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## **THE ENVIRONMENTAL IMPACTS OF FOREIGN DIRECT INVESTMENT - FDI IN BRAZIL: CHALLENGES AND OPPORTUNITIES**

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### **Executive Summary**

1. This paper provides a brief overview of Brazil, its political, institutional and legal framework, as well as some economic and environmental aspects related to foreign direct investment – FDI, its impacts, challenges and opportunities. The focus is on the State of São Paulo as from 1993, when the liberalisation process with privatisation, as well as the macroeconomic stabilisation promoted by government, gained momentum.
2. Brazil, the largest and most populated country in South America, now ranks as the eighth economy in the world. It is presently acknowledged as a major player in the field of foreign direct investments – FDI (OECD, 1998). As a Federal Republic, Brazilian fiscal and economic law are matters of shared competence between the different levels of government. Regarding FDI, the regulatory framework is defined exclusively at Federal level, except in terms of incentives and provision of infrastructure projects.
3. The present Brazilian economic plan aimed at curbing inflation was proposed in 1994, towards the end of the previous mandate by Fernando Henrique Cardoso, who was Finance Minister at the time, and his team. Since then, the new monetary policy has been struggling to stabilise the Brazilian economy. In 1994, Brazil accomplished two consecutive years of economic growth, with the Gross Domestic Product real variation rate showing a 5.7 percent increase, compared to the previous year, the largest increase since 1986. Considering a preliminary estimate of population growth of about 1.42 percent, per capita GDP variation was 4.2 percent, the highest in the nineties. The trend followed a process initiated in the early eighties, rising sharply after 1993. The MERCOSUR agreement signed in 1994 is another important influence in increasing capital flows in the region vis-à-vis the global economy.
4. The most visible inflow of foreign investment is related to The National Privatisation Programme – PND, created through Law no. 8031 in 1990, that allowed the participation of foreign investors in key sectors such as infrastructure, energy and telecommunications. Federal privatisation, including operations within the scope of the PND, amounted to US\$ 23.4 billion, or US\$ 26.6 billion, if US\$ 3.2 billion of debt is included (BNDES, 1998). Privatisation within the telecommunications sector raised US\$ 21.8 billion (US\$ 24 billion including debt), of which US\$ 18.9 billion from the sale of the Telebrás system and US\$ 2.9 billion from the sale of B Band cellular concessions (BNDES, 1998).

5. Regarding the environmental area, the Worldwatch Institute (1997) considered Brazil as one of the eight key leaders in the world, the environmental 'heavyweights' - E8 (Flavin, 1997). Due to the complexity of these issues in a country of continental dimensions and wide regional diversity, government needed to change its legal and institutional framework, moving from a policy of command and control to a new approach, adopting economic instruments to regulate productive activities. The Ministry of the Environment is being restructured after President Cardoso's re-election, creating four new theme Secretariats, namely: Human Settlements Environmental Quality Policies, Environment and Production, Biodiversity and Forests, and Water Resources.

6. The state of São Paulo has 32 million residents, a population nearly as large as that of Argentina. Located in the south-eastern part of Brazil, its territory is equivalent to that of Great Britain. It has the largest industrial complex in South America and is responsible for about half of Brazil's federal taxes. São Paulo state has the world's second-largest commodities exchange after Chicago's, over 50 per cent of the industrial production of the country is located there, and its factories produce nearly a million cars a year. Steel industry in the state accounted for almost 25 per cent of Brazil's total production in 1997. Development is concentrated in certain regions, and there are entire areas where investments in infrastructure are being heavily made by the state government. Several industries are coming to the state of São Paulo, others are expanding and moving away from the São Paulo metropolitan area. Its capital, the city of São Paulo is one of the fastest growing cities in the world with 9.6 million inhabitants, almost 15 million in the metropolitan area. However, just as it happens in Brazil, São Paulo presents marked contrasts: universities and scientific institutions that rate among the best in the world go alongside almost three million illiterates.

7. Nevertheless, no other place in Brazil or even South America, has better investment opportunities today. The State privatisation Plan (PED) provides business and investment opportunities in all sectors which were previously restricted to government, such as electricity generation and distribution, natural gas distribution, transport etc. These sectors have been attracting great interest from national and foreign investors.

8. An appropriate assessment of the environmental implications of FDI would require addressing each particular industry and location. Therefore, for the purpose of this debate, we must consider the impacts from FDI as associated to development in general.

9. Besides the obvious economic growth brought about by the capital inflow, it is expected that multi-national enterprises – MNEs introduce cleaner technology (more environmentally friendly) and investment in local capacity building of both material and human resources. New challenging direct jobs are created, as well as new markets for small and medium enterprises - SMEs, which generate revenue for local businesses, thus strengthening local and regional economy. Provided there are more adequate environmental standards within a global framework set by the parent companies, MNEs establish parameters and stimulate competition with and between national industry.

10. On the other hand, competition can develop into a process of entropy, instead of business growth. Fiscal wars turn against the environment: advantages such as tax exemption, loans, land and services donation, offered by competing local and state government usually harm the environment, when a more holistic approach is taken in considering the long-term impacts. A good example is the car industry, which is a driving force for economic growth but has profound environmental consequences. It is impossible to dissociate the auto industry from global development and economic growth in this century, and in developing countries such as Brazil its impacts have been dramatic, particularly in the last 50 years. With the new surge brought about by the macroeconomic stabilisation process since 1996, the automotive sector (manufacturing and auto parts) attracted the largest percentage of the FDI inflows in Brazil.

11. Within a wider debate on sustainability, we should consider environmental impacts in terms of the indirect implications of development, when increased consumption is encouraged, thus generating energy demand and production of waste. Existing legislation is prepared to address the installation and operation of new plants by requiring environmental impact assessments - EIAs, but not the indirect impacts, such as unforeseen urban sprawl. Fostering local and regional development implies population growth, and therefore increased demand on local urban infra-structure (roads, water and energy supplies, sanitation and waste management), as well as increased demand for housing, health, transport and education. The burden is left to the local authorities, that have a high degree of discretionary power but scarce financial, human and material resources to cope with increased levels of demand.

12. Dumping is also a common practice that results in unfair competition. Despite the fact that jobs are created by the expansion of international businesses through FDI, many other formal jobs are lost when locals cannot cope with the economic power of MNEs, who are prepared to handle initial losses. This stimulates further informal structures, with all its social and environmental consequences.

13. In spite of the positive results for President Cardoso's first term displayed by officials, the need for further reform in several sectors is imperative at all government levels. Right now government is facing difficulties in implementing the structural changes needed to attain the objectives of the economic plan.

14. The São Paulo state, for instance, faces emblematic problems that continue to challenge Brazil, such as internal and external debt, high interest rates and increasing unemployment. Perspectives, however, are optimistic in the long run. Government has shown marked signs of economic stamina and an open economy to foreign, despite high levels of uncertainty. Even after the economic turmoil generated by the Asian crisis in 1997, Brazil is still regarded as an attractive option for the international community, particularly in the productive sector. A whole new economic outlook for productive activities looms large, particularly with the momentum gained by the privatisation process in the last three years. Taxes, prices, and exchange rates are being harnessed to the main objective of monetary stabilisation. Private sector is also satisfied with the possibility of productive growth within the new economic rules. A competitive market is being regarded as a stimulating condition for improving the standard of living in Brazil.

15. Within a very dynamic international and national context today, for developing countries such as Brazil, keeping pace with global changes opens new perspectives for economic growth, but entails social and environmental costs. In order to achieve sustainable development, a careful balance in establishing social, environmental and economic priorities, and in defining strategies is necessary, which must include public participation in planning and decision making processes for government and business alike. Implementation of environmental auditing and reporting, adopting environmental management systems and certification, can be instrumental in guaranteeing sustainable business.

16. To establish integrated policies, both horizontally and vertically, within government and with society is the best strategy in moving toward sustainable development. This includes promoting public awareness in order to create pressure for improved corporate environmental performance and quality, and strengthening the existing legal and institutional frameworks, in order to consolidate the democratic process and a healthy society.

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