Delegated Delegation: Environmental Rules for Project Finance

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Over the last two decades we have witnessed the proliferation of environmental policies among providers of international finance. Under the pressure of an international NGO campaign with the support of the U.S. government first the World Bank Group and then other multilateral development banks (MDBs) adopted environmental rules for their operations. A second wave of NGO and U.S. government activity then resulted in export credit agencies (ECAs) adopting similar rules. Most recently, the broadening of this NGO campaign has forced private banks to adopt a comparable set of policies, known as the Equator Principles, to which they subject their large-scale project finance business. The overall result has been a proliferation of related policies (rooted in the U.S. National Environmental Policy Act’s environmental review logic) among many providers of international project finance. This has occurred as a consequence of widespread concern about the environmental performance of such projects in the past. The move towards environmental rules for international finance has coincided with an expansion of private financing available for types of projects that were predominately financed with official development assistance (ODA) and by MDBs previously.

What sets this rules apart from each other, are their very different compliance monitoring and enforcement mechanisms – ranging from the World Bank’s independent Inspection Panel over peer monitoring among ECAs to opaque and almost non-existent formal monitoring for compliance with the Equator Principles. However, in all three cases NGOs play an important role in monitoring the performance of these rules. In the case of World Bank policies, their role has been institutionalized and they have been given access to World Bank policy development. Though the OECD’s export credit group conducts annual consultation sessions with NGOs, access to ECAs has been much more limited. Still, the international agreement on environmental standards for ECAs, the Common Approaches, has established reporting mechanisms which effectively provide the basis for outside monitoring by NGOs. However, at no point in the agreement is this intentional mechanism made explicit. The Equator Principles, finally, do not provide for any NGO access. Still, NGOs do monitor private banks’ environmental performance and employ name-and-shame tactics to entice banks to live up to their commitments.

This paper takes stock of the varying roles NGOs and financial institutions play in monitoring and enforcing these three sets of policies and explores challenges these monitoring arrangements pose for the involved actors’ legitimacy bases. Theoretically, the different accountability mechanisms and power structures in public governance (World Bank), mixed private-public governance (ECAs), and corporate governance (Equator banks) are analyzed. The role of transparency provisions as a basis for monitoring and enforcement as well as the resulting role of non-state actors in monitoring the implementation of these rules is of particular concern here. NGOs can provide the monitoring and enforcement functions quite comfortably as they are in line with their primary accountability mechanisms. Financial institutions, however, find themselves caught between competing financial and environmental mandates. The next two sections provide an overview of environmental rule development for ECAs, MDBs, and private banks. Section three discusses the delegation of regulatory tasks to financial actors and their fulfillment of this task through delegation of responsibilities to their clients through conditional access to finance. The final part builds on the preceding empirical and theoretical foundations and discusses the legitimacy of these rules, with a special focus on
transparency provisions as a prerequisite for effective monitoring and enforcement.

1. Greening international finance

Export credit agencies, multilateral development banks, and Equator Principle financial institutions (EPFIs) all follow substantially similar guidelines when evaluating environmental impacts of projects which they consider to provide financing for. This overarching international financial regime regulating environmental review of projects and providing performance standards for supportable projects is a rather recent phenomenon.

After the introduction of the U.S. National Environmental Policy Act (NEPA) of 1969 NGOs exploited weak language in the Act’s provision concerning its reach. NEPA required that an environmental review had to be conducted for any project with federal involvement, i.e. any project receiving federal funding. The way NEPA was formulated allowed for an interpretation that the Act not only applied to domestic U.S. environmental impacts but also impacts abroad. NGOs exploited this vagueness in NEPA’s language and challenged a number of federal agencies in court to subject their foreign operations to NEPA (Sierra Club v. U.S. Atomic Energy Commission 1974; Environmental Defense Fund v. U.S. AID 1976; Sierra Club v. Coleman 1976; NRDC v. Ex-Im 1979; NRDC v. NRC 1981). Initially fairly successful, this campaign resulted in the establishment of environmental policies for the United States Agency for International Development (USAID), required the Atomic Energy Commission to conduct environmental review of nuclear exports, and resulted in the adoption of the first limited set of environmental review procedures at the Export-Import Bank (ExIm), the U.S. export credit agency (The Extraterritorial Scope of NEPA's Environmental Impact Statement Requirement 1975; Renewed Controversy 1977; Forthcoming CEQ Regulations 1978; Peirce 1979; Allegag 1980; Pincus 1981).

While these lawsuits during the 1970s were not very successful in promoting the extraterritorial application of NEPA, which was later limited by a set of Executive Orders, they did manage to put the issue of environmental effects abroad on the political agenda. This concern was initially confined to the effects of development projects. Much of the large-scale infrastructure development of the 1960s and 1970s not only promoted economic development but also resulted in unintended environmental problems. The World Bank became the first international target of a coalition of activists in the early 1980s who criticized the bank for environmental problems and unjust resettlement policies that were the consequence of Bank-sponsored colonization projects in Brazil and dam projects in India. The Polonoroeste and Narmada dam projects showcased the need for the consideration of environmental and social consequences up front. However, the Bank did not react to NGO concerns until the activists managed to exert influence on U.S. Congress so that the U.S. government threatened to withhold funding for the World Bank’s International Development Agency (IDA). The combined pressure of NGOs and the U.S. government resulted in slow and step-wise development of World Bank environmental policies throughout the 1980s and 1990s. Today, the World Bank policies are considered strong and serve as the international benchmark for other organizations’ environmental rules. The World Commission on Dams (WCD) and the Extractive Industries Review (EIR) are recent World Bank initiatives that have defined internationally acceptable practices in dam and mining development (Gutner 2002; Horta 1996; Rich 1994; Wade 1997).

A second target of the same coalition of NGOs that pressured the World Bank to develop its environmental rules were export credit agencies. Export credit agencies are public or semi-public national agencies, which serve as lenders or insurers of last resort to support exports by domestic firms into high-risk markets. Prominent ECAs include the United States Export-Import Bank, the British Export Credit Guarantee Department (ECGD), French Coface, and the German Hermes guarantees. While their operations include everything from short term buyer credit for export of goods over support for exports of ships and aircraft to cover for infrastructure development, the discussion here is concerned with their long-term business which includes the very same types of projects the World Bank got in trouble for earlier: dams, pipelines, mining, pulp-and-paper plants among other types of large infrastructure projects. Projects such as these had been predominately built by states and financed by multilateral development bank or development assistance. However, the private sector has assumed a considerable share of this market over time and today these projects are also developed by project development companies which finance them with debt that is later repaid with profits.
Components are often sought from producers headquartered in many different countries. Exporters which supply components to such projects seek support from their domestic ECA. ECAs cover the political and commercial risks involved in the export transactions and thus provide insurance against non-payment by the project developer with which exporters can seek financing from banks. Some ECAs also operate as banks and provide both cover and financing. Financing is needed to cover the period between delivery and payment of the supplied project components. This cover becomes especially important in project finance arrangements when payment may only occur years later once the project has become operational and generates revenue (for ECA politics in general see: Evans 2005; Walzenbach 1999).

Initially, litigation by U.S. NGOs was not very successful in prompting ExIm to adopt environmental rules for its operation. Following President Carter’s Executive Order No. 12114 in 1979 (for a recent review see: Schiffer 2004; for the legal discussion preceding the Executive Order see: Renewed Controversy 1977), Ex-Im only had to subject its nuclear business and projects with an environmental impact on U.S. territory to the stringent review under NEPA. For its remaining business, Ex-Im established “Concise Environmental Reviews” which Evans (2000) describes as little more than a “boiler plate form added to project documents”.

The review process remained largely unchallenged until ExIm’s 1992 reauthorization which contained a provision requiring the Export-Import Bank to develop environmental policies. Section 105 “Environmental Policy” was inserted in the Senate version of the reauthorization bill on the initiative of Senator Timothy Wirth (D - Colorado) in order to provide “a permanent statutory authority for environmental policies and procedures currently being carried out by the Bank” (United States Senate 1992). In retrospect, the Wirth amendment did much more than providing “a permanent statutory authority” for what Ex-Im was already doing: it resulted in the development of the first set of comprehensive environmental review procedures and standards for project evaluation at an export credit agency anywhere.

One consequence of ExIm’s new environmental policies, which were implemented in 1995, was a disadvantage of U.S. exporters seeking ECA support vis-à-vis their competitor from other countries which did not have to comply with similar rules. The unilaterally implemented policies amounted to a hurdle in access to ECA financing that only ExIm clients faced. From 1998 on the U.S. government sought to re-level the playing field for American exporters by initiating international negotiations on a common baseline for ECA environmental policies across the OECD. Negotiations on the OECD Recommendation on Common Approaches on Environment and Officially Supported Export Credits were slow and finally led to agreement on a set of procedural policies and benchmarks in 2003 after an earlier draft was not supported by the United States in 2001.

The Common Approaches establish environmental review procedures and reference international standards, including World Bank criteria, as benchmarks in project evaluation. They follow the same logic as U.S. NEPA, USAID, and World Bank policies: projects need to undergo environmental assessments, results of the environmental reviews are made available for public comment and support decisions need to take projects’ environmental performance into account. The Common Approaches now provide harmonized environmental review procedures among OECD ECAs and have re-leveled the playing field (Schaper forthcoming; Görlach, Knigge, and Schaper 2007; Knigge et al. 2003).

In addition to the World Bank and ECAs, NGO activists targeted private banks active in project finance. Banks like Citibank, ABN Amro were criticized for the environmental performance of projects financed by them very much in the same manner as activists had targeted the Bank and ECAs before. One key difference in strategy, however, was that NGOs did not seek to employ state leverage in their campaign but rather threatened consumer boycotts unto those banks which would not address the environmental impacts of their operations. Besides the NGOs in the International Financial Institutions campaign, the Rainforest Action Network and its Citibank campaign played a central role in this case.

The shift of NGO attention from the World Bank to ECAs and eventually private banks has been part of a deliberate strategy rather than coincidence. The protagonists of the World Bank
campaign, including Bruce Rich of Environmental Defense, also became leading figures in the ECA campaign. Similarly, the NGO community started brainstorming about next targets for their financial institutions campaign in the late 1990s. A historical overview by the BankTrack network (BankTrack 2005) mentions 1996 as the year of birth for the private financial institutions campaign.

In addition to this expansion of the international financial institutions (IFI) campaign, the Rain Forest Action Network (RAN) started targeting Citibank for its financing of environmentally controversial politics. While the IFI campaign relied on traditional lobbying and litigation, RAN has specialized in private politics, that is, targeting of corporations aimed at influencing their environmental behavior. What the campaigns have in common is their goal of establishing environmental policies for institutions active in international project finance.

For the World Bank and ECA campaigns Congressional budget and statutory authority was an important tool. Changes in World Bank policies were possible when Congress could threaten to withhold U.S. contributions to the organization. With regard to Ex-Im, Congressional power is even more immediate as the Bank’s charter need to be re-authorized by Congress periodically, that is its very existence is at the mercy of Congress. Gaining leverage on private sector entities obviously required different tools and strategies. NGOs mounted a campaign aimed at the banks’ reputation by publicizing environmentally problematic projects and by threatening consumer boycotts. In this case of international project finance this strategy was complicated by the fact that many of the target banks specialize in commercial banking and that these banks were largely immune to threats of consumer boycotts. However, one of the industry leaders, Citibank, is also involved in private banking worldwide with a strong presence in the U.S. credit card market. Not surprisingly, Citibank was chosen as a first target as it combined vulnerability through its private customer business with significant impact on international project finance.

The World Bank Group’s International Finance Corporation (IFC) helped to give birth to the Equator Principles which established a common framework for private financial institutions to address environmental and social risks in project financing (see Martin in this collection as well as Amalric 2005; Wright and Rwabizambuga 2006). Initiated at a meeting in London in October 2002, the Principles’ early adopters and promoters included ABN AMRO, Barclays, Citigroup, and WestLB. The Equator Principles serve the dual purpose of managing reputation risk stemming from controversial projects and integration of environmental and social concerns into overall credit risk management. Similar to World Bank rules and Common Approaches, the Equator Principles require environmental assessments and stakeholder consultations for projects which are likely to harm the environment. In July 2006 the principles were updated and expanded from their initial 2003 version to include monitoring and reporting requirements among other changes (The "Equator Principles" 2006).

2. Environmental standards for international finance

Environmental policies of the World Bank, ECAs, and EPFIs share common roots and history. All are based on the environmental review procedures established by the U.S. National Environmental Policy Act in 1969 and they were all promoted by a similar group of NGOs. However, the policies are not identical and they differ especially with respect to compliance mechanisms and the degree of transparency incorporated into these rules. The World Bank Group has become very transparent in its operations and has established its Inspection Panel as an independent body to monitor compliance with Bank policies. Transparency provisions among ECAs vary and so do domestic compliance mechanisms. Among the OECD ECAs which are subject to the Common Approaches formal compliance monitoring is limited to reports to the Export Credit Group’s secretariat. However, by requiring the publication of environmental reviews, the Common Approaches have empowered NGOs to monitor ECA compliance with the agreement: monitoring and enforcement have been implicitly outsourced (for a detailed discussion see Görlach, Knigge, and Schaper 2007). Private banks are the least transparent financial institutions discussed here. The Equator Principles only require that stakeholders are granted access to environmental reviews and compliance monitoring is limited to reviews of project documents by independent experts who are hired by the financial institutions themselves. There is no formal authority or secretariat to administer the Principles. In fact, even hosting and maintenance of the Principles internet site (http://equator-principles.com/) is a contentious issue as member institutions are concerned about bureaucratization and formalization of the Principles (personal communication with Christopher Wright, London School of Economics, 2 March 2007).
Still, NGOs use the little information available to pressure banks into improving compliance with the Principles.

World Bank environmental policies are contained in the Bank’s operational manual and deal with a number of general and sector-specific aspects of operations. Qualitative and quantitative standards for project performance as well as mitigation strategies are contained in its Pollution Prevention and Abatement Handbook (PPAH). Whereas it once was criticized for its secretive operations, the Bank has now become a very transparent organization that not only makes its reports available publicly but also provides for consultation procedures in both project and policy development. Stakeholders are involved in designing projects and their input is also sought when the Bank revises current policies and develops new ones. Furthermore, the Bank’s Inspection Panel is a strong compliance mechanism that allows the public to file requests for investigations of potential violations of Bank policies in project development and implementation (for detailed discussions of the World Banks’ environmental policy development see Gutner 2002; Horta 1996; Rich 1994; Wade 1997).

Beyond its own operational policies the Bank now serves as an international standard-setter: its policies serve as models for other organizations and it has taken over a leading role in the development of the international regime governing environmental performance of infrastructure development. The World Commission on Dams and the Extractive Industries Review were convened by the Bank to develop international guidelines for use in dam-building and mining projects. Over time, the World Bank has evolved from an environmental laggard to an international leader raising the bar for acceptable environmental and social performance of projects.

Thus far I have equated the term “World Bank” with the most prominent part of the World Bank Group, the International Bank for Reconstruction and Development (IBRD). However, in addition to the IBRD and the International Development Association (IDA) which both provide direct financing for projects, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) are also part of the Group. The IFC’s environmental policies have slowly evolved from World Bank policies. Initially, the IFC applied World Bank environmental policies which did not match well with its different type of business highlighted by a controversial dam project in Chile in the early 1990s which led to the subsequent adaptation of the Bank’s safeguard policies to IFC business (Park 2003). The IFC has recently replaced its safeguard policies dating from 1998 with new environmental and social standards. Its new policies represent a shift from a process-oriented approach to one focused on outcome. This change also delegates environmental review responsibilities from the financial institution to its client – quite analogous to the ECAs’ and EPFIs’ procedures. Building on the previous safeguards, these standards were expanded to include labor rights, human rights, community health and safety, as well as greenhouse gas emissions and incorporate expanded disclosure requirements resulting in increased transparency of IFC operations (see International Finance Corporation 2006).

The IFC policies are not only relevant in this comparison because of their modification to better match IFC operations but also because the IFC played a crucial role in facilitating development of the Equator Principles and ECAs follow policy development at the IFC since this organization best resembles their own operations.

Environmental policies of ECAs have been harmonized by the OECD Common Approaches which require ECAs to (i) classify projects over SDR 10 million according to likely impact; (ii) conduct environmental reviews of projects with potentially substantial environmental impact; (iii) apply international or home-country environmental standards to projects evaluation; and (iv) make environmental review information available to the public prior to making support decisions. Being an OECD “gentlemen’s agreement” formal procedures for ensuring compliance with the Common Approaches are weak. Member ECAs report to the OECD Export Credit Group Secretariat annually on supported projects, project classification, and applied environmental standards. They also notify other ECAs if they intend to deviate from the agreement for specific projects allowing other members to offer the same project-specific deviations to their exporters. Members can use the annual data as well as information about deviation from the Common Approaches to exert peer pressure on agencies which do not fully comply with the rules. Public reporting, however, is very weak: the Secretariat aggregates country data in its reports so that OECD reports are only helpful in assessing overall compliance. Information about individual members’ compliance is not available if it is not supplied by
the agencies themselves. There is no formal compliance mechanism beyond the reporting requirements. External government transparency to the ECG Secretariat is much stronger than domestic government transparency (Grigorescu 2003).

However, the need to make environmental review information available prior to cover decisions (ex-ante transparency) enables NGOs and the press to monitor the performance of individual ECAs and employ name-and-shame tactics in those cases where ECAs violate their own rules or obligations under the Common Approaches. The United States lobbied hard to incorporate ex-ante transparency into the agreement knowing that such rules would provide for an implicit but effective compliance mechanism by raising the reputational and political risks of non-compliance (Chayes and Chayes 1995).

Private financial institutions have been the latest group of financial institutions to adopt a similar set of environmental policies for their project approvals in project finance transactions. The Equator Principles (see box 1) are the weakest re-incarnation of NEPA provisions discussed here. World Bank rules are written into its operational policies. The Common Approaches are a non-binding agreement, but contain detailed rules for implementation and reporting. The Equator Principles, however, are simply a list of ten principles concerning project evaluation which leaves implementation completely to the adopting institutions. Still, the list of principles covers the same environmental review logic as contained in ECA rules: classification according to likely environmental impact, environmental assessment of projects with considerable environmental impact, and consultation with stakeholder groups.

**Box 1: The Equator Principles**

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<tr>
<th>Principle</th>
<th>Description</th>
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<tr>
<td>1.</td>
<td>Projects are categorized based upon the IFC environmental and social screening criteria;</td>
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<td>2.</td>
<td>For all category A (significant adverse environmental impact) and category B (less adverse environmental impact) projects the borrower completes an environmental assessment;</td>
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<tr>
<td>3.</td>
<td>Environmental assessments evaluate projects based on IFC environmental standards or host-country standards in high-income OECD countries;</td>
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<tr>
<td>4.</td>
<td>For all category A and some category B projects an action plan and environmental management system is prepared;</td>
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<td>5.</td>
<td>For all category A and some category B projects stakeholders are consulted and are provided with access to the environmental assessments;</td>
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<tr>
<td>6.</td>
<td>For all category A and some category B projects the borrower establishes a grievance mechanism for groups and individuals from project-affected communities;</td>
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<tr>
<td>7.</td>
<td>For all category A and some category B projects independent experts review the assessment, action plan, and consultation process as well as assess compliance with the principles;</td>
</tr>
<tr>
<td>8.</td>
<td>For all category A and some category B projects the borrower covenants to comply with the principles;</td>
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<tr>
<td>9.</td>
<td>For all category A and some category B projects an independent environmental expert is appointed to verify monitoring; and</td>
</tr>
<tr>
<td>10.</td>
<td>EPFIs report on their implementation of the principles at least annually.</td>
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Since 2006, the principles apply to all project finance transactions of $10 million and more. Being a voluntary industry code, financial institutions adopt the Principles with an announcement and a declaration to integrate them into their operations. However, the adoption is entirely voluntary and no authority monitors implementation or requires reports from adopting institutions. On the project level, independent experts are to evaluate the environmental review process and assess compliance with the Principles, but their work is limited to providing input to the financial institution and is unlikely to become publicly accessible. Adopting institutions are to require their clients to provide environmental assessments to their stakeholders and EPFIs need to report on their implementation of the principles annually. However, no further transparency requirements exist which is quite typical for industry self-regulation (for a discussion of the UN Global Compact see Hemphill 2005). Despite the secluded
nature of banking operations, NGOs have been successful in identifying projects with EPFI involvement that stand in conflict with the Principles. Similarly to the Common Approaches, the lack of a formal compliance mechanism is mitigated by NGOs’ name-and-shame tactics which can induce compliance by raising the reputational risks of noncompliance (for NGO critiques see BankTrack 2006; Chan-Fishel 2005; Missbach 2004).

3. Delegated delegation: tasking finance actors with setting environmental rules

In the case of environmental policies for providers of finance, regulation occurred in a delegated fashion: pressured by NGOs which exercised their discursive power (see Fuchs 2006; Park 2005; Schaper 2005), states, MDBs, and private banks established environmental conditionalities for access to finance. This delegated nature becomes especially apparent in the cases of MDBs and ECAs: instead of seeking international environmental standards for infrastructure development, governments tasked MDBs and ECAs with developing policies to restrict the access to support based on environmental performance criteria. In the cases of Equator Principles (EPs) for private banks, ECA standards, and IFC policies, the standards do not directly affect project design, but instead put pressure on project developers to (re-)design their projects in such a way that they become compliant with the standards. As Haufler observes, this “turn to using financial leverage over companies to effect change in other countries is less costly, more competitive, and potentially more effective than other options” (Haufler 2005).

This possible gain in efficiency, however, may be accompanied by a trade-off in legitimacy in two ways: (i) rules are set without or with only limited input by the targets of regulation, and (ii) non-state actors take on regulatory tasks of implementing the policies as well as in monitoring compliance with these policies. With regard to the voice of regulatory targets in the standard-setting process environmental standards for ECAs are problematic as they are set in a transdomestic fashion: that is, by regulating conditions in another polity through a domestic policy process. Similarly, establishment of the Equator Principles occurred without input from clients in project finance.

Scharpf (2004) notes: “Beyond the nation state, the institutional prerequisites of input-oriented legitimacy are weak or lacking. […] What is possible is output legitimacy, but its normative reach is limited.” Neyer describes governance beyond the state as non-hierarchical or heterarchical. He suggests that legitimacy in non-hierarchical systems is the process of a discursive process that centers on the acceptance of rules. In such heterarchical authority systems, interactions among actors are circular as opposed to vertical relationships in hierarchical systems or horizontal dealings under anarchy. That means that actors co-depend on each other by legitimizing actions through mutual acceptance of their activities in discursive practices (Neyer 2002).

Thus Neyer provides the mechanism by which the legitimacy of policy output is established, the missing link in Scharpf’s discussion. Without a generally accepted performance standard to serve as a benchmark, Scharpf’s suggested recourse to output legitimacy still begs the question by which standards we are to consider an output as legitimate. Following Neyer, legitimacy of that output is established through acceptance by the involved actors. In our case of environmental standards for international project finance, legitimacy is thus conferred (and challenged) by general agreement (or lack thereof) on the nature of the rules by providers of finance, NGOs and other involved actors. However, the legitimacy of these rules is negotiated and conferred on the heterarchical level of finance providers only. Also note that such output oriented heterarchical legitimation only requires agreement on the suitability of rules among those involved in the discourse. Inputs to the rule-setting process are only relevant if they are injected into the discourse on these norms with enough weight to justify their consideration by the involved actors. Clients of the financial institutions or project developers in recipient countries are unlikely to possess enough clout to make their voices heard in the discourse legitimizing rules on the international level. Project sponsors interact with financial institutions in a hierarchical setting and are thus bound by the rules set by the providers of finance.

Such heterarchical interactions provide varying levels of challenge to the different kinds of actors studied here. These actors are constituted based on different accountability mechanisms and legitimacy concepts. In addition to rule-setting, legitimacy in monitoring and enforcement also provides varying challenges to the different types of actors involved.

Besides the implementatory roles assumed by MDBs, ECAs, and private banks, NGOs play an
important role in monitoring these financial actors and enforcing compliance with standards. With regard to private banks and NGOs, this raises questions of accountability in governance processes beyond exclusive state control. This “outsourcing” of regulatory tasks to non-state actors is not an insular phenomenon. David Levi-Faur observes “an increase in delegation” as a shift in regulation (Levi-Faur 2005).

Delegating governance tasks to actors across sectoral boundaries can present formidable accountability changes which have only been addressed in part in the literature. Gilboy has discussed compelled participation by non-state actors, but the role of NGOs in policing agreements in the absence of an obligation to do so is still under-researched. Gilboy is concerned with the “government’s enlistment of private entities (industries, businesses, professionals) to help public enforcement” (Gilboy 1998: 135). Key features of such third-party liability systems are that “(1) private entities are compelled to help deter misconduct; (2) civil and criminal sanctions exist for failure to perform duties; and (3) little or no compensation is provided to cover the costs or performing duties” (Gilboy 1998: 140). In her research cultural factors impacting compliance of these private entities feature prominently, but she does not address concerns of legitimacy and accountability in her otherwise comprehensive treatment of the issue. Compelled participation applies to ECA clients when exerting influence on project developers to bring projects in compliance with ECA environmental standards. However, it does not encompass clients of EP banks in implementing the principles or NGOs in monitoring financial institutions’ compliance with their environmental policies.

Scott (2005) incorporates gatekeepers who do not have a duty to do so and thus are driven by an intrinsic motivation to fulfill their enforcement functions. The concept of gatekeeping builds on the work of Kraakman on gatekeeper liability which imposes the duty “on private ‘gatekeepers’ to prevent misconduct by withholding support” (Kraakman 1986). While traditional gatekeeping functions rely on an obligation imposed by the regulator, Scott draws on Goodin’s (2003) argument of the distinctiveness of the third sector which suggests that the third sector’s accountability based on intentions enable it to carry out similar functions outside of the state sector’s hierarchy.

According to Goodin, a key difference between state, market, and societal actors is their primary accountability regime. He argues that the accountability regime of state actors “focuses relatively more heavily on the actions of officials as its subject of accountability; and [that it] relies relatively more heavily upon hierarchical authority structures as its characteristic mechanism for achieving accountability” (Goodin 2003: 366). With regard to market actors, accountability is focused on results and based on competition as the main mechanism. The non-profit actor, finally, is said to be held accountable based on intentions while operating in cooperative networks of shared norms and believes as its accountability mechanism (Goodin 2003: 367).

Thus NGOs find themselves at home not only with regard to their monitoring function but also with respect to the heterarchical legitimization of rules. The next section highlights how NGOs can comfortably fill their monitoring function while ECAs and EP banks find themselves caught in roles that do not square with their accountability regime. As Goodin observes: “arrangements that straddle sectors […] inherently blur the distinctions between the sectors. In so doing, those arrangements undermine the accountability of each sector in its own terms […]” (Goodin 2003: 360).

World Bank policies are the result of concerted pressure by NGOs and the U.S. government. While IBRD and IDA policies affect primarily projects developed with involvement by their own staff, the implementation of IFC policies is delegated to its clients. The regulatory task of improving the environmental performance of projects is delegated by the U.S. government via the World Bank and its Executive Board to clients. The use of finance as a lever serves to regulate the environmental performance of projects in client countries. As an international organization, the World Bank operates in the realm of state authority to which Goodin ascribes action-based accountability. However, from this perspective the creation of Bank policies hardly seems legitimate: the U.S. government used its influence unilaterally to bring about the desired changes. From a perspective of intention-based accountability (Goodin 2003) or output legitimacy (Scharf 1998), the U.S. involvement is less problematic. In fact, following Neyer, the general acceptance of the Bank’s environmental policies as well as the diffusion of environmental reviews legitimizes these policies.

ECAs do not conduct environmental reviews themselves. They require their clients to supply environmental impact information which is in turn supplied by project sponsors in the recipient countries. Thus implementation on the ground is carried out by the ECA clients’ business partners in
order to gain access to financing. ECA clients themselves have an interest in ensuring compliance at the project level since a violation of environmental requirements may compromise their cover against non-payment if the terms of cover are violated. The use of finance as a lever serves to enlist domestic exporters to pressure project sponsors to make their projects compliant with ECA rules. Gilboy (1998) calls this strategy compelled third-party participation: exporters become liable for the environmental performance of the project to which they supply goods and services if these are to be covered by ECAs. The regulatory task of ensuring good environmental performance has been delegated by the government via its ECA to the exporter.

Despite their similarity and close relationship to the public policies governing World Bank and ECA operations, the Equator Principles are of substantially different nature: private regulation of the private sector. Nevertheless they also delegate the regulatory task of managing environmental project performance to clients. The use of finance as a lever serves to compel project developers to design projects in a way that they are compliant with the Principles. When compared with World Bank and ECA policies, the chain of delegation is shortest for EPFIs. From a risk management perspective requiring clients to minimize environmental and social risks that could potentially transform into reputational risks makes good business sense. Thus implementing non-market standards in financial transactions does fit with Goodin’s market-based accountability mechanism. However, a potential pitfall is that the EPFIs are likely to be judged based on their stated intention of improving environmental performance of their project loans. As a result they may find themselves caught between their primary accountability regime (competition) and that of the third sector based on intentions.

4. Legitimacy of environmental standards

A considerable share of international financing is now subject to environmental policies courtesy of the U.S. government and a NGO coalition concentrated in Washington, DC. Furthermore, these policies regulate environmental conditions inside polities which had little or no input into the development of these rules and may object to them. Finally, by employing transparency as an informal compliance mechanism, these policies rely to a large extent on non-state actors for monitoring compliance and enforcing the application of these environmental rules. All three aspects raise important questions relating to the legitimacy of these policies.

4.1 Pushed by a small NGO campaign

The NGO campaigns have made a range of financial institutions accountable to the public. However, this means that these institutions are now subject to environmental mandates and public scrutiny even if this contradicts their primary missions. Private banks are profit-seeking institutions which are primarily accountable to their shareholders. Adding the interested public as an additional constituency to which banks are expected to be accountable to may conflict with their primary objective in maximizing profits for their shareholders. MDBs have a mandate which is more conducive to public input: they were set up by governments and receive funding from donor governments. Yet, only part of their business is in making grants. Where loans are disbursed, MDB banks operate similar to commercial banks when viewed from the client perspective. Yet, this non-concessional business is subject to the same environmental rules as their aid business, despite the self-sustaining nature of the loan business. ECAs are public agencies and thus should be most amenable to public control over their operations. However, the environmental mandate appears to be at odds with ECAs’ primary mission of job creation through export promotion.

While public accountability in itself may be problematic for these institutions, the role of a small group of NGOs in bringing about such sweeping changes also needs to be scrutinized. Both the ECA and the MDB campaigns received domestic legitimization through the involvement of the U.S. Congress and U.S. government in furthering the campaign objectives. While the Congressional endorsement does render U.S. government initiatives in these respects legitimate from a domestic perspective, the situation is not as clear internationally. Harmonization of ECA standards proceeded internationally with G7 and OECD ministerial council endorsements eventually leading to an international agreement under the umbrella of the OECD. Thus, these standards have been legitimized by the relevant international bodies. Environmental policies for MDBs were championed by NGOs
and endorsed by Congress. However, different to the ECA standard-setting process, change came about through unilateral pressure exerted by the U.S. government. Viewed from a domestic perspective this was a legitimate and appropriate behavior; however, viewed from an international perspective, this behavior lacked legitimization through a relevant international body. Private banks finally were coerced into developing the Equator Principles by NGOs without government intermediation. Though a political act, this campaign took place entirely in the sphere of private politics. Given the lack of generally accepted accountability relationships among sectors outside the sphere of public politics, the legitimacy of NGO campaign on private banks is more difficult to assess. However, in corporate governance, the main accountability relationship is that of management to shareholders. Such a relationship does allow for shareholder activism, but it does put a question mark behind the legitimacy of activism by non-shareholders.

Applying output rather than input legitimacy would justify all three campaigns but this also raises the question for the most appropriate legitimacy concept. Similarly, an emphasis on intention-based rather than action- or results-based accountability would validate the MDB and private bank campaigns. Following Goodin’s argument that NGOs primarily operate under an accountability mechanism based on intentions certainly validates the private bank campaign. However, such an argument becomes more difficult with regard to the U.S. government’s role in pressuring the World Bank as the prevailing accountability mechanism for state actors is based on the legality of actions.

Thus far, I have equated concerns voiced by the NGO campaigns with those of the public at large. However, only a few of the NGOs involved in the campaigns have large membership bases who they can claim to represent. Most of the organizations in the networks are specialized advocacy groups with a small staff and no or small membership. While they can claim to work for the common good and to represent widely held grievances, they do not possess the input legitimacy for making political demands that groups with large membership have.

All three campaigns were predominantly funded by two foundations, the Charles-Stewart-Mott Foundation and the Wallace Global Fund (does not support BankTrack). The Mott Foundation’s program area Reform of International Finance and Trade Institutions states that these must “become more responsive to environmental and social concerns […].” The foundation “support[s] the efforts of non-governmental organizations to influence global policies and institutions […]” (Charles Stewart Mott Foundation 2005). Similarly, the Wallace Global Fund’s program areas include “shifting public and private financial flows out of environmentally harmful investments and into environmentally sustainable ones, by influencing multilateral lending and credit institutions and global trade mechanisms, and changing U.S. tax policies and corporate subsidies” (Wallace Global Fund 2004).

Those NGOs without a membership base of their own are ultimately only accountable to their funders (Schepers 2006). Which, in the case of these foundations, are organizations with a large capital stock and activist mission in their program statements who are only accountable to their boards (for a detailed discussion of foundations’ legitimacy see Prewitt et al. 2006). Adding Goodin’s concept of intention-based accountability as an extra layer makes these NGOs accountable to others in the same network organized around shared norms and believes. Thus, NGO activities are legitimate as long as their intentions are in concert with the shared norms within the network. Following Neyer, their actions would be legitimized through acceptance by other actors beyond the subset of NGOs.

4.2 Transdomestic regulation

Hauffler states that financial sector “standards agreements are based on consensus among interested parties, and they are voluntary but widely accepted; they are a form of self-enforcing agreement” (Hauffler 2005). This characterization applies to environmental policies only to a limited extent: private banks were coerced into establishing green policies by NGOs and sought to pre-empt government intervention; the World Bank was coerced into its environmental leadership role by the U.S. government; and ECAs did in fact establish consensus and rely on the self-enforcing nature of the Common Approaches. However, ECA rules are limited in their inclusion of “interested parties” in the agreement.

ECA standards are transdomestic in nature. These standards are domestic regulations that are aimed at domestic exporters. Yet, their impact occurs elsewhere: environmental conditions in another polity are being regulated. Furthermore, since the exporters need to make environmental impact
information available to their ECA, project sponsors need to conduct environmental impact assessments, even if their domestic regulations do not provide for such a requirement. By means of these environmental standards, advanced industrialized countries project their environmental regulations into other polities.

In most states, these rules were devised without input from those polities in which the standards have the most direct impact. Similarly, the international negotiations on harmonization of these standards were conducted in the context of the OECD without consulting the recipient countries. Turkey is among the states represented in the OECD Export Credit Group because it operates its own ECA. Yet, Turkey is also a recipient country of numerous ECA-supported projects. As such, the Turkish delegation was opposed to standards established in 2001 and in 2003. Both times it felt its interests as a recipient country threatened by them.

For many developing countries environmental concerns are secondary to the establishment of infrastructure. While it is generally accepted that donors have a say over what is acceptable or unacceptable in terms of social and environmental externalities of development projects, this does not apply to ECA supported projects. By definition, ECAs provide support at market or near-market conditions and supported projects are usually of a commercial nature or they are funded with little or no aid involved. As such it is not surprising that project sponsors and recipient country governments are concerned about their loss in autonomy and control if the exporting countries’ ECAs require environmental impact assessments and potentially costly modifications to the projects’ design despite compatibility with the recipient countries’ regulations. After all, costs that result from the compilation of assessments or from modifications to the projects are borne by the project sponsor or the recipient country.

All three sets of rules are dominated by the interests of the providers of finance and only consider the interests of receivers in terms of providing for a better environment as an unspecified common good. Material interests of the receivers (e.g. costs associated with preparing environmental assessments or providing mitigation measures) are externalized. In all three cases, establishment of the policies was possible because of diffused costs and concentrated benefits. The reputational benefits of having implemented environmental policies go exclusively to the providers of finance, whereas the costs generated by these policies are borne by the receivers.

In the case of ECAs this required the establishment of common environmental rules among ECAs because unilateral environmental measures would have upset the cost-benefit balance by creating domestic costs in the form of foregone export opportunities. The transdomestic nature of ECA standards facilitated the establishment of ECA rules. Rules with domestic targets, such as environmental standards imposed on exported goods are even more likely to hurt domestic exporters and are politically more visible, rendering agreement to such policies more difficult. While regulating the access to financing for exports may have the same effects on exports as setting product standards for exports the indirect nature of this strategy may be politically less costly.

4.3 Transparency: how to provide for monitoring and enforcement in gentlemen’s agreements

All three policies rely on transparency provisions as compliance mechanisms. While this mirrors the U.S. approach in NEPA in which these policies find their common root and was championed by NGOs as well as the U.S. government, it places a considerable responsibility and burden on non-state actors (for an in-depth discussion of transparency see Mitchell 1998).

The World Bank Group has coupled its disclosure policies with institutionalized compliance mechanisms. Thus, outsiders, such as NGOs, can not only monitor Bank operations, but also trigger review mechanisms in those cases where operations do not comply with rules. The IBRD’s inspection panel and the IFC’s Compliance Advisor/Ombudsman enable the affected public with effective means to initiate independent reviews of problematic projects.

Disclosure provisions in the Common Approaches are modeled after NEPA and World Bank rules: environmental review information needs to be available to the public 30 days prior to making a cover decision. However, the Common Approaches do allow for deviation from this rule (see Görlach, Knigge, and Schaper 2007) and the transparency commitment is also not backed up by a formal compliance mechanism. Still, the availability of environmental project information implicitly tasks
NGOs with policing the agreement. Ex-ante transparency was introduced into the Common Approaches precisely for this reason (interview with U.S. government official, 25 June 2003).

Monitoring and compliance provisions are weakest in the case of the Equator Principles. No central authority exists to watch over the Principles’ implementation. Without a body dedicated to administering the Principles, monitoring by participating institutions and outside actors must rely on information made available by the adopting institutions to evaluate their performance. Thus, transparency provisions appear to be most important in that case of environmental policies in which they are developed the least. Concerning implementation on the project level, the 2006 Equator Principles equip financial institutions with fairly strong monitoring tools. However, the formal accountability chain ends at the level of the individual financial institution. Still, even the limited information disclosure practices provide for an implicit compliance mechanism by raising the reputational risk of non-compliance (see also Overdevest 2005).

Effectively, these policies are policed by NGOs utilizing the transparency provisions to flag problematic decisions and projects. With the existence of an inspection panel or ombudsman, the capability burden on these organizations is limited as they can initiate a review process with little impact on their own resources. However, where such a mechanism does not exist – most ECAs and all Equator banks – the only way to enforce these policies is by researching violations and making them public. In the absence of explicitly delegated authority to assume this function and no compensation for such services, the role of NGOs in this area is problematic.

The Common Approaches and the Equator Principles are both voluntary agreements. The Common Approaches are described as a gentlemen’s agreement among its signatories – adherence to their prescriptions is left to the participating parties. Similar to this, equator banks declare their adoption of the Equator Principles and can implement their provisions as they deem appropriate. Industry self-regulation and international agreements tend to suffer from the same regulatory deficiency: the lack of an authority to which signatories are accountable and which can enforce implementation of the agreements.

In both sets of standards, this void is addressed to some extent – albeit very differently. The Common Approaches provide for information sharing among the signatories and the secretariat making the parties somewhat accountable to each other. The Equator Principles have no accountability provisions. The way out are monitoring provisions: ex-ante transparency in ECAs’ cover decisions provides civil society actors with a powerful tool to monitor their environmental performance. The Equator Principles stipulate independent expert review of environmental assessments and environmental management plans and have recently introduced reporting requirements.

NGOs address this shortcoming of the Equator Principles in their critique:

A fatal flaw of the EPs is that there is no mechanism for ensuring that endorsing banks actually implement them. The lack of transparency requirements prevents endorsing institutions, peer banks and the public to monitor implementation of the Principles. In addition, the EPs should have captured other IFIs’ accountability policies and embraced the concept of prior and informed consent in community consultation. (http://www.profundonl.nl/english/publications/equator4.html)

Because the Equator Principles currently do not include a commitment to disclosure of information, it limits the ability of the public, and even of the endorsing banks themselves, to measure the efficacy of the Principles. Naturally, external verification provides extra credibility to any claim of success for the EPs. For this to happen, banks must disclose information that is now kept confidential with reference to client confidentiality. A commitment to transparency is vital to promote accountability and demonstrate banks' good faith effort to implement the Equator Principles.

(http://www.profundonl.nl/downloads/nouturn.pdf)

Similar to the banks, ECAs have long resisted transparency in their cover decisions with reference to business confidentiality. Yet, the Common Approaches require ECAs to make environmental assessments publicly available 30 days prior to making a coverage decision. The Equator Principles already require environmental assessments or summaries of them to be made available; thus banks could implement similar policies within the Equator Principle framework. However, no such policies are in effect – most likely because of the fear of too much NGO scrutiny. In the ECA case, the Common Approaches’ transparency provisions appear to result in a de-facto outsourcing of monitoring.

While ECAs possess only limited capacity to monitor the environmental performance of rival agencies, they can be sure that NGOs will use the information made available by their domestic ECAs prior to granting cover. Thus, NGOs monitor the projects approved by their ECAs and indirectly supply other ECAs with information about their environmental performance. In addition to
monitoring, NGOs also enforce the Common Approaches by openly criticizing ECAs for covered projects that do not conform to established standards. “Outsourcing” of compliance monitoring and enforcement is inherent in the ex-ante transparency provision of the Common Approaches but at no point is it explicit. The level of monitoring in such an arrangement depends heavily on the civil society capacity within the state to be monitored. Strong NGOs can provide detailed monitoring and thus facilitate sincere implementation of the agreement, while states with weak NGOs may enjoy more leeway in devising their own regulations. Thus, the result could be uneven implementation corresponding to civil society strength.

This form of monitoring also brings up accountability as a concern. NGOs monitoring state activity provide an important independent watchdog function where legitimacy and accountability is only of minor concern. However, if states start to rely on them to provide such functions as services, one has to ask where the NGOs’ authority and legitimacy for such tasks stems from. This is less a concern for NGOs whose function has not changed considerably but rather for governments which need to consider when and under which conditions they can rely on non-state actors to perform tasks which rest within their own responsibilities.

The transparency approach to monitoring and enforcement taken in the Common Approaches may provide an interesting example for controlling compliance with agreements in which it is difficult or impossible to task a certain authority with these tasks. References to business confidentiality long prevented ECAs from moving into this direction and confidentiality is of even greater concern to banks which do not hold national monopolies like ECAs do. And banks are less likely to move on this issue the way ECAs did whose governments are fully accountable to the electorate.

5. Conclusion

Transparency provisions can be a very potent compliance tool – especially where a lack of formal authority (or lack of agreement) does not allow for monitoring and enforcement by an authorized body. However, trade-offs include the legitimacy of the process as well as the authority of the actors providing the enforcement functions. This is especially problematic in cases where actors transcend their own primary accountability mechanisms and may find themselves caught between competing imperatives. Nevertheless, NGOs appear to be well equipped for providing such enforcement functions and the challenges rest primarily with the regulatees.

If monitoring and enforcement is conducted independently, unstructured, and in an ad-hoc fashion one also needs to be concerned whose compliance will be scrutinized when and by whom? Assuming that NGO resources are scarce, the initial assumption is that those actors with the worst track record are targeted first. However, different activists may pursue different financial institutions and the level of NGO activism may differ across countries. The result of this would be uneven enforcement that does not result from different levels of compliance but rather stems from the idiosyncracies of the NGOs involved.

The proliferation of World Bank policies has not only expanded the reach of environmental policies in international finance, but it has also brought new actors into the fold of stakeholders in policy development. While the Common Approaches commit ECAs only to specific versions of select IFC safeguard policies, the equator banks have adopted the entire set of standards including future modifications. Consequently, they also seek to influence their future development. In response to recommendations by the World Bank sponsored Extractive Industries Review (EIR), they call upon the World Bank to reject several of them. In this letter, eleven of the 21 equator banks also demand to be consulted in changes to the safeguard policies.

Should implementation of any EIR recommendations or other considerations require changes to the Safeguard Policies or Sector Guidelines, we expect that the banks which have adopted the Equator Principles, as important stakeholders to the [World Bank Group], will be fully consulted in this process, given our role in the application of these Policies and Guidelines in our day to day business. (Mulder et al. 2004)

Consulting equator banks as stakeholders in World Bank policy revisions because of their adoption of the principles is problematic. While private banks claim to keep their policies independent of the IFC, providing them with privileged access in policy revisions would in fact change the character of the World Bank Group’s policies which many value for their neutrality. This letter also hints at an important question that needs to be addressed: if the World Bank Group’s policies are increasingly
applied elsewhere, who can be considered a stakeholder and who is merely an outsider free-riding on World Bank policy development?

References


