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**Rapporteurs report from the OECD Global Forum on International
Investment conference**

**« FDI and Environment – Lessons from the
Mining Sector »**

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Background

At the end of the 1990's the debate on FDI and environment was polarised and polemical. Some commentators were concerned that competition for FDI between countries would lead to a "race to the bottom" in environmental standards (the pollution haven hypothesis). Others thought that FDI would promote the establishment of higher environmental standards through technology and management know-how transfer (the pollution halos hypothesis). An OECD conference on FDI and Environment held in The Hague, January 1999¹ reviewed the evidence available at the time and recommended:

- To take a broader perspective beyond the issues of pollution "havens" and pollution "halos". More emphasis should be given to monitoring the net environmental performance of investments, including their cumulative and scale effects;
- To better take into account sectoral differences. The resource-using sectors (e.g. mining, forestry) merit priority attention in view of their environmental, economic and social importance in many FDI-host countries; and
- To strengthen policy and institutional frameworks for integrating investment and environmental policy goals. The development and promotion of appropriate environmental standards/policies for FDI is particularly necessary in those FDI-host countries where existing environmental policies and standards are either low or poorly enforced.

Taking these recommendations into account, the OECD organised a follow-up conference with a focus on the mining sector on the 7 and 8 February 2002 in Paris. Key aspects of the mining sector that motivated this choice were:

- **The important role that mining FDI is playing in many developing country economies;** Global FDI flows, at a level of USD 1.3 trillion in 2000, are overwhelmingly (80%) taking place between OECD countries. This situation is also reflected in the mining sector. While overall FDI flows into the mining sector of developing countries are thus small (they represent no more than 4-5% of total FDI flows to DCs), they can represent a significant share of overall FDI in some regions and countries; in the Southern African Development Community (SADC) for instance, 23% of FDI flows into the mining sector². In Ghana, FDI into gold mining represents 55% of total FDI, the export share of mining is 45%. In Indonesia state revenues from mining account for more than 800 million USD per year³. In many countries, a large share of state revenue depends on the mining sector. However, even in such countries, mining FDI generally represents only a small share of GDP and employment. In Ghana for instance, mining represents only 1,5% of GDP⁴. In Indonesia it represents about 0,1% of total employment⁵. Thus even in countries where mining represents a significant share of FDI inflows, its overall contribution to the domestic economy is generally still limited.

¹ The proceedings of this conference are available: OECD, 1999, Foreign Direct Investment and Environment, Paris.

² Caroline Digby, MMSD, Economic and financial aspects of the mining sector, presentation at the OECD conference "FDI and environment – lessons from mining", 7 and 8 February 2002, Paris

³ S. Suryantoro and MN. Manaf, The Indonesian Mineral Resources Development and its Environmental Management to Support Sustainable Development, presentation at the OECD conference "FDI and environment – lessons from mining", 7 and 8 February 2002, Paris Indonesian government presentation

⁴ George Awudi, The Role of FDI in the Mining Sector of Ghana and the Environment, Friends of the Earth Ghana, paper prepared for the OECD conference "FDI and environment – lessons from mining", 7 and 8 February 2002, Paris

⁵ Emmy Hafild, FDI in the Indonesian Mining Sector – It myths and facts, Walhi, Friends of the Earth Indonesia, paper prepared for the OECD conference "FDI and environment – lessons from mining", 7 and 8 February 2002, Paris

- **The potential environmental costs and benefits that mining FDI can generate;** The empirical evidence suggests that the environmental effects of FDI in the mining sector can reduce or increase pressures on the environment, as compared with domestic investment, depending on the geographical location and whether regulatory, technology or scale effects are considered. In Chile, for instance, foreign investment into copper mining has facilitated a significant inflow of environmentally sound technologies, such that foreign investors' environmental performance is often better than that required by local regulations and standards. In that country, foreign investors have outperformed domestic operators for the last two decades⁶. However, there are also cases where foreign mining investors have exerted downward pressure on environmental requirements. Foreign investors in Ghana, for example, are exerting pressure on the government to allow exploration and mining in its forest reserves, despite a 1996 moratorium on exploration and mining in these reserves pronounced by the government⁷.
- **The potentially important environmental and social impacts generated by the mining sector, and its relatively poor past track record;** Historically the most important environmental impacts of mining activity have included, the discharge of toxic substances into river systems, large volume waste disposal, the inadequate disposal of hazardous waste, as well as long run environmental impacts resulting from poorly planned mine closure. Standards have risen, particularly among the larger companies but damage continues to occur. Social impacts include, the displacement of populations and the destruction of local communities' livelihoods. A UNEP survey suggests that despite the increased scrutiny of the environmental performance of the mining sector, the number of annually reported serious mining accidents has not decreased. Accidents such as cyanide spills from gold mines into river systems in Romania and Papua New Guinea are just some of the most serious recent examples⁸.
- **The threat to the mining sector of losing its "social licence to operate" in a number of countries;** As a result of this poor environmental and social track record, civil society's support for mining activity has significantly decreased. The mining industry, along with the tobacco and chemical industries, receives the lowest public ratings. As a consequence of this situation, it has become increasingly difficult for the mining industry to open up new deposits in those states with strict planning requirements.
- **The increasing reluctance of financial institutions (public and private) to provide finance to the sector;** In parallel with the increasing public scrutiny of the mining sector environmental and social performance, financial institutions involved in mining have come under increasing pressure to not support projects that could have adverse social and/or environmental impacts. For a number of years there have been demands from environmental NGOs that the World Bank disengage from mining. Similarly, the number of commercial financial institutions providing equity or loans to the mining sector has continued to decline – although this is also related to the low rate of return from the sector⁹.

⁶ Borregaard Nicola, Annie Dufey, (2001), Environmental effects of foreign direct investment versus domestic investment in the mining sector in Latin America, paper prepared for the OECD conference "FDI and environment – lessons from mining", 7 and 8 February 2002, Paris.

⁷ Boocock Colin, (2002), Environmental Impacts of Foreign Direct Investment in the Mining Sector in Sub-Saharan Africa, paper prepared for the OECD conference "FDI and environment – lessons from mining", 7 and 8 February 2002, Paris.

⁸ International Task Force for Assessing the Impact of the Baia Mare Accident, Final Report, 2000, Brussels

⁹ Grieg-Gran, Marianne, Financial Institutions and the Greening of FDI in the Mining Sector, paper prepared for the OECD conference "FDI and environment – lessons from mining", 7 and 8 February 2002, Paris.

- **An important initiative by mining industry CEOs to address the concerns on the sustainability of mining operations;** As a response to the mounting pressure, and in the context of preparations for the World Summit on Sustainable Development in Johannesburg in 2002, CEOs from leading mining companies launched in 1999 a Global Mining Initiative to identify how mining and the minerals sector can better contribute to sustainable development¹⁰.

While the mining sector has attracted a lot of attention in recent years, its proportions should be kept in mind. The combined market capitalisation of the 10 largest mining corporations still does not match half that of British Petroleum. At the same time, due in part to low commodity prices, the average financial return in the mining industry is currently about 2%. This comparatively low rate of return puts considerable pressure on companies to reduce costs.

Some of the key issues that arose during the conference are summarised below.

Policy and institutional responses to the FDI and environment challenge

- *Good governance is an important prerequisite for the effective management of the mining sector*

It was unanimously recognised that good governance is an essential prerequisite for the effective management of the mining sector. Ideally this implies predictable, transparent policy-making, decision making based on the rule of law, the presence of a bureaucracy imbued with a professional ethos, an executive arm accountable for its actions, and civil society institutions with real opportunities to participate in public affairs.

- *Well designed environmental requirements and enforcement are crucial*

Participants generally agreed that many avoidable environmental impacts of mining occur due to regulatory failures. While landscape change is an inevitable consequence of all mining (save for the most advanced open cast mines) other impacts relating to discharges, biodiversity loss, waste disposal etc are avoidable.

- *A key factor: fund for post operations activities*

Post closure reparation is also possible. But in developing countries the weakness of governance systems and in particular of environmental regulations and the institutions to administer them was seen to be a main reason why substandard mining took place. Even when many developing countries established a solid system of rules and regulations to manage mining and the environment, they often lack well functioning enforcement institutions and procedures. The case of Baia Mare in Romania, which led to the release of more than 120 tons of cyanide into the nearby river system, was only one among many examples reported during the conference and illustrating the need for a strengthening of FDI host country environmental management systems¹¹.

- *Local communities require particular attention*

Participants generally agreed that a key problem with mining activity occurs at the local level. Local communities often receive only a small part of the benefits resulting from mining operations, while bearing the brunt of the environmental and social costs. For instance, in a paper presented by Nicola Borregaard¹² it was shown that in Chile only about 10% of mining tax income is channelled back to mining regions, and much of this is spent in an uncoordinated way. It was therefore recommended that mechanisms should be

¹⁰ see www.iied.org/mmsd

¹¹ International Task Force for Assessing the Impact of the Baia Mare Accident, 2000, idem

¹² Borregaard, Nicole, 2001, idem

developed that help to secure an adequate share of mining benefits to local communities. This may be achieved through earmarked taxes, local mineral development funds or direct company contributions. In South Africa, local communities are frequently involved in the management and ownership of the mine¹³. Another proposal was to support civil society groups through the establishment of an international, transparent information system about the rents from mining and their distribution.

- *There is a need to address mining in protected areas*

A particular danger for the environment results from the pressure to extend mining into protected areas such as natural reserves. In this connection it was proposed to identify so called “no-go-zones” according to certain criteria (e.g. areas classified according to IUCN or other authorities). Some participants called for the mining industry to make a voluntary declaration on “no-go zones”¹⁴. It was also proposed that violations of the principles of such a declaration should invite official sanctions and be subject to enforcement at international levels.

- *The non-discrimination principle poses particular challenges for environmental policy in mining*

A particular challenge for the design of environmental regulation in the mining sector was seen to be posed by the non-discrimination principle in investment policy. While it was accepted that foreign and domestic investors should be treated equally, the implementation of the principle in the mining sector appears to have posed difficulties¹⁵. Whether a government decision with a discriminatory impact has been taken for legitimate environmental reasons or with a discriminatory intent or both may be difficult to determine, given the problem of identifying “like circumstances” of mining operations. This appears to be due to the environmental and geological specificity of each mining site, which results in differentiated mining processes and technologies, as well as to the long-term nature of mining operations. This should not diminish the need to clearly identify the environmental rationale for such decisions. At the same time, some saw that an overly rigorous application of the non-discrimination principle in the mining sector could unduly constrain environmental policy makers in their efforts to protect the population from the environmental impacts potentially associated with the activity.

- *OECD countries can help FDI host countries through support for capacity building to governments, civil society and business*

The need for further support for the strengthening of environmental and mining institutions in developing countries was unanimously recognised by all stakeholder groups at the conference. This would need to include support for the strengthening of the general governance system, as mining and environment can not be addressed successfully in isolation. Particular support would be required for the enforcement systems. While participants recognised the overwhelming need for capacity development, they also pointed to the fact that there are a number of important prerequisites for the effectiveness of such measures. Information disclosure, effective anti-corruption measures, as well as the presence of political will to accept and promote the necessary changes were seen to be key in this respect¹⁶.

¹³ Frick, Nock, FDI and Environment – The African Mining Sector, paper prepared for the OECD conference “FDI and environment – lessons from mining”, 7 and 8 February 2002, Paris.

¹⁴ Wicks, Clive, To dig or not to dig, Friends of the Earth International, 2002

¹⁵ Von Moltke Konrad, 2001, Discrimination and Non-Discrimination in Foreign Direct Investment Mining Issues, paper prepared for the OECD conference “FDI and environment – lessons from mining”, 7 and 8 February 2002, Paris.

¹⁶ Bond, James, and Monika Weber-Fahr, Attracting FDI in Mining – The role of reliable environmental frameworks and of competent institutions, The World Bank, paper prepared for the OECD conference “FDI and environment – lessons from mining”, 7 and 8 February 2002, Paris.

Capacity building is not only needed in developing country government institutions. Participants also identified the need to improve the capacity of civil society and in the business community. This will be important in order to allow for the full participation of the civil society in stakeholder processes and to exert their “watch dog” function effectively. Disclosure policies are needed to ensure that all effected groups (labour, local communities and Governments) have regular and understandable data on what the mine is doing. This would help civil society groups to identify non-compliant behaviour of companies more easily. For business there is a need to build additional capacity to cope with situations where governments are weak, but also to build capacity into small and medium sized enterprises which often experience difficulties in complying with regulatory requirements.

However, increasing needs for capacity building in developing countries have to be seen against the background of steadily decreasing levels of official development aid (ODA). If the benefits of globalisation are to be more equitably distributed, there will be a need to strengthen capacity in areas like trade and investment. The recent WTO Doha declaration explicitly identifies the need for capacity building for investment.

- *International Financial Institutions and Export Credit Agencies can play an important role, too*
Participants saw an important role for IFIs in helping to develop capacity in developing countries, and in providing finance with environmental conditionality attached to mining projects. While IFIs mostly provide only a small share of the overall finance for mining projects, export credit agencies oftentimes play a more important role. In the case of the Antamina project in Peru, export credits accounted for more than half of the total finance¹⁷. Participants noted the work that was under way in OECD to reach agreement on common approaches for environmental assessments of projects supported by Export Credit Agencies (ECAs), and called on ECAs to integrate such approaches into their operations as soon as possible.

- *Extending liability - extraterritoriality*
Given that most of the capital for mining investment is generally provided by commercial financial institutions, some participants proposed that liability for environmental damages caused in their projects should be extended to them. If this extended to extra territorial liabilities this would increase the incentives for financial institutions to monitor the environmental aspects of their investment projects more carefully and help to compensate for the possible weakness of regulatory systems. Some participants emphasised the challenges that would need to be overcome to develop such an international convention. They suggested that a voluntary negotiated agreement among financial institutions on environmental requirements in their operations could be a more practical step forward¹⁸.

The role of voluntary approaches

- *Existing initiatives have not led to the expected results*
When regulatory systems are weak and basic principles of good governance are not in place, the role of business in ensuring sound environmental and social practice gains added importance. Mining companies have attempted to improve their environmental performance through the adoption of codes of good practice, environmental management systems, environmental charters or other forms of voluntary initiatives. However, there was a recognition that generally the efforts in the mining industry to date had not been sufficient to improve the sector’s “social licence to operate”.

¹⁷ Caroline Digby, MMSD, Economic and financial aspects of the mining sector, presentation at the OECD conference “FDI and environment – lessons from mining”, 7 and 8 February 2002, Paris

¹⁸ Garvey, Tom, Lessons from Baia Mare for FDI, paper prepared for the OECD conference “FDI and environment – lessons from mining”, 7 and 8 February 2002, Paris.

The main reasons identified were:

- The problem of free-riders
- The frequent lack of a set of clearly-defined targets
- The absence of monitoring and enforcement procedures
- The absence of external, independent verification
- *More transparency and partnership are needed*

New generations of voluntary environmental performance codes should be science based, accountable, rigorous and transparent. The cyanide code, which is being launched by major gold producers, UNEP and the International Council on Mining and Metals (ICMM) to address urgent cyanide management needs, was seen to be an important step forward by many participants¹⁹. Given the frequent conflicts about the environmental impacts of mining, it was proposed that an international mining technology centre that could provide independent assessments should be created.

- *OECD Guidelines for Multinational Enterprises – a step forward*

The OECD guidelines, which have been approved and signed by 36 OECD and non-OECD governments, were perceived to be an important complement to existing regulatory frameworks in developing countries²⁰. Participants perceived some of the strengths of the guidelines in their generic character, which makes them applicable to a wide range of issues, as well as in their implementation procedure. Some saw that key to the effectiveness of the MNE guidelines will be whether national contact points, who are in charge of their promotion and of monitoring their implementation, will act as “honest brokers” in the case of complaints. In the mining sector several cases, spanning a range of issues (e.g. disclosure of information, resettlement, environmental health and safety) had already been forwarded to national contact points²¹.

- *Voluntary initiatives require proper government regulation to be effective*

While participants generally acknowledged that voluntary initiatives can be a useful complement to regulatory systems, they also pointed to the fact that initiatives will only work well where general principles of good governance are in place²². For this reason, and because the key incentive for business to engage into voluntary initiatives is to protect its reputation, they can not be expected to substitute for effective government regulation. Voluntary initiatives have proven to be of little effectiveness especially with the SME sector, where companies do often not have a public image to protect.

Areas for further work

Participants identified several priority areas for future work:

¹⁹ Hair, Jay, Lessons from the Mining Sector: Sustainable Development and Voluntary Approaches for Enhanced Performance, presentation at the OECD conference “FDI and environment – lessons from mining”, 7 and 8 February 2002, Paris.

²⁰ Gordon, Kathryn and Florent Pestre, Moving towards healthier governance in host countries – The role of extractive industries, paper prepared for the OECD conference “FDI and environment – lessons from mining”, 7 and 8 February 2002, Paris.

²¹ Feeney, Patricia, The relevance of the OECD Guidelines for Multinational Enterprises to the Mining Sector and to the Promotion of Sustainable Development, Oxfam UK, paper prepared for the OECD conference “FDI and environment – lessons from mining”, 7 and 8 February 2002, Paris.

²² Gordon and Pestre, idem.

- While there are numerous case studies documenting the economic, social and environmental repercussions of mining, some participants stressed that **further research is needed to identify the aggregate impacts of mining FDI on developing country economies**. In particular the distribution of costs and benefits among different groups within the host country and externally would merit further attention. An extension of this approach to other industrial sectors would provide interesting cross-sector comparisons.
- Good governance is a key prerequisite for mining and other foreign investments to contribute in a positive way to sustainable development. Where governance systems are not functioning well, it is difficult to deal adequately with the complex environmental and social problems that are being posed by mining activity. Otherwise, there is a range of policies that help to ensure a positive contribution to sustainable development from mining. Participants recognised that many of the sustainable development challenges posed to the mining sector are linked to the frequently weak governance frameworks in FDI host countries. Many avoidable environmental impacts of mining FDI are due to regulatory weaknesses and failures. There is therefore a crucial need for the **strengthening of FDI host country policy and institutional frameworks to manage the mining sector**. Particular attention will be required for the strengthening of enforcement mechanisms. A greater degree of involvement of non-governmental organisations and community groups in the process of public decision-making concerning mining operations could support these efforts. Civil society groups can play important roles in monitoring the environmental performance of mining operations, but need support to develop appropriate capacities.
- FDI home countries, and in particular **OECD members, can support these efforts in several ways**. (i) They can **work with multinational enterprises** and encourage them to apply best practices in their overseas operations (e.g. to follow the OECD Guidelines for Multinational Enterprises); (ii) they can **tie financial assistance** provided through Export Credit Agencies **to the implementation of adequate environmental and social assessment procedures**; and (iii) they can **provide assistance for capacity building** in FDI host country institutions and organisations. Participants recognised however, that it has become increasingly difficult to find resources for capacity building in the context of steadily decreasing levels and the direct poverty focus of Official Development Assistance (ODA). If effective means and resources for capacity development cannot be found there is a danger that ensuing negative environmental and social effects may generate further resistance to globalisation. Therefore alternative and innovative ways have to be found to overcome such constraints.
- **Technical standards for environmental protection developed by the World Bank**, and promoted through its financial mechanisms, **appear to be becoming the major international environmental reference**. However, the legitimacy of these standards to play such a role has been questioned. The World Bank standards have been developed largely through an expert process and are designed primarily for use by the Bank. Some developing country representatives are concerned that they are losing control of environmental standards that are applied on their territory. **The question was posed as to whether a more widely agreed set of standards is needed, and how those should be developed**. It was noted that the MMSD would be making recommendations in this regard.
- A particular challenge for the design of environmental regulation in the mining sector was seen to be posed by **the non-discrimination principle in investment policy**. Clearly the environmental rationale for any decision that had a discriminatory impact should be clearly established. However, this may be difficult to do in practice (e.g. defining like circumstances). Some saw the danger that an overly strict application of the non-discrimination principle could unduly constrain environmental decision-making. **Work to follow-up the WTO Doha declaration will need to take up this challenging issue**.

- The role of financial institutions (public and private) in helping to ensure positive environmental and social outcomes of mining was also addressed. IFIs and export credit agencies, and to a lesser extent commercial FIs, are increasingly attaching environmental requirements to the finance that they provide to the mining sector. While this has led to some improvements, it has not prevented a number of severe mining accidents to occur in bank-financed mining projects. Some participants suggested that further **work should be carried out on the possible development of an international legal instrument addressing the liability of financial institutions for the environmental impacts of their operations.** A voluntary agreement on environmental risk assessment and management could be a more practical option in the short term.
- Going beyond the usual debate on voluntary approaches (VAs) versus other environmental policy instruments, **participants recognised that VAs should be seen as one element in a policy-mix** instead. Experience shows that within an appropriately designed policy framework voluntary business initiatives can help to improve the environmental performance of companies. The ways in which voluntary initiatives can be usefully articulated with other policy instruments remains largely unknown however. Further work is therefore needed in analysing voluntary initiatives in a policy-mix. In particular, **the ways in which a policy-mix might help to provide crucial functions such as verification and arbitration to voluntary initiatives will be of particular interest.** Further work to review the implementation of the OECD Guidelines for Multinational Enterprises was recommended.
- Given the difficulties **to include environmental and social objectives** effectively into corporate governance systems on a voluntary basis, it was suggested that they could be included **into company law** instead. This could have the advantage of creating a level playing field by constraining all companies alike to incorporate public good aspects into their decision making.