

# Financing Sustainable Development

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## *Editor's Summary*

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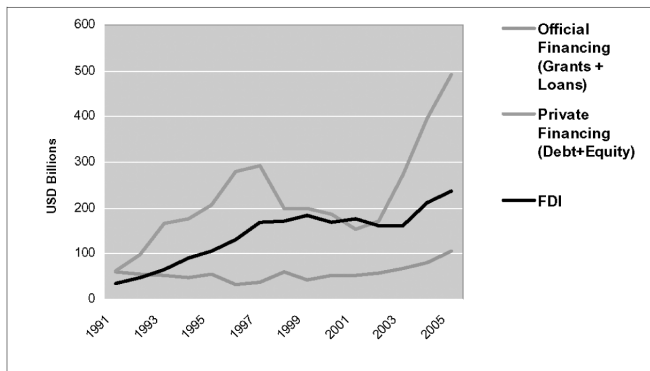
Although the United States led sustainability reforms in international financial institutions in the 1980s and 1990s, these environmental and social considerations were not given sufficient attention during the last presidential administration. The United States is still in a position to continue positive change on these issues, however, and can do so by encouraging multilateral development banks and export credit agencies to integrate social and environmental considerations into their lending decisions.

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It has been 26 years since the Brundtland Commission presented the world with the concept of sustainable development, recognizing that environmental and social well-being contribute directly to poverty alleviation and are essential to the economic development and welfare of current and future generations. At the United Nations Conference on Environment and Development at Rio in 1992, known as the Rio Summit, governments of the world formally charted out a map to sustainability in the form of Agenda 21, concluding that its achievement would require an annual investment of \$600 billion primarily in the form of public overseas development assistance (ODA).<sup>1</sup> At the World Summit on Sustainable Development in Johannesburg in 2002, the international community explicitly recognized for the first time that nongovernmental actors, particularly business and the private sector, would have to work together with public and multilateral institutions to realize these goals. In 2003, governments adopted the Millennium Development Goals to address extreme poverty and hunger by 2015, with a relatively modest price tag of \$100 billion per year in ODA to achieve these minimum standards.<sup>2</sup> Nevertheless, commitments have fallen far short of this requirement.

Private financial flows to developing countries now dwarf development assistance: In 2005, total development assistance was \$106.5 billion, whereas net private flows were \$491 billion (see Figure 1).<sup>3</sup> But only limited progress has been made in aligning either public or private capital flows with either Agenda 21 or the Millennium Development Goals. Private financial flows to developing countries are concentrated in a few emerging economies. Brazil, China, India, Mexico, and Russia receive 80 percent of foreign direct investment (FDI),<sup>4</sup> and it tends to be concentrated in sectors such as oil, gas, and telecommunications, rather than in sectors that have more direct developmental impacts such as health care, sanitation, or education.

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1. U.N. Conference on Environment and Development (UNCED), Agenda 21, the Rio Declaration on Environment and Development, and the Statement of Principles for the Sustainable Management of Forests, *available at* <http://www.un.org/esa/sustdev/documents/agenda21/index.htm>.
  2. U.N. DEV. PROGRAMME, HUMAN DEVELOPMENT REPORT 2003, MILLENNIUM DEVELOPMENT GOALS: A COMPACT AMONG NATIONS TO END HUMAN POVERTY (2003).
  3. WORLD BANK, GLOBAL DEVELOPMENT FINANCE 2006 (2006).
  4. JAMES HARMON ET AL., DIVERGING PATHS: WHAT FUTURE FOR EXPORT CREDIT AGENCIES IN DEVELOPMENT FINANCE? (2005), at 3.

**Figure 1: Financial Flows to Developing Countries**

Source: WORLD BANK, GLOBAL DEVELOPMENT FINANCE 2006.

To finance sustainable development, environmental and social considerations need to be integrated into the investment decisions of financial institutions, both public and private. Two types of organizations—export and investment promotion agencies (called export credit agencies or ECAs, and specifically the ECAs of developed countries) and multilateral development banks (MDBs)—are well situated to lead this process, and should be held accountable for doing so. This Article focuses on the U.S. role in influencing the policies of ECAs and MDBs in ways that significantly enhance the alignment of private financial flows to developing countries with environmental and social agendas.

Historically, the United States has played an important role in prompting international financial institutions to link environmental and social considerations to their operations and investments.<sup>5</sup> As the majority shareholder in the World Bank group, for example, the United States has exerted its influence to prompt the Bank to adopt environmental and social safeguard policies to ensure that the Bank did not finance efforts that would negatively impact people and the environment. Over the last six years, however, U.S. leadership in these policy arenas has been inconsistent, and in some cases even counterproductive.

## I. Steering International Finance Toward Sustainable Development

Public financial institutions such as ECAs and MDBs are in a position to steer some of the abundant private capital available for investment in the developing world toward countries, projects, and sectors in ways that would serve development objectives. ECAs can provide financial incentives to companies to invest in poor, high-risk countries in sectors that have development benefits. MDBs can set environmental and social standards for their financing and assist governments to con-

struct enabling policy frameworks to make investment in sustainable development more attractive to private-sector actors.

Public financial institutions can help align both private and public financial flows with sustainable development objectives by ensuring that environmental and social standards for lending and investment are in place to provide incentives and frameworks to advance these objectives. Private-sector actors who take their lead from or work in the same countries as these public financial institutions can incorporate these standards into their own policies and practices, thereby supporting the integration of environmental and social concerns into financing decisions. Adoption of such lending standards is an important step toward mainstreaming environmental and social sustainability into development activities.

### A. Export Credit Agencies: Guaranteeing Development

Export credit agencies are public institutions that facilitate financing for home-country exporters and investors doing business overseas, particularly in developing countries and emerging market economies. The U.S. Export-Import Bank (Ex-Im Bank) is the official ECA of the United States; it offers working capital guarantees and export credit insurance to U.S. exporters and offers direct loans and guarantees of commercial loans to foreign buyers of U.S. goods and services. In 2006, the Ex-Im Bank approved US \$12.1 billion in loans, guarantees, and export credit insurance, while receiving a US \$172.5 million allocation from Congress,<sup>6</sup> which signaled continued political support for the Bank's role in financing export programs that are consistent with broader international U.S. economic and financial policies.

To date, public resources directed via ECAs to support export promotion have contributed very little to sustainable development, and questions are being raised about whether ECAs are needed to fill market gaps supposedly underserved by private banks.<sup>7</sup> Some fiscal conservatives even refer to ECA financing as "corporate welfare" because it supports large corporations in markets where private equity is readily available.<sup>8</sup>

At the same time, ECAs play a significant role in the world's poorest countries, where international private-sector actors have a limited presence. The World Bank has estimated that ECA financing currently represents 80 percent of gross capital-market financing in the 70 poorest countries in the world. Between 1997 and 2002, every commercial bank loan for more than \$20 million in these poorest countries was backed by an official guarantee from institutions such as ECAs.<sup>9</sup> It

5. Robert Wade, *Greening the Bank: The Struggle Over the Environment 1970-1995, in THE WORLD BANK IN ITS FIRST HALF CENTURY* (Lewis et al. eds., 1997).

6. EXPORT-IMPORT BANK OF THE UNITED STATES, ANNUAL REPORT 2006 (2006).

7. HARMON ET AL., *supra* note 4, at 12-13.

8. *Id.* at 7.

9. WORLD BANK, GLOBAL DEVELOPMENT FINANCE 2002: ANALYSIS AND SUMMARY TABLES (2002).

is clear that few private-sector companies are likely to risk investing in these economies without public guarantees.

Within the United States and other OECD countries, ECAs are facing increasing public pressure to address the social and environmental consequences of the large infrastructure projects that they back. As part of its 2006 reauthorization of the Ex-Im Bank, Congress called on the Bank to establish a specialized renewable energy office with staff that has significant renewable energy experience in order to identify opportunities for investment in clean energy.<sup>10</sup> Anticipating that similar demands would be made during its congressional reauthorization, the United States' other major export promotion agency, the Overseas Private Investment Corporation (OPIC), announced its Greenhouse Gas Initiative in June 2007 and set a goal to reduce emissions from its investment portfolio by 20 percent over the next 10 years.<sup>11</sup>

While it is too early to gauge the impact of these new initiatives on the operations of the Ex-Im Bank and OPIC, they represent promising efforts to reform these institutions to do more to support sustainable development, and are prompting a much needed reexamination of portfolio priorities. These initiatives have been prompted by public pressure, including litigation. For example, Friends of the Earth and other environmental groups brought an action in federal court against OPIC and the Ex-Im Bank, claiming that these agencies have provided financial support for coal-fired power plants, oil and gas fields, and pipeline projects around the world without giving legally sufficient consideration to the direct and indirect impacts of those projects on climate change.<sup>12</sup> While initiatives from Congress, advocacy groups, and the agencies themselves have resulted in incremental progress toward a sustainability agenda for U.S. ECAs, progress in raising global sustainability standards for ECAs through multilateral forums has been limited.

In 2003, the ECAs of the OECD countries adopted the Common Approaches on Environment and Officially Supported Export Credits,<sup>13</sup> a policy requiring that all projects comply with the environmental standards of the host country or the World Bank Group, which typically holds projects to higher standards than would national law in many developing countries. The United States played a leadership role in this effort to raise standards for all OECD member ECAs, in part because it recognized that U.S. companies might be disadvantaged by the relative stringency of its own environmental policies.

While the Common Approaches are intended to minimize negative development impacts of ECA-supported projects, they

allow significant exemptions. They do not require all pertinent World Bank safeguard policies to apply to all projects. There is limited transparency in the implementation of the Common Approaches; for example, the agreement does not mandate the public release of environmental impact assessments. Nor do the Approaches address the broader human rights impacts of projects supported by ECAs. In 2007, all parties to the Common Approaches reviewed their experiences with the policy and examined their adequacy with respect to the evolving standards at the World Bank Group.<sup>14</sup> Unfortunately, the revisions resulting from the review have not adequately responded to the challenges of ensuring rigor, transparency, and accountability in project assessments. Individual ECAs now have even greater discretion in deciding how to apply environmental and social standards to their investments.

## *B. Multilateral Development Banks: Leveraging for a World Free of Poverty*

Multilateral development banks play a significant role in influencing the character of investment from developed nations to poorer developing countries. Their missions include global poverty reduction and sustainable growth, and they have committed to helping to achieve the Millennium Development Goals. Thus, they play a major role in affecting the degree to which private financial flows to developing and transition economies are consistent with sustainable development objectives.

### 1. World Bank

The World Bank Group<sup>15</sup> has participated in global initiatives such as the Millennium Ecosystem Assessment, which concluded that better ecosystem management is critical to reducing poverty and meeting the MDGs. Recognizing the Bank's potential to help the international community to operationalize this insight, in 2005, the G-8 countries asked the Bank to take the lead in helping its clients address climate change, which poses a particular threat to poor countries and communities. But many decisions taken by Bank management over the past three years would seem to signal wavering commitment to the sustainable development agenda. In June 2006, World Bank President Paul Wolfowitz reorganized the World Bank Group, merging its infrastructure and environment departments into a new vice presidency for sustainable development.<sup>16</sup>

The reorganization created doubt about the extent to which environmental considerations are prioritized as there is no longer a member of the Bank's senior management team

10. Export-Import Bank Reauthorization Act of 2006, Pub. L. No. 109-438, 120 Stat. 3268 (Dec. 20, 2006), available at [www.aaainc.org/fileadmin/aaainc/pdf/Key\\_Legislation/Public\\_Law\\_109-438\\_S\\_3938\\_December\\_20\\_2006\\_Export-Import\\_Reauthorization\\_Act\\_of\\_2006\\_-\\_Text.pdf](http://www.aaainc.org/fileadmin/aaainc/pdf/Key_Legislation/Public_Law_109-438_S_3938_December_20_2006_Export-Import_Reauthorization_Act_of_2006_-_Text.pdf).

11. JON SOHN, WORLD RES. INST., OPIC'S GREENHOUSE GAS INITIATIVE, (2007), available at [www.wri.org/stories/2007/06/opics-greenhouse-gasinitiative](http://www.wri.org/stories/2007/06/opics-greenhouse-gasinitiative).

12. Friends of the Earth v. Mosbacher, 488 F. Supp. 2d 889 (N.D. Cal. 2007) (denying plaintiffs' motion for summary judgment and granting in part defendants' cross-motions for summary judgment).

13. OECD, OECD ADOPTS STRONGER ENVIRONMENTAL COMMON APPROACHES FOR EXPORT CREDITS (2003), available at [www.oecd.org/document/56/0,2340,en\\_2649\\_201185\\_21688824\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/56/0,2340,en_2649_201185_21688824_1_1_1_1,00.html).

14. HARMON ET AL., *supra* note 4, at 33.

15. Although multilateral development banks include regional development banks, such as the Asian Development Bank and the African Development Bank, this section focuses on the World Bank Group as the most influential in policy and practice. Recent developments at the Inter-American Development Bank are also discussed.

16. By custom, the president of the World Bank is nominated by the United States. While this custom has become increasingly controversial, for the purposes of this analysis it is reasonable to infer that the policy directions of Presidents Wolfowitz and Zoellick broadly reflect those of the U.S. administration that selected them.

responsible solely for environmental and social actions or objectives. The reorganization began at a sensitive moment, when development professionals seemed less convinced that rigorous environmental and social impact assessments are crucial instruments for avoiding mistakes that could harm fragile ecosystems and vulnerable human communities. Further, there is a perception that the “hassle costs” involved in borrowing from the Bank—including the costs of compliance with environmental safeguard policies—are deterring development, especially as the Bank has seen a decrease in investment in hard-sector infrastructure projects and a concurrent decrease in loans to middle-income countries.<sup>17</sup> The reorganization creates a potential conflict of interest because the same unit tasked with finding environmentally and socially sustainable approaches to development is also tasked with increasing lending to hard-sector infrastructure projects.

There have also, however, been new developments within the Bank that hold significant potential to support the sustainable development agenda. For example, governance and anti-corruption emerged as high-level priorities under President Wolfowitz’s leadership. In 2006, the World Bank launched an effort to develop a strategy for, in the words of the report title, *Strengthening World Bank Group Engagement on Governance and Anti-Corruption*. The controversial strategy had the stated purpose of helping member countries create capable, transparent, and accountable government institutions. While the Bank has not explicitly articulated the links between governance and environmental sustainability in its strategy, building strong, accountable states is nevertheless essential to decreasing poverty and realizing sustainable development objectives.

Although environmental and social safeguard standards were initially put in place at the World Bank Group as a result of U.S. pressure, in recent years the United States has made little effort to advance the sustainability agenda within the institution. To the contrary, there are accounts that the United States sometimes used its position on the board of the World Bank to block projects associated with implementation of the Kyoto Protocol.<sup>18</sup> Even as the Bank worked to develop the Clean Energy Investment Framework in response to the G-8’s 2005 Gleneagles Plan of Action on Climate Change, President Wolfowitz’s deputies with close ties to the Bush Administration reportedly sought to water down references to climate change in the strategy document.<sup>19</sup>

In June 2007, former U.S. Trade Representative Robert Zoellick succeeded Wolfowitz as president of the World Bank. While it is too soon to tell how issues of environmentally sustainable development will be addressed under this new leadership, early signs suggest that President Zoellick sees helping poorer countries benefit from globalization in a more sustainable manner as a priority. A year into his presidency, he has

launched a new set of Climate Investment Funds. In January 2008, President Bush announced a contribution of US \$2 billion to these funds to support the deployment of clean technologies in developing countries.<sup>20</sup> Serious questions have been raised about whether the Clean Technology Fund will support truly transformational change.<sup>21</sup> Nevertheless these developments may signal the beginnings of a change in attitude from the United States regarding the need for the MDBs to support a global response to climate change.<sup>22</sup>

## 2. International Finance Corporation

Recent revisions to the environmental and social standards in place at the International Finance Corporation (IFC)—the arm of the World Bank that lends to the private sector—have raised a new set of challenges. In 2006, the IFC replaced its safeguard policy with a set of performance standards. While the safeguard policy relied on compliance with procedural and substantive requirements, the new standards are outcomes-based and allow investment officers and clients significant discretion in interpreting and conducting environmental and social due diligence, with limited accountability mechanisms to monitor and evaluate the impacts of projects financed. The United States has supported the shift to this new outcomes-based approach.

Any weaknesses in the IFC’s performance standards have international ramifications for private financial flows. The IFC’s policies also apply to the project finance investments in developing countries by 52 private banks that have signed onto the Equator Principles, a financial industry benchmark for determining, assessing, and managing social and environmental risk in project financing. The banks that have signed onto the Principles are responsible for 80 percent of project financing worldwide.<sup>23</sup> As a result of the adoption of the Equator Principles, the IFC explicitly sets international environmental and social standards for private financing. Yet despite the weaknesses in the IFC’s performance standards, the Equator Principles represent a significant step forward within the private banking sector, and a sign of growing awareness and intent to manage environmental and social risks.

## 3. Inter-American Development Bank

In 2005, the Inter-American Development Bank (IDB), which has historically had the weakest environmental and social standards of all the MDBs, adopted an Environmental Safe-

17. FRANCES SEYMOUR, *SUSTAINING THE ENVIRONMENT AT THE WORLD BANK* 6 (2006).

18. JON SOHN ET AL., *WORLD RES. INST., MAINSTREAMING CLIMATE CHANGE CONSIDERATIONS AT THE MDBS* 3 (2005).

19. Krishna Guha, *Deputy’s Woes Stir World Bank Turmoil*, *FIN. TIMES*, Apr. 25, 2007, available at [www.ft.com/cms/s/0/e67b4470-f2c8-11db454-00b5df10621.html?ncklick\\_check=1](http://www.ft.com/cms/s/0/e67b4470-f2c8-11db454-00b5df10621.html?ncklick_check=1).

20. As of July 2008, the United Kingdom and Japan have also committed some \$3 billion to the Clean Technology Fund of the World Bank-administered Climate Investment Funds.

21. As of July 2008, the World Bank has proposed that a portion of the Clean Technology Fund might be used to finance new coal-fired power plants using more efficient technology such as supercritical or ultra-supercritical coal. The Bush Administration has supported this approach. However, such technologies are already cost-effective, and while marginally more efficient than business as usual, still lock in new infrastructure that will produce significant greenhouse gas emissions for decades to come.

22. SMITA NAKHOODA, *WORLD RES. INST., CORRECTING THE WORLD’S GREATEST MARKET FAILURE: CLIMATE CHANGE AND THE MULTILATERAL DEVELOPMENT BANKS* 4 (2008).

23. See the Equator Principles website, [www.equator-principles.com](http://www.equator-principles.com).

guards Compliance Policy, with U.S. support. In 2006, as part of IDB's contribution to the Gleneagles Plan of Action, it launched the Sustainable Energy and Climate Change Initiative that seeks to scale up IDB support for renewable energy, increase support for biofuels, grow its presence in the carbon markets, and help its member countries adapt to climate change.

However, under the leadership of Luis Alberto Moreno, who took over as president of the IDB in 2005, the Bank has undergone its own internal reorganization bringing its environment and infrastructure departments together, mirroring the World Bank's reorganization. A key challenge will be to ensure that environmental considerations are prioritized in practice under this new operational structure. U.S. members on the IDB Board of Directors have been supportive of the idea that the Bank should promote internal compliance with its safeguard policies through an autonomous unit, and that additional financial and human resources need to be committed to promote environmental mainstreaming as part of the realignment.

## II. Looking Forward

As the world's largest economy, the United States continues to have significant influence over the priorities of multilateral financial institutions. The operations of U.S. ECAs remain significant in global financial markets, particularly in promoting U.S. investments in the world's poorest countries, and give the United States a potentially powerful voice within international forums that set standards for ECA financing. A persistent challenge for financial institutions, and the development community more broadly, is to operationalize the understanding that environmental protection is central to long-term poverty reduction. The United States, for its part, should play a more proactive role in pressuring global financial institutions to facilitate private-sector finance for sustainable development.

### *A. The Operation of U.S. ECAs Gives the United States a Potentially Powerful Voice*

The United States has led the ECAs of OECD countries to adopt environmental standards under the Common Approaches. But as ECAs based in emerging economies such as Brazil, China, and India become increasingly active in international development finance, the international community confronts new challenges in achieving upward harmonization of environmental standards to include these new actors. Upward harmonization entails a common minimum standard of due diligence so as to prevent any ECA from gaining competitive advantage by lowering its environmental standards. The United States has taken some initiative in raising with China the issue of sustainability standards for projects

financed by Chinese ECAs.<sup>24</sup> The United States should seek to ensure that financial institutions in emerging economies adopt robust minimum standards and do not finance projects that have damaging environmental and social impacts. One way to do this would be to demonstrate a commitment to robust standards at institutions over which the United States has direct influence, such as U.S. ECAs and the MDBs.

### *B. The United States Should Demonstrate Its Commitment to Robust Standards at MDBs*

The World Bank Group and other MDBs, in appropriate partnership with others, have the potential to provide leadership on the question of how to balance environmental and social concerns with other factors that influence financing decisions. But the countries that own the MDBs, and their representatives on the respective boards of directors for each institution, must acquiesce to movement in this direction.

Over the past five years, innovations such as the Equator Principles have demonstrated that MDBs can in fact have significant influence over private investors and banks. There is evidence to suggest that private-sector actors increasingly recognize that taking on strong environmental and social standards for their operations can make good business sense, seemingly influenced by the experience of the MDBs. Several private banks such as Goldman Sachs and JP Morgan Chase have gone beyond their commitments under the Equator Principles. Such institutions have now begun to address global environmental sustainability challenges such as tropical deforestation and climate change—for example, by adopting renewable energy targets and greenhouse gas accounting and management practices for their investment portfolios.

## III. Conclusion

While the United States can claim credit for initiating and leading sustainability reforms at the MDBs and ECAs in the 1980s and 1990s, these issues have not been given sufficient priority by the Bush Administration in recent years. There is much that remains to be done to align private investment with sustainable development objectives. The United States has significant influence over the activities and policies of the MDBs, whose goals are to promote sustainable development. Despite some progress over the past six years, however, the agenda of aligning private international flows with sustainable development objectives still remains far from complete.

24. *G-7 to Warn China Over Costly Loans to Poor Countries*, WALL ST. J., Sept. 15, 2006.