

MEMORANDUM

SUSTAINABLE DEVELOPMENT ISSUES RELATING TO THE FORTHCOMING REPORT OF THE INSTITUTE FOR INTERNATIONAL ECONOMICS ON THE ROLE AND MISSION OF THE OVERSEAS PRIVATE INVESTMENT CORPORATION

ON BEHALF OF

Environmental Defense, AFL-CIO

*Oxfam America, Friends of the Earth-U.S., Greenpeace USA,
International Rivers Network, Institute for Policy Studies, Bank Information Center,
Pacific Environment, Rainforest Action Network*

1. Composition of the IIE OPIC Study Group

We were and remain perplexed and concerned by the composition of the approximately 30-member Study Group, which, with the exception of two members from non-governmental groups in the environment and labor communities (Environmental Defense and the AFL-CIO), consisted almost entirely of representatives of OPIC's corporate and financial clients, and trade and lobby associations representing the interests of these clients, along with a number of U.S. government officials. The Study Group had no representatives or voice from the development community, nor any representative from any one of numerous respected human rights organizations, some of which have directly criticized specific OPIC operations.

The unbalanced make-up of the Group is in our view difficult to justify, especially given the statements of OPIC representatives, including OPIC President Peter Watson, that a major rationale for the study--in anticipation of future Congressional deliberations on renewing OPIC's charter--would be to set out a framework in which OPIC could refocus and better justify its operations in a development context. Yet it was quite apparent from the discussions and the make-up of the Group that the overwhelming majority of the persons present, including the individual charged with writing the report, have no primary background or extensive knowledge of recent trends and debates concerning sustainable development within the United Nations, OECD, or multilateral development bank context.¹

The question of how OPIC could better contribute to sustainable development, as it has been elaborated and discussed in countless international fora for the past decade since the

¹ There was one representative from the World Bank's MIGA, an entity which has come under increasing scrutiny for its lack of effective development impact in comparison with other affiliates of the World Bank Group. For fiscal year 2002 the Congress cut the Administration's appropriations request for MIGA by 50%. The bipartisan Meltzer Commission recommended that MIGA be abolished. MIGA is the entity in the multilateral system that most resembles OPIC.

1992 Rio Earth Summit, was hardly touched upon in the three sessions. Presumably this should be a major focus of the report if the intent is to avoid more “near death” experiences (to use the words of some members of the Working Group) in Congressional rechartering deliberations, where allegations of corporate welfare and lack of development effectiveness in OPIC operations could be major issues. Indeed, much of the discussion in the three Study Group sessions seemed to focus on how OPIC could expand, somewhat indiscriminately, its operations, rather than articulating sustainable development criteria that would result in greater selectivity and development effectiveness. Only greater selectivity and demonstrated development effectiveness will garner wider political support among constituencies other than the companies and financial institutions that benefit directly from OPIC financial services.

2. Process and Methodology through which the Report is being produced

We regret that it was not made clear in advance to members exactly what the role of the Study Group would be, or how its deliberations would feed into and influence the report, or whether they would be reflected or not reflected in the report at all. After explicit questions were raised in the first session, representatives of IIE asserted that the report was the exclusive product and property of IIE, that all decisions were at IIE’s exclusive discretion, and that the Working Group sessions were for informational purposes of a vague and undefined nature, viz. some, many or none of the views and information presented by members might or might not be reflected in some form in the Report, most of which is being drafted this summer by Professor Ted Moran of Georgetown University. One of the reasons Environmental Defense and the AFL-CIO have drafted this memorandum and the attached cover letter (endorsed by and submitted on behalf of eight additional development and environment groups) is that Environmental Defense and the AFL-CIO do not wish to have their institutional reputations associated with a document over which they have no input or control, with such a vague and untransparent methodology. Mention of institutional participation in the Study Group might possibly create confusion concerning our contribution to, or partial endorsement, of any of its findings and recommendations. We believe that the ambiguous and untransparent methodology that appears to characterize the process so far does not contribute to the eventual credibility of the exercise.

3. Learning from Recent Controversies Concerning OPIC-Supported Projects

A number of recent OPIC-supported projects have been the subject of highly publicized international controversy involving allegations of social, human rights, labor and environmental abuses as well as allegations of corruption and undue influence of corporate clients. A number of these cases, such as the Indonesia Paiton thermal power plant in Indonesia and the Cuiaba pipeline running from Bolivia to Brazil, have received the most prominent and credible international media attention, including front-page exposé stories highly critical of OPIC in the *Wall Street Journal* and *Washington Post*. The India Dabhol power plant, besides having been the subject of numerous recent news stories alleging undue influence, corruption, and possibly illegal financial misrepresentations on the part of OPIC’s client Enron, is also the subject of a 165-page

book by the respected human rights organization Human Rights Watch. The book's title, "The Enron Corporation: Corporate Complicity in Human Rights Violations," speaks for itself.

These cases were not even on the agenda for the IIE discussion until they were explicitly raised. In the short discussions that took place concerning projects such as Paiton and the India Dabhol power plant, as well as the Cuiaba pipeline, we were disappointed and dismayed at the defensive and insouciant reaction of some participants in the Working Group and of OPIC staff, who appeared to defend the projects as environmentally, economically and socially sound decisions which only went awry because of "unforeseeable" events, for example the East Asia financial crisis. The reporters of the *Wall Street Journal*, *Washington Post*, and the researchers of Human Rights Watch have done a much more thorough analysis of the abuses in these projects than could be summarized in this letter. We have attached articles from the *Journal*, *Post* and the Human Rights Watch book as initial reference materials, the allegations and implications of which for OPIC's future we would hope and expect will be addressed in the report.

In the area of environmental, labor and human rights abuses, and violations of host country law, three other recent controversies involving OPIC supported projects deserve mention. The first concerns the approval of \$350 million in loans by OPIC in February, 2002 for the construction of deep-water oil and gas production platforms, at least 40 production wells, and two 60-kilometer oil and gas pipelines for the expansion of Unocal's Indonesia East Kalimantan operations. Unocal's operations in the deeply Islamic East Kalimantan coastal region have been plagued by environmental and human rights abuses reported by Indonesian NGOs, spurring protests by over 300 local residents in October 2000. The protesters blockaded access to Unocal operations, resulting in the intervention of security forces who shot seven protesters and severely beat and injured sixteen others.

OPIC sent a due diligence team in January 2002, but claimed to find no way of ascertaining whether alleged environmental and human rights abuses had occurred. Indonesian groups are protesting OPIC's negligence of human rights and environmental abuses in the project, including Unocal's apparent violation of Indonesian environmental assessment laws. It is particularly disturbing that OPIC has proceeded in such a fashion in coastal East Kalimantan, known for the devoutness of its Islamic population, where there are growing tensions concerning the behavior of OPIC's client in the midst of an ongoing situation of alleged human rights and environmental abuses. Attached is a longer document on this situation based on detailed reports of Indonesian NGOs and prepared by Environmental Defense Senior Social Scientist Stephanie Fried.

The second controversy concerns the Philippine Casecan power and irrigation project, for which OPIC provided a \$100 million loan guarantee and a \$150 million insurance to California Energy in 1995. The Philippine Freedom From Debt Coalition is now urging the current Philippine government to rescind the power purchase and water use agreements associated with the project, alleging violations of various Philippine laws, undue influence and cronyism in the awarding of the contracts to OPIC's client,

unmitigated adverse environmental and social impacts, excessively high power and water use fees, and corrupt practices adversely affecting the lives of local inhabitants. The recent report on the OPIC-supported Casecan Project of the Philippine Freedom from Debt Coalition is attached.

The third project concerns the case of illegally fired workers (in contravention of local national law, OPIC labor standards, and core conventions of the International Labor Organization to which the US is a party) in the San Jose Power Station in Escuintla, Guatemala. In 1998 OPIC provided a \$32 million loan for the project to support the Florida firm Teco Power Services. According to local and international NGOs, Teco contracted another US firm, J.A. Jones, to construct the plant. J.A. Jones, in turn, subcontracted the work out to eight companies, one of which was the Salvadoran firm Dymel. In 1999 Dymel fired some 158 workers who were attempting to unionize to improve unsafe and dangerous working conditions. Supervisors had subjected the workers to escalating harassment, including death threats. Guatemala's highest court ruled that the dismissals were illegal and ordered Dymel in 2001 to reinstate the workers and pay back wages. Dymel refused and the illegally fired workers have been staging vigils outside the Presidential Palace in Guatemala City demanding justice and enforcement of the court's decree. In May 2002 OPIC sent two lawyers to meet with the union representatives. The lawyers aroused hope that some sort of action would be forthcoming on the part of OPIC, but none has taken place. OPIC has given no assurance that Teco Energy will be sanctioned in any way for the non-compliance of its sub-contractors, despite OPIC's being aware of the situation since 1999 and OPIC's requirements under the Foreign Assistance Act to maintain internationally recognized labor standards.

The Teco situation is an important precedent, since it raises the generic issue of enforcing OPIC labor standards for sub-contractors of its clients in developing nations. Similar situations will undoubtedly arise and may already exist in other countries as noted in annual State Department Country Reports.

More information on the Guatemala Teco controversy is also included with this letter as an attachment.

The IIE report will lack credibility if it does not address the institutional and policy issues raised for OPIC by the economic, environmental, social and legal abuses alleged by numerous media and non-governmental groups in these and other projects. Based on its findings, the report should set out a framework and recommendations that will credibly address how such abuses can be avoided in future OPIC operations.

4. The Need for OPIC to Articulate Specific Measures and Staffing Changes to Improve the Implementation of Existing Environmental and Labor Standards

The above-mentioned cases and other examples clearly demonstrate that OPIC is not adequately implementing its existing environmental and labor standards. We believe that part of the problem is capacity, and part political will and priority setting. The repeated involvement of OPIC in projects with major environmental, labor and human rights problems would indicate that OPIC's current staffing is not becoming apprised of such problems early enough or in the due diligence process. Moreover, even when OPIC is apprised of such problems, through protests or by communications from local or international NGOs, the political will and institutional priority to act in some cases appears to be lacking.

Indeed, many in the non-governmental community who follow OPIC have lost confidence in the willingness of decision-makers at OPIC to implement environmental and labor guidelines and standards in an effective and transparent manner. The May 6, 2002 front page *Washington Post* story on OPIC's involvement in the Bolivia-Brazil Cuiaba pipeline project portrays an alarming situation where political pressure to satisfy a particular corporate client—Enron—distorted judgment from top management down, despite site visits of environmental staff and opposition even from within the U.S. Government. The Guatemala Tecu power project case mentioned above involves a situation where labor rights violations have continued for the better part of three years; OPIC's client does not appear to have perceived any particular urgency or priority for remedying clearly identified abuses.

It is for these reasons that we recommend the establishment, within OPIC, or based within an appropriate agency of one of OPIC's US Government Board Members such as USAID, the Department of Labor, or the State Department, of an independent ombudsman's office to address independently claims of environmental, social, labor and human rights abuses in prospective and ongoing OPIC operations. Such an ombudsman would have a dedicated budget separate from general management resources, would not be subject to direct control or replacement by OPIC management, and would report directly to OPIC's directors. One model for such an ombudsman function would be the IFC/MIGA Compliance Advisor Ombudsman in the World Bank Group.

We believe that such a measure is in OPIC's best interest if it is to avoid future development debacles and consequent scandals that could clearly undermine the development constituency it seeks for support in Congressional rechartering.

5. The Need for Improved Policies and Procedures to Adequately Address Social, Environmental, Labor Rights and Human Rights Issues in OPIC Operations.

In addition to the independent ombudsman function described above, we believe there are several other needed changes in OPIC policies and procedures to ensure more credible performance with respect to sustainable development.

First, there is a need for far greater transparency with respect to environmental assessment of sub-projects financed under OPIC Investment Funds. Currently environmental assessments for sub-projects financed by OPIC investment funds with

significant adverse environmental impacts (Category A) are not made public, nor is there any requirement for public consultation and comment. In effect, there is a double standard for environmental assessment: transparency and public consultation and comment are required for Category A projects directly supported by OPIC, but not for investment fund projects. Transparency, public consultation and comment are the most important elements of the environmental assessment process as it has evolved in international good practice over the past thirty years.

If OPIC believes that it cannot make environmental information and assessments public in a timely fashion before the approval of sub-projects in its investment funds, it should institute a categorical prohibition against the financing of any Category A investments by the investment funds.

Second, OPIC's support for large-scale oil and gas and extractive projects is particularly subject to scrutiny and skepticism concerning their positive development impacts. If OPIC wishes to improve its reputation as an agency promoting development, it should seek to limit its support for such operations, and be much more selective in the projects it does support. The development record of such oil, gas and extractive projects in developing countries is particularly poor.

In the words of George Soros, in a June 13 *Financial Times* editorial, "though blessed with valuable minerals such as oil, diamonds and gold, the ordinary people of Angola, Nigeria, Kazakhstan, and elsewhere, are mired in poverty while corrupt officials prosper.... There is a close connection between the exploitation of natural resources and the prevalence of corrupt and oppressive regimes." Soros cites a number of countries where OPIC operates and of corporations accused of abuses, including some OPIC clients. The situation is particularly acute in Africa and Central Asia. We support his affirmation that multinational corporations "cannot escape responsibility for what happens in the countries in which they operate," and, we would add, neither can official agencies that offer them support, such as OPIC.

We also urge OPIC to adopt as policy the recommendation that Soros and more than 30 international NGOs have recently put forth, that all corporations involved in oil, gas and natural resource extraction projects in developing countries be required to make public disclosure of taxes, fees, royalties and other payments to governments as a condition of receiving OPIC support. (The Soros and NGO recommendation was that this be a condition of their receiving listing on any major national or international stock exchange.) The companies already gather this information, and its public disclosure would be an important first step in fighting large-scale corruption and misappropriation of funds in host developing countries. We also believe that OPIC should require its clients in extractive industry sectors to make production sharing, profit sharing, power purchasing and other agreements between them and host governments transparent and subject to public consultation. These agreements greatly influence many of the environmental and developmental impacts of projects, and it is therefore incumbent upon OPIC to include them in its exchange of project information and discussion with civil society.

Third, OPIC should undertake more vigorous measures to reduce the annual level of greenhouse gas emissions its insurance, guarantees and loans support. Options include an annual cap on total emissions from new projects financed, phasing out support for extraction and pipeline projects where the fuel is then exported to the United States leaving undefined development benefits in the host country, and a commitment to increase the proportion of its energy portfolio devoted to renewable alternative energy such as wind, solar and geothermal via a set percentage target.

Fourth, OPIC should require its clients to follow the recommendations of the World Commission on Dams in all dam projects it will support. The World Commission on Dams provides a consensus on international good practice for dam construction, worked out by major stakeholders, including industry leaders, NGOs, and representatives of international financial institutions. Official support by OPIC for the WCD recommendations would reduce long term social and political risk in investments OPIC supports, and would contribute to the emergence of a international level playing field for social and environmental standards for investors in this highly contentious area.

Fifth, the widespread criticism of OPIC's interpretation of its categorical prohibition on extractive and infrastructure projects in primary tropical forests in the Cuiaba pipeline project underscores the need for strengthening and clarifying which primary forests are covered by this guideline. Leading conservation organizations have suggested that the term "primary forests of high conservation value"—which can include mostly intact forests that have undergone some secondary human modification—would avoid such controversies in the future. OPIC President Peter Watson has pledged to review this issue, but so far no action has been forthcoming.

6. The Need to Fully Evaluate the Development Benefits and the Impacts on U.S. Employment of OPIC Support for Investment in Labor Intensive Manufacturing and Processing Industries Abroad

Labor and development groups are concerned by some suggestions made in the Working Group discussions that OPIC should increase its support for U.S. businesses to move overseas and/or invest in, labor intensive manufacturing and processing industries abroad. Agencies of the U.S. government should not be subsidizing the export of American jobs. Outward U.S. foreign direct investment (FDI) does not uniformly and inevitably create high-quality jobs in the United States, despite the assertions made by several Study Group participants. While certain kinds of outward FDI can have that effect, others (like shifting U.S. production offshore) displace American jobs and put downward pressure on American wages. It is precisely because of the mixed impact of outward FDI that stringent and accurate measures of the U.S. economic impact of OPIC loans are essential, contrary to the suggestion repeated numerous times at the Study Group, that such economic impact measures should be weakened or eliminated.

Moreover, there is alarming evidence that increased investment in off-shore labor intensive industry for export back to the United States and other industrialized countries

is not leading to increased wages in developing countries, but to the opposite. Economist Alan Tonelson examined the apparel sector in a June 2, 2002 Washington Post article, noting that real wages in this sector in major developing countries such as Pakistan, China, Indonesia and Turkey have fallen steadily over the past decade as investment in new manufacturing and assembly facilities has increased. “The figures show,” Tonelson notes, “that there has been almost uniform wage meltdown in the apparel industry in the Third World.” Indeed, Tonelson adds, “in some countries, the pattern extends far beyond the apparel industry. A 1999 report from the Harvard Institute of International Development and the World Economic Forum revealed falling real wages, in local currency, across all sectors in China, Indonesia and the Philippines between 1990 and 1997. This backsliding occurred well before the region’s financial collapse.”

7. The Need for OPIC to Articulate New Measures to Fight Corruption in Investments it Supports.

According to Transparency International, the problem of corruption is endemic in much private direct investment and export finance in developing countries. In some highly publicized cases such as the India Dabhol and Indonesia Paiton power plants there have been widespread allegations of corruption involving OPIC clients and OPIC supported projects. According to a 1997 research paper by Shang-Jin Wei of Harvard University American investors are not “necessarily more adverse” to corruption in host countries “than average OECD investors...in spite of the US Foreign Corrupt Practices Act.”² We believe OPIC should adopt the following seven measures to more rigorously address potential corruption by clients or in the investments it supports. Measures two through seven reiterate the recommendations of Transparency International for publicly support export credit agencies and investment insurers.

First, OPIC should document in its Annual Report how for its clients it is monitoring and ensuring adherence to the Foreign Corrupt Practices Act.

Second, every applicant for OPIC cover should be required to submit a no-bribery affidavit.

Third, if there is a bona-fide charge of bribery or any suspicion, OPIC should investigate and, while doing so, suspend all claims under this cover until the suspicion has been removed.

Fourth, OPIC should introduce effective sanctions against applicants who have violated the no-bribery policy, including denial of indemnification on the ground of invalidity of the bribe-tainted contract, disqualification from access to ECA support for an appropriate period of time, and forfeiture of any fees already paid. A violation should be assumed not only, when a criminal conviction has occurred, but also when an explicit confession

² Shang-Jin Wei, Harvard University and NBER, “How Taxing is Corruption on International Investors,” paper delivered at Eighth International Anti-Corruption Conference, Lima, Peru, September, 1997, http://www.transparency.org/iacc/8th_iacc/papers/jinwei.html, Abstract, p. 1.

has been made or when convincing evidence for the violation exists and the violation is not convincingly contested.

Fifth, whenever an indemnification case arises, the company covered should be required to disclose all commissions, fees or other payments made by it or on its behalf to anyone in connection with the contract.

Sixth, OPIC should develop effective information and guidelines for its customers and its staff so as to assure full knowledge of its corruption policies and practices among its customers and staff. This includes clear information to all applicants about the consequences of bribery.

Seventh, OPIC should assure transparency and publish cases of confirmed violations and denials of cover or indemnification, through the Internet and its Annual Report.

8. The Need for Greater Selectivity in OPIC's Choice of Investment Projects

We were disturbed by the arguments offered by some IIE staff that imply that all private direct investment in developing countries is economically and socially beneficial for the host nation. In many developing countries large-scale extractive projects in the petroleum and mining sectors have left little long-term social and economic benefit, but have wrought environmental and social damage that has economically and politically destabilized whole regions.

OPIC should create a development screen to select the best projects for support based on clear development benefit standards. The articulation of these development screen standards should be subject to a public comment process via the Federal Register.

The financing of developmentally and economically sub-optimal investment projects can have a negative development impact, particularly if the terms of the project arrangement require onerous host country financial commitments. This can occur through power purchase agreements that courts would rule unconscionable in the United States; through host country counter-guarantees for overly risky projects; and through the increased debt burden that host country governments may assume for parts of the financing of large, economically sub-optimal investment projects (for example, projects for which the driving force is the political clout of American corporations and banks and local rent-seeking elites rather than the optimal development path for the host country.) The Paiton and Dabhol debacles are emblematic for this kind of 'maldevelopment' which OPIC must cease to support if it wishes to obtain credibility as an institution that is serious about fostering development.

APPENDICES

1. India Enron Dabhol Power Project:

Human Rights Watch, *The Enron Corporation: Corporate Complicity in Human Rights Violations*, Human Rights Watch, 1999.

2. Indonesia Paiton Power Project:

Peter Waldman and Jay Solomon, "Power Deals With Cuts for First Family in Indonesia Are Coming Under Attack," *Wall Street Journal*, December 23, 1998, p. 1.

3. Bolivia-Brazil Enron Cuiaba Pipeline Project:

James V. Grimaldi, "Enron Pipeline Leaves Scar on South America: Lobbying, U.S. Loans Put Project on Damaging Path," *Washington Post*, May 6, 2002, p. A1.

4. Indonesia East Kalimantan UNOCAL Oil and Gas Production and Pipelines Project:

Stephanie Fried, Senior Scientist, Environmental Defense, "Deceived Again? The 'War Against Terrorism,' OPIC, and UNOCAL Operations in East Kalimantan," Environmental Defense, June, 2002.

5. Philippine Casecan Power and Irrigation Project:

Maria Teresa Diokno-Pascual and Shalom MK Macli-ing, Freedom from Debt Coalition, "The Controversial Casnecan Project," Philippine Citizens IPP Review Commission, 2002.

6. Guatemala Tecu Power Services San Jose Power Station Project:

Annie Bird, Director, Rights Action, letter to Peter Watson, President, OPIC, June 7 2002.

Rights Action, SITRADYMELSAAC Energy Workers Union, Campaign Briefing Paper, June 2002.

Rights Action, STRADYMELSAAC Energy Workers Union, Timeline of Events, 2002