

UK Export Credit Policy, Corporate Governance and Future Investment in Turkey: Lessons from the Ilisu Hydroelectric Project

A Memorandum from Concerned Non-Governmental Organisations

January 2002

Background

In November 2001, the UK construction company Balfour Beatty announced its withdrawal from the Ilisu Hydroelectric Project in the Kurdish region of South East Turkey.¹ The company had been seeking an export credit of \$200 million from the UK Export Credits Guarantee Department – a credit which the government had indicated it was “minded” to approve, subject to a number of environmental and social conditions. In a statement, Balfour Beatty explained that its decision to withdraw: "follows a thorough and extensive valuation of the commercial, environmental and social issues inherent in the project. With appropriate solutions to these issues still unsecured and no early resolution likely, Balfour Beatty believes that it is not in the best interest of its stakeholders to pursue the project further."

The announcement followed a sustained international campaign against the project, which would forcibly evict some 78,000 people, mainly ethnic Kurds, and submerge the ancient town of Hasankeyf, a site of major archaeological significance. Critics have charged that the project fails to meet the most basic international standards with regard to resettlement and environment – and that the long and continuing history of repression of the Kurdish majority in the region by the Turkish authorities makes a just outcome to the project unrealisable. Fears have also been expressed that the dam would adversely affect downstream agriculture and exacerbate the potential for regional conflict over water between Turkey and its neighbours, Syria and Iraq.

Balfour Beatty's involvement in the dam had been the subject of widespread public concern, both in the UK and abroad. Within the UK, the Ilisu project – and the wider issue of UK export credits policy – has been the subject of a number of parliamentary hearings by two House of Commons committees: the Trade and Industry Committee and the International Development Committee. Both have expressed concern over the institutional practices of the UK Export Credits Guarantee Department (ECGD) and have made a series of recommendations for reform. The corporate governance procedures of Balfour Beatty have also come in for scrutiny – a shareholder motion urging the company to adopt the recently-issued guidelines of the World Commission on Dams gained significant, albeit passive, support from institutional investors.

Balfour Beatty's decision not to pursue its interests in Ilisu means that the UK government is no longer involved in the project, since the company's application for an export credit has now been withdrawn. The UK government has thus been spared having to make a decision on whether or not to support the project. As a result, an expected debate in Parliament, which a number of Select Committees had called for in the event of the government approving an export credit for the project, will no longer take place.

The need for such a debate, however, is urgent. The Ilisu controversy has highlighted numerous institutional failures within the ECGD and has raised critical questions over the effectiveness of the Department's current practices in delivering the sustainable development objectives of the government. Balfour Beatty's handling of the project also raises concerns over corporate governance standards in the UK – and the extent to which greater government direction is required over investments and corporate involvement in countries where human rights abuses are routine. The foreign policy and trade implications of Ilisu have also yet to be analysed or discussed.

¹ Balfour Beatty Press Release, 13 November 2001.

This memorandum seeks to explore some of these issues and to draw some broad policy recommendations. Given that the ECGD has stated that it is still open to considering applications from other UK companies seeking to become involved in Ilisu² – and that it is currently considering projects, such as the Yusufeli Hydroelectric Dam, also in Turkey, which shares many of the same characteristics – it is of critical importance that the policy implications of the Ilisu experience to date are not only learned but also heeded.

1. Ilisu and Export Credit Agency Reform

Ilisu set a number of important precedents in ECGD practice. It was the first time – to our knowledge – that the ECGD has ever rejected an Environmental Impact Assessment (EIA) for a project;³ the first time that it has insisted on the final EIA being made public; and the first time that the ECGD has made approval of an export credit conditional on the project developers' meeting specified environmental and social conditions. It was also the first time that the ECGD had sought to evolve a "common approach" with other export credit agencies (ECAs) as to how to assess the environmental and social impacts of a project. In these respects, Ilisu represented a watershed in the ECGD's approach to the financing of infrastructure projects: previously, such projects would have been approved with little or no consideration of environmental factors.

More broadly, there is little doubt that Ilisu sparked a major internal debate within the ECGD on future policy. Indeed, the UK government acknowledges that the controversy over Ilisu helped prompt reform of the ECGD's mandate and its criteria for assessing credits,⁴ notably through the adoption of a set of "Business Principles" in January 2001.

Whilst these developments are to be welcomed, they fall far short of a policy, let alone a policy that would bring the ECGD into line with international best practice on the financing of infrastructure projects with potential environment, human rights and cultural heritage impacts. For example:

A) Lack of Clear, Legally-enforceable Standards

A constant theme in parliamentary discussions of Ilisu has been the need for the ECGD to adopt clear, ex-ante human rights and development standards. The case for such standards was made particularly forcibly by the International Development Committee in its Sixth Report, *ECGD, Developmental Issues and the Ilisu Dam*:

*"There is good reason for the expectation that relevant international criteria should be met before a proposal is agreed and cover sought - it is a sign of political will, institutional capacity, development commitment and good faith. The shotgun wedding approach to export credit that we find in the case of the Ilisu Dam does not in our view bode well for the implementation of commitments but is rather the worst form of export credit practice."*⁵

Unfortunately, the ECGD's new Business Principles continue the very shotgun wedding approach that the Committee criticised. Instead of introducing a set of clear, legally binding, ex-ante environmental,

² David Allwood, ECGD, quoted in Grossman, J, "Blue Planet: Turkish dam fight to continue", UPI, 9th January 2002.

³ The initial EIA for Ilisu was rejected by the participating Export Credit Agencies. It was never released to the public. Subsequently, an "updated" EIA was undertaken and published.

⁴ The Fifth Report of the International Development Committee (4 April 2001): "The government has itself acknowledged the policy significance of the Ilisu Dam in its response to our report 'ECGD, Development Issues and the Ilisu Dam', stating that 'The careful work that has been devoted to considering the Ilisu Dam application and pressing the Turkish authorities to improve aspects of the project has helped inform ECGD's Mission and Status Review'".

⁵ International Development Committee, Sixth Report, *ECGD, Developmental Issues and the Ilisu Dam*, House of Commons, The Stationery Office, 6 July 2000, p.vii.

development and human rights standards, the new procedures are based on a "benchmarking approach" under which the ECGD decides what standards should be applied on a case-by-case basis.

Different standards are thus applied (or not applied) at the discretion of ECGD staff, encouraging an ad hoc approach that is bureaucratic, unwieldy and potentially open to abuse. Not only is the legal status of the Business Principles unclear but the Principles themselves fail to commit the ECGD to anything; even the "expectation" that project developers comply with the laws of the host country is entirely discretionary.⁶ Moreover, the Principles provide none of the incentives, penalties, binding rules and avenues of redress that would make them a suitable instrument for governing the ECGD's business practice.

Significantly, there is no requirement to reveal the basis on which such standards are chosen; those affected by a project are thus denied an opportunity to question the basis on which decisions of critical importance to their future are being made. In the case of Ilisu, the ECGD explicitly refused requests to list the international conventions and standards that it would take into account in order to assess compliance with the four conditions it had laid down for export credit support,⁷ giving only a general indication that the UK would comply with its international obligations.⁸

The ad hoc approach embodied by the Business Principles also fails to provide exporters with the clarity and predictability that they need for long-term planning – to the potential detriment of the UK economy as a whole and to the disadvantage of individual companies. We note, for example, that, despite the clear similarities between the Ilisu project and the Yusufeli project, the ECGD has placed no conditions on export credit support for Yusufeli. This would appear to contravene directly the Trade and Industry Committee's important recommendation that "Ministers must not only be even handed between the two projects but must be seen to be even-handed."⁹ Ad hoc standard setting is also likely to build unnecessarily elaborate and bureaucratically time-consuming processes in the determination of standards for each particular case. This can only create extra demands on ECA staff time that could instead be freed up for other aspects of environmental review and risk analysis if, for instance, benchmarking were replaced by a clear, consistent and transparent commitment to common ex-ante standards.

We recommend that:

- **ECGD adopt clear, ex-ante standards that apply to all its projects. Such standards should reflect best international practice, as exemplified, for example, by the recommended guidelines of the World Commission on Dams, and should cover human rights, environment, cultural heritage, gender and development impacts. At a minimum, the ECGD should adopt standards based on those of the World Bank/IFC, EBRD and European Union.**

⁶ ECGD, "An Introduction to ECGD's Impact Screening and Analysis Procedures", January 2001. The discretionary nature of the language of the standards is clear from the highlighted phrases in the following passages describing the standards: "As a minimum, ECGD *expects* all projects/goods/services to comply with host/destination legislation, regulations and standards"; "Suppliers of goods and services forming only a minor part of a project will *normally be expected* to comply with UK legislation, regulations or standards. Any departures from this will need to be justified to the satisfaction of the ECGD"; "Projects/goods/services that comply with an international standards (eg. World Bank, IFC or relevant regional Development Bank) *will not normally* be investigated further for environmental impacts (except possibly for verification of compliance)"; "Host/destination country or project standards which are below international standards *may be* unacceptable and would need to be justified. ECGD will use international standards as benchmarks against which to make this judgement. We will look to the customer/exporter to provide this justification wherever possible."

⁷ The four conditions, laid down by the Secretary of State for Trade and Industry in December 1999, were: "1. Draw up a resettlement programme which reflects internationally accepted practice and includes independent monitoring; 2. Make provision for upstream water treatment plants capable of ensuring that water quality is maintained; 3. Give an assurance that adequate downstream flows will be maintained at all times; 4. Produce a detailed plan to preserve as much of the archaeological heritage of Hasankeyf as possible."

⁸⁸ Letter from Baroness Symons, Minister of State at the Foreign Office, to Philip Leach, Legal Director, Kurdish Human Rights Project, undated but received on 13 August 2001.

⁹ Trade and Industry Committee, May 2001.

B) Project Screening and Exclusion Lists

The debate over Ilisu has also revealed major deficiencies in the environmental screening procedures which have recently been adopted by the ECGD. The lesson from Ilisu would appear to be clear: projects which do not meet international standards and the UK's obligations under international law should not be considered for support and should be screened out at an early stage. Although the ECGD's commitment to a policy of "constructive engagement" to improve the quality of projects is laudable, it has neither the capacity nor the expertise to undertake such a demanding task. In that respect, it is noteworthy that almost two years after the ECGD first announced its four conditions for its support of Ilisu, the project was still in violation of 15 international standards for resettlement on 78 counts. Considering projects that fail to meet international standards is costly to the taxpayer and sends a misleading message to exporters: it may also, as in Ilisu, give tacit approval to regimes that habitually abuse human rights.

Although the ECGD excludes certain categories of export for support - arms to Highly Indebted Poorer Countries (HIPC) for example - it has not extended this "exclusion list" approach to its general portfolio. Instead it now requires applicants to fill in a questionnaire on the environmental and social impacts of the projects for which they are seeking support. Although described as a screening procedure, the questionnaire amounts to no more than an information gathering exercise.¹⁰ Despite the recommendation of the Trade and Industry Committee,¹¹ defence and aerospace contracts – a major segment of the ECGD's portfolio – are excluded from the screening process. The onus is on the applicant to provide the solicited information.

As with the Business Principles, the screening process commits the ECGD to nothing. Indeed, it is significant that of the 200-plus projects screened up to July 2001, not a single project has been rejected on the basis of the screening process.¹² Even where the questionnaire reveals that a project lacks an Environmental Impact Assessment (EIA), there is no requirement for the ECGD to demand one or to insist on measures to mitigate any adverse project impacts.

We urge parliamentarians to press for the following reforms:

- **The adoption of an exclusion list against which projects are screened prior to their consideration for support. Categorical exclusions should include: arms and other non-productive expenditure; nuclear projects; fossil fuel power stations; oil exploration projects in frontier areas; projects affecting indigenous lands which do not enjoy the prior informed consent of the indigenous occupants; projects involving involuntary displacement; projects in protected areas; projects in HIPCs and countries with poor human rights records; and projects that undermine international conventions to which the exporting country is a signatory, not just the host country.**
- **The adoption of a "positive listing" (for example, projects which promote the government's sustainable development objectives).**

C) Transparency

The Ilisu project was criticised by several parliamentary committees for its lack of transparency. Writing in February 2000, for example, the Trade and Industry Committee commented: "The process of consideration of whether to grant export credit for the dam has been bedevilled by an excessive degree of secrecy."¹³ In particular, the Committee criticised the ECGD for its failure to release key documents, such as the first EIA undertaken by the companies.

¹⁰ The Trade and Industry Select Committee has described the screening process as "possibly the weakest form of environmental assessment that could have been chosen." Trade and Industry Committee, Third Report, *The Future of the Export Credits Guarantee Department*, House of Commons, The Stationery Office, 11 January 2000, p.xxxi.

¹¹ Trade and Industry Committee, Third Report, p.xxxi: "We can see no reason for defence and aerospace sectors to be exempted from the [environmental] screening process."

¹² Information supplied by the ECGD, July 2001.

¹³ Trade and Industry Committee, Sixth Report, *Application for Support from ECGD for UK Participation in the Ilisu Dam Project*, House of Commons, The Stationery Office, 28 February 2000, p.x.

With the adoption of the Business Principle – which commit the ECGD to “being as open as possible whilst respecting legitimate commercial and personal confidentiality” – ECGD staff have shown themselves willing to share information. Nonetheless, the rules under which they operate frequently prevent them from doing so. In the case of Ilisu, for example, the ECGD refused to release the Resettlement Action Plan (RAP) for the project – on the grounds not of confidentiality but that it was the property of the Turkish government. The EIA and RAP for the Yusufeli hydroelectric project – for which the UK construction company AMEC is currently seeking credits – have both been denied on similar grounds.

The denial of EIAs and RAPs constitutes a major institutional failure. Public access to environmental information and participatory consultation with stakeholders *prior* to decisions on financial support is a *sine qua non* of best international development practice. Moreover, non-disclosure runs counter to – and may be in violation of – a number of conventions to which the UK is a signatory, including the European Convention of Human Rights and the UN/ECE Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matter (the Aarhus Convention) which recently entered into force.

We also note that the ECGD has still to publish its assessment of the EIA and RAP for Ilisu and has yet to acknowledge the comments on the EIA made by NGOs at the request of the Department itself – a full six months after their submission. Given that the ECGD has stated that it is still willing to consider applications for export credits for Ilisu, the public is entitled to know the ECGD's views on the extent to which the project currently meets the conditions attached to export credit support.

We recommend that:

- **ECGD adopts a presumption in favour of disclosure, with the onus of proving commercial confidentiality resting on the applicants for export credits.**
- **ECGD make the release of EIAs and RAPs a pre-condition for applying for export credit support.**
- **ECGD undertakes to release EIAs to the public in both the project country and the ECA country for a period of no less than 120 days prior to any final commitment.**
- **ECGD should not approve a project until an EIA which meets international best practice, and, where relevant, a RAP to similar standards have been released to the public.**

D) Ilisu and the OECD Negotiations

Throughout the time that the ECGD was considering Balfour Beatty's application for export credits for Ilisu, the ECGD was negotiating an agreement on common environmental guidelines for export credit agencies (ECAs) within the OECD. The ECGD has placed considerable emphasis on the negotiations, arguing that any proposals for change should be placed within a strategy for internationally-agreed reform of ECAs. This view was supported by both the International Development Committee and the Trade and Industry Committee.

Although the ECGD should be congratulated for pushing for reforms within the OECD that went beyond the "built-in agenda" – for example, arguing for the adoption of human rights standards – it has latterly adopted a weaker position, endorsing a version of the proposed agreement which does not even require the release of EIAs and which eschews mandatory standards in favour of benchmarking. We note that, in doing so, the ECGD failed to adhere to the recommendation of the UK's own environment minister who, along with other G-8 Environment ministers, recently called for:

"... the international community to quickly develop and implement common binding environmental guidelines for ECAs for encouraging strengthened integration of environmental consideration in investment decisions."¹⁴

Negotiations within the OECD are currently at a stalemate, the US having rejected the proposed agreement as too weak. The US is insisting that, at a minimum, OECD export credit agencies should commit themselves to following World Bank standards. The likelihood is that the negotiations will now be reopened at the OECD ministerial meeting later in 2002.

We urge members of parliament to press for:

- **A stronger agreement that, at a minimum, fulfills the G-8 Environment Ministers recommendations.**
- **The unilateral adoption of mandatory environmental, human rights and development standards in the event of a failure to reach a satisfactory outcome in the OECD negotiations.**
- **Clarification of the UK's current obligations under the OECD's draft Agreement, given the ECGD's recent statement that the Agreement would be implemented on a voluntary basis.**

Corporate Governance and Ilisu

A key concern raised by the Ilisu project was human rights abuses in the Kurdish region of South East Turkey and the continuing repression of the local Kurdish majority. Unsurprisingly, the involvement of Balfour Beatty in the project incurred major reputational risks for the company, raising concerns amongst institutional investors about the company's corporate governance.

Such concern was reflected in the support shown for a shareholder resolution submitted by Friends of the Earth. Although only 3,416,218 votes were cast in favour of the resolution, as against 102,211,464 against, an estimated 73,096,464 abstentions were registered. For the Board to "fail to win the support of more than 40 per cent of institutional investors", in the words of the *Financial Times*, was a major blow to the company. Although the resolution was defeated, Balfour Beatty nonetheless conceded that human rights abuses were an issue in South East Turkey. It issued a press release stating that the company "has committed itself to taking the WCD principles, criteria and guidelines into account in determining whether and how it should be involved in any future hydro-electric projects".

The reaction of institutional investors to Balfour Beatty's involvement in Ilisu has important lessons for other companies seeking to invest in South East Turkey. In addition to the reputational risks that companies are likely to incur as a result of undertaking contracts in a region where human rights abuses are commonplace, Ilisu also brought to light major institutional problems within Turkey's bureaucratic infrastructure, raising questions over Turkey's current capacity (and commitment) to ensure that infrastructure developments meet international standards. The implications for the shareholder value of companies involved in such projects are likely to come under increased scrutiny following Ilisu.

We recommend that:

- **Institutional investors review their portfolios and assess whether the reputational and project risks of companies with investments in Turkey are sufficiently contained.**

¹⁴ Final Communique of the G8 Environment Ministers Summit, Trieste, March 2-4th 2001, para 35. The statement continues: "These common guidelines should be based on the practices of other internationally recognized publicly-supported multilateral finance agencies such as the European Bank for Reconstruction and Development and the International Finance Corporation of the World Bank. ECAs should also adopt common measures to increase the transparency of decision-making, including public access to environmental information, public consultation and consideration of relevant elements of the recommendations of the World Commission on Dams (WCD)."

Ilisu and Foreign Office Advice on Future Investment in Turkey

In evidence to the Trade and Industry Committee, Balfour Beatty stated that it had been encouraged to participate in Ilisu by the British Embassy in Ankara. Given that the Ilisu area is under Emergency Rule and that human rights abuses, including torture, denial of the freedom of expression and disappearances, are routine in the region, the nature of the advice provided by the Embassy should be thoroughly and transparently investigated.

We recommend that:

- **The Foreign Affairs Committee press the government to release the advice provided by the Foreign Office on investment in Turkey.**

Finally, we note with concern that continuing human rights abuses in the region have led many to question whether international human rights and environmental standards can ever be met whilst the Kurdish region of South East Turkey remains under military rule.

Given the urgent need for investment in the region, we therefore urge that:

- **The UK government request the European Union heads of states to reaffirm that Turkey's accession to the European Union be conditional on the fulfillment by Turkey of the Copenhagen criteria, agreed in June 1993.**
- **The Organisation for Security and Co-Operation in Europe (OSCE) adopt legally-binding measures in order to ensure the implementation of its agreed commitment to ensuring the language, cultural and political rights of the Kurds and other minorities in Turkey.**
- **The UK government uses its influence to press for an urgent political resolution to the Kurdish question.**