integrity, promote human and labor rights, and enhance social and economic development. In the case of FDI, some of these substantive standards can draw from existing standards and norms, such as the multilateral environmental agreements, the World Bank's global pollution standards, ISO, ILO core labor standards, and various human rights conventions. For portfolio investment, standards for environmental and social due diligence, fiduciary responsibility, and liability would be most relevant.

2) Governance standards: Commitments to enhance accountability, including to promote transparency via the reporting, disclosure, verification and monitoring of social and environmental performance, such as the Global Reporting Initiative (GRI). The Aarhus Convention recently concluded by the European Union could serve as a model. Additional mechanisms for disclosure include recently passed pension legislation in the U.K and France which requires pension funds to disclose whether and if they use environmental and social criteria in their portfolio selection criteria.

3) Rules of Deference: Clarity about the limits to the jurisdiction of global or regional rules and institutions and protection of national governments' "right to regulate" by enacting environmental, health and social standards above the global minimum.

Where would such sustainable and ethical investment rules reside? Or, put another way, in what institutional framework could such rules be articulated, implemented and enforced? There are a number of potential routes to implementation. One strategy would be to append or include them within regional investment agreements, such as the ASEAN Agreement on Investment in Southeast Asia or, as Fundacion ECOS has advocated, within the Mercosur Agreement in South America.

Another approach is to insert them into appropriate international environmental agreements, such as the UN Framework Convention on Climate Change. Still another approach, promoted by Konrad von Moltke of IISD, is to develop them via a stand-alone framework agreement. A fourth possibility is that they be appended to bilateral investment and trade treaties (BITs), such as that recently concluded between the U.S. and Jordan. Yet another approach looks to the benefits and limitations of sub-national governance of investment, such as the State of California, which could promulgate higher standards of environmental and social performance through increased disclosure and transparency.

The Future?

A 'sustainable and ethical development' framework would articulate the responsibilities of private investors, as well as home and host country governments. Indeed, the central challenge-and promise--of sustainable and ethical investment rules is not only to protect the 'right to regulate' of governments but to actively channel global capital towards social and environmental objectives. Such a shift from the present volatility and responsibility vacuum of capital flows will require a global governance framework-an ensemble of rules, regulations, policies and practices - which articulates government jurisdiction and explicitly embraces substantive standards on human rights, economic inclusion and social equity, and environmental protection as part and parcel of orderly global capital markets.

Project Partners:

Lyuba Zarsky is Co-Founder of the Nautilus Institute for Security and Sustainable Development. Ms. Zarsky directs the Institute's research and advocacy program on Globalization and Governance, focused on promoting environmental and human rights norms in the governance of international trade and investment. She has written extensively on regional environment, development and governance issues in the Asia-Pacific region and was twice on the U.S. delegation to meetings of APEC Environment Ministers. In her twenty years as an economic analyst and activist, she has directed a number of multi-contributor, multi-national research projects which aimed to both produce the intellectual foundations and nurture the partnerships which catalyze paradigm or policy shifts.

Most recently, she co-directed an Earth Council project examining conflicts over human rights and environmental values involving international actors, including multinational corporations. In the early 1990s, as the Staff Economist for the Australian government's Commission for the Future, she produced a policy blueprint for a national sustainable development strategy and organized multisectoral dialogues involving business, trade union and environmental groups. She is a frequent consultant to the OECD, US-Asia Environmental Partnerships and others.

Konrad von Moltke works on international environmental relations. Recently his work has focused on environmental policy and international economic relations: debt, trade and development. He has contributed to developing the agenda on trade and environment at global and regional levels. He is a Senior Fellow at World Wildlife Fund in Washington, D.C., Adjunct Professor of Environmental Studies and Senior Fellow of the Institute on International Environmental Governance at Dartmouth College and Visiting Professor of Environmental Studies at the Free University, Amsterdam. From 1989 to 1998, he edited International Environmental Affairs, a journal for research and policy.

Dr. von Moltke studied mathematics at Dartmouth College (B.A. 1964) and medieval history at the University of Munich and the University of Göttingen (Ph.D. 1970). He taught at the State University of New York/Buffalo where he was also a member of the administration, concerned with the development of interdisciplinary undergraduate programs. Six new programs were established during his term as Director of the Collegiate System, including an environmental studies college.

Simon S.C. Tay, LLB Hons (National University of Singapore), LLM (Harvard), teaches international and constitutional law at the Faculty of Law, National University of Singapore. He is a publicly nominated Member of the Singapore Parliament and also Chairman of the Singapore Institute of International Affairs. His work focuses on the environment, human rights and civil society in Asia. A Fulbright scholar, he won the Laylin Prize at the Harvard Law School for the best thesis in international law.

María Leichner Reynal is the Founder and Executive Director of the Fundación Ecos, a non-profit educational and research center created to promote sustainable development and transform environmental principles into concrete action. She holds a Doctorate in Law, 1987, School of Law and Social Sciences, National University of Litoral, Argentina. Before joining Fundación Ecos, Dr. Leichner Reynal had served as Professor at Buenos Aires University, School of Social Sciences and Economics. She became a Commission Member of the Centre for International Sustainable Development Law at the Faculty of Law of McGill University in 2001. Since 1999, she has consulted for World Wildlife Fund, USA; and worked as a project associate with the Institute for International and Sustainable Development, Canada. She has been invited to participate as expert in the Environmental Sustainability Index (2000-2001) organized by the World Economic Forum. Author of several publications and articles on Mercosur trade, environment and investment policy priorities for WWF Sustainable Commerce Program: Environmental Dimensions on the Mercosur Process (October, 2000), Institutional Organisation of the Mercosur and also she is Co-author of Ecological Rules and Sustainability in the Americas (2001) with IISD.

Miguel Reynal, originally from La Barra de Maldonado, Uruguay, is the founder and Executive President of Fundacion Ecos, a nonprofit educational foundation focused on sustanaible development and environmental management for decision makers in South America. Mr. Reynal was founding president of Fundacion Vida Silvestre Argentina, the foremost Argentine NGO and a WWF Associate Organization, where he serves on the Executive Council and Board of Directors. From 1987 to 1991 he was general representative of the Bank of Indo-Suez for Argentina, Chile, Uruguay, Paraguay, and Bolivia, and a Board Member of Save the Rainforests. From 1980 to 1987 Mr. Reynal was Executive Vice President of Lechiguanas, S.A., a land reclamation company. From 1975 to 1980 he was CEO of Austral Airlines, South America's second-largest private airline, and was CEO of Sol Jet Brazil from 1973 to 1975 and of Sol Jet Argentina from 1970 to 1973.

Mr. Reynal is a recepient of the United Nations Global 500 Environment Award. In 1996 he became a member of the National Council of the WWF US. Mr. Reynal received a B.A. in economics from Harvard University.

Sandy Buffett is the Senior Program Officer in the Nautilus Institute's Globalization and Governance Program. Prior to joining Nautilus, she coordinated Quantum Leap, a joint project of the National Wildlife Federation and Friends of the Earth, which educates NGOs about the role of private financial flows in global infrastructure and development projects. She also participated in NGO/shareholder dialogue with Wall Street investment banks towards the development of environmental guidelines. As a consultant with the World Resources Institute, she co-authored "Leverage for the Environment: A Guide to the Private Financial Services Industry". Sandy holds an MA in international development from American University and a BA in political science and environmental studies from Colorado College. She recently completed an Executive Certificate Program in International Finance and Multinational Business at Georgetown University's McDonough School of Business.

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