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CLIMATE NOTES

CLIMATE PROTECTION INITIATIVE

THE CLIMATE OF EXPORT CREDIT AGENCIES

CRESCENCIA MAURER WITH RUCHI BHANDARI

INTRODUCTION

The environmental and social impacts of export credit and investment insurance agency (ECA) activities have received limited public scrutiny. Outside trade and finance circles little is known about ECAs—financial institutions that governments create to promote exports and facilitate investments in riskier overseas markets. During the 1990s, ECA financing through loans, project guarantees, and investment insurance averaged $80-$100 billion or more per annum,[1] roughly twice the levels of official development assistance during the same period ($50 billion).[2] By the late 1990s, bilateral banks, made up largely of ECAs, accounted for 31 percent of all the long-term financing received by developing countries while multilateral institutions accounted for 17 percent.[3]

In the past decade, the economic liberalization policies adopted by many countries, and a phenomenal rise in private capital flows has dramatically accelerated global economic integration. This has been particularly pronounced for developing countries. Between 1990 and 1997, private capital flows to developing countries, virtually all of it from the world's leading industrialized economies, roughly quintupled.[4] ECA provision of project and trade financing grew in tandem, following much the same pattern.[5] During the same period, governments throughout the world negotiated international environmental treaties to address the degradation of the world's environmental commons. But these conventions, including the United Nations Framework Convention on Climate Change (UNFCCC), are structured in terms of the nation state, largely ignoring the power of private finance to shape environmental outcomes in an increasingly integrated world economy. To an ever greater extent, private capital flows are responsible for building developing countries' physical infrastructure. Much of this infrastructure will shape the pattern of emissions growth in these countries, including power generation, transportation infrastructure, manufacturing plants, and development of coal, oil, and natural gas resources.

In the same way that international environmental agreements ignore private capital flows, commitments made by governments to address the environmental impacts of ECA financing do not address threats to global commons, including climate change. In June 1999, the world's seven leading industrial economies (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States) plus Russia (the G8)* met at a summit in Cologne, Germany, and agreed to work toward a set of common environmental guidelines among their ECAs. The G8 communiqué from the Cologne Summit also emphasized the problem of climate change and the importance of helping developing countries address its challenges. Efforts to move these commitments forward, however, have not connected these two priorities. As a result, negotiations of common ECA environmental guidelines have not included climate change concerns.

The failure to place ECAs within a wider development and environmental context is generating a *policy perversity*. Governments pursue one set of objectives through climate negotiations, while their finance and trade arms ignore the global environmental implications of their activities. Although industrialized countries emphasize the importance of addressing carbon emissions in developing countries, evidence presented below indicates that ECA financing to developing countries favors exports and investments that disproportionately benefit energy- and carbon-intensive industries.

The following analysis examines ECAs in more detail—in particular, the climate

* These seven industrialized economies are referred to as the G7. In negotiations and discussions between foreign affairs ministries and heads of state, the group has expanded to include Russia and is referred to as the G8.

implications of their financing activities. The analysis discusses why ECAs have remained outside of public debates and how this contributes to the contradictions outlined above. Particular attention is given to the fact that most ECAs operate with little or no transparency, and, as a result, are rarely accountable for the environmental consequences of their financing. The analysis suggests a reform agenda for ECAs, and actions that might help to align trade and investment policies with climate commitments.

Fossil-fueled power generation and oil and gas development alone accounted for nearly 40 percent of project and trade finance flows to developing countries from 1994 to the first quarter of 1999.

The Nuts and Bolts of ECA Financing

ECAs exert a powerful leveraging effect because they draw in additional private financing for exports and overseas investments. ECAs generate leverage because they spread or reduce risk through such instruments as trade finance, project finance, guarantees, and insurance.[6] *(See Box 1.)* The last three instruments have grown in importance during the past decade.

Project financing attracts private investors because it is based on the merits of the project rather than the credit worthiness of the investors themselves. It is non-recourse in nature, meaning that a project's sponsors have no legal requirement to ensure repayment if project cash flows prove insufficient to cover the debt.[7] Through guarantees or insurance ECAs assume partial or full liability for a project's failure or a borrower's default, providing a safety net to exporters and private investors.

ECAs take different institutional forms (export-import banks, state-owned com-panies, and even private banks that manage and disburse government funds), but most specialize in a particular subset of financial services. ECAs generally fall into two categories: those that concentrate on export credits, project finance, and guarantees (export-import banks) and those that underwrite investments against losses (investment insurers).

In the last decade, the role of ECAs in reducing risk has become more important. The worldwide growth in private capital flows, particularly foreign direct investment, has increased the demand for ECAs' project financing, risk guarantees, and insurance. Roughly half of new ECA commitments in recent years has been for project financing of large infrastructure, power generation, and telecommunication projects.[8] Similarly, the volume of investments underwritten by ECAs that belong to the International Union of Credit and Investment Insurers, known as the Berne Union, climbed from $17 billion in 1990 to $43 billion at the end of 1996.[9] During the same period, the traditional financing provided by ECAs—short-term export credits with maturities under a year—diminished as ECAs increasingly privatized or delegated this form of lending to private commercial banks.

Project financing has grown in tandem with increases in international private capital flows.[10] Over half of new commercial bank lending in the mid-1990s was for project financing of infrastructure, roughly $22 billion per annum.[11] Other statistics indicate that project finance increased from $10 billion in 1990 to $80 billion in 1995.[12] Although project finance has grown dramatically, official statistics of capital flows do not separate out this category; and do not provide any disaggregated information on ECA finance. The analysis that follows relies on information from a commercial database, *Project Finance Ware. (See Box 2.)* The data reflects the growing importance of project relative to trade finance, with the former representing almost three-quarters (74 percent) of all the flows that this database captures.

ECA Financing and Climate Change in Developing Countries

Overall, flows of trade and project finance going to developing countries is concentrated in sectors with important implications for future greenhouse gas (GHG) emissions. From 1994 through the first quarter of 1999, three-fifths of project and trade finance going to developing countries ($216.6 billion out of $376 billion) supported exports or investments that are energy-intensive: fossil-fuel power plants, oil and gas development (exploration, extraction, refining, and distribution), energy-intensive manufacturing (chemicals, iron and steel, pulp and paper),[13] transportation infrastructure, and aircraft.[14] Fossil-fueled power generation, and oil and gas development alone accounted for nearly 40 percent of project and trade finance flows to developing countries. The remaining energy-intensive sectors (transportation infrastructure, energy-intensive manufacturing, and aircraft) accounted for another 20 percent of all the financing destined for developing countries.[15]

Flows going to fossil-fueled power generation along with upstream and down-

Box 1 **Export Credit and Investment Insurance Agencies: The Tools of Their Trade**

ECAs are bilateral organizations that provide financial services to support the overseas trade and investment activities of private domestic companies. Their business is directed at companies from their home countries trying to enter or compete in emerging market economies or economies in transition (newly independent states). Unlike commercial banks that seek a market return on their loans or insurance, ECAs only seek to recover their operating and financing costs, providing an implicit subsidy to their clients. The financial instruments employed by ECAs are described below.

Trade Finance. This type of finance consists of loans with shorter maturities (less than 2 years) that finance the export or import of equipment or services. ECAs generally divide their trade financing into two categories ***export credits*** and ***import credits***. In the case of export credits, short-term loans are provided directly to exporters or to intermediary banks that, in turn, loan to exporters. Import credits are similar, but they are directed at foreign buyers of goods and services originating from the ECA's home country. Lending to foreign buyers is usually done indirectly with ECAs establishing credit facilities or agreements with banks in developing countries that in turn provide the loans to foreign buyers.

Project finance. ECAs provide longer-term loans (maturities of 5 to 10 years) to overseas projects (building a power plant or manufacturing facility, for example) when companies from their own countries are substantially involved. Project finance is usually non-recourse in nature, meaning that the loan is to be repaid from the revenues the project generates; if the project fails, the only recourse available to the lender is the value of the project's assets. In effect, the lender cannot go after the assets of its creditors.

Guarantees. ECAs grant guarantees to cover investor losses caused by civil unrest, expropriation of property, nationalization (these are classified as political risk guarantees), the inability to convert local currency into hard currency (currency transfer risks), or from breach of contract by a host country government (partial risk guarantees). ECAs also back loans against default (loan guarantees), making it attractive for commercial banks to lend money to private exporters or investors. Sovereign governments back guarantees. When a private client's losses are covered by a guarantee, the government of the ECA that issued the guarantee assumes the liability. In some cases, ECAs are able to recover losses from the government where the project or borrower is located (usually a developing country). A developing country government assumes the loss as part of its official debt with the country that issued the guarantee. In effect, the liability passes from the private to the public domain, and in some cases from an industrialized country to a developing country's official debts.

Insurance. This instrument is similar to a guarantee, but tends to be narrower in scope with regard to the losses covered. Insurance is sold to private clients at premium prices that reflect the risks associated with the country, project, or specific risk being covered. The higher the risk, the higher the premium. Governments replenish reserves with public funds on regular intervals or when insurance claims require it, but ECAs generally help build their own reserves and cover operating costs from insurance sales.

Equity Funds. A limited number of ECAs are creating equity funds that invest directly in development, infrastructure, or other commercial projects in developing countries. Private investors that contribute their own money to such funds are sometimes guaranteed minimum returns. Equity funds help ECAs spread risks across a number of projects and make it possible to invest in smaller projects. When guaranteed returns are provided, they also attract additional private money.

Sources: Michelle Chan, *The Anatomy of a Deal: A Handbook on International Project Finance*, (Washington, D.C.: Friends of the Earth-US, 1996); and Genaro G. Fullano, *Introduction to Transactional Project Finance* (Washington, D.C.: Nixon, Hargrave, Devans & Doyle, LLP, 1997).

stream oil and gas development are facilitating the extraction of fossil fuels and the power base that will consume them over the next 30 to 50 years. This is the same period during which developing countries' annual and total contributions to industrial emissions will achieve parity with that of industrialized countries.[16] Although these investments are likely upgrading infrastructure, introducing more energy-efficient technologies, and permitting fuel-switching from coal to less carbon-intensive natural gas, it is unclear whether such upgrades can transform the fixed capital that drives the carbon-intensity of many economies.

Historically, increases in GHG emissions closely track economic expansion.[17] Developed countries have mature economies experiencing lower rates of growth, most of which is concentrated in service sectors. Stable or falling population sizes are also dampening growth in energy consumption. By contrast, developing countries have rapidly growing populations and expanding industrial sectors. How much these countries increase energy consumption and emissions will depend on these economies' energy mix, economic structure, and the efficiency of their fixed capital. These factors drive energy consumption; moreover, private

Box 2 **Overview of *Project FinanceWare***

Private banks and other financial institutions use *Project FinanceWare*, a commercial database available from *Capital Data Limited* (London, United Kingdom) to track the status of project finance transactions. *Capital Data Limited* obtains its information directly from commercial banks, investment houses, and multilateral development banks. These institutions report on the financial transactions in which they play a banking role and include information on whether or not there is ECA involvement. Consequently, the data on ECAs is indirect.

Project FinanceWare provides details on discrete tranches of capital that are assembled for individual trade and project finance deals. The database identifies the financing roles played by participating banks, including brokers, managers, arrangers, providers, facility agents, securitizers, and guarantors. It is possible to sort projects by sector and subsector categories, country location, country finance source, and whether it is a development project that involves multilateral development banks. The database reports on ECAs in the context of their primary banking roles; i.e., whether they are providing or guaranteeing (the latter includes investment insurance) a tranche of financing.

Project FinanceWare contains time series data beginning in 1994 and is updated quarterly. The cumulative total project and trade financing recorded in *Project FinanceWare* for the five-year time period examined in this report (1994 through the first quarter of 1999) is $998 billion. About 38 percent of the total ($376 billion) went to developing countries. This proportion is consistent with official statistics on the flow of foreign direct investment to developing economies. The latter figure is also roughly equivalent to 30 percent of total capital (both public and private) that entered developing countries during the same five-year time period.

The values of project or trade financing supplied by *Project FinanceWare* are not corrected for inflation or adjusted to reflect any base-year currency values. Consequently, all the figures presented in this document are also unadjusted for inflation or currency values. Capital Data Limited, calculates project amounts using the U.S. dollar value of the financing at the time they enter it into the database. In the case of foreign-currency denominated projects, Capital Data Limited converts these to U.S. dollar equivalents based on exchange rates published by the *Financial Times*.

Source: *ProjectWare Fields, Roles and Tables*. Unpublished document. May 1999. Produced by Capital Data Limited, United Kingdom.

capital has the greatest influence over them. For example, between 1975 and 1990, carbon emissions from manufacturing in Germany and the United Kingdom fell by 4 and 2 percent respectively, and remained almost flat in the United States and Japan[18] even as this sector continued to grow. The decoupling of energy consumption from economic growth in industrialized countries resulted from switches in fuels, increases in energy efficiency, and shifts to less energy-intensive products.[19] The key question is: are ECAs spurring similar transformations in developing countries?

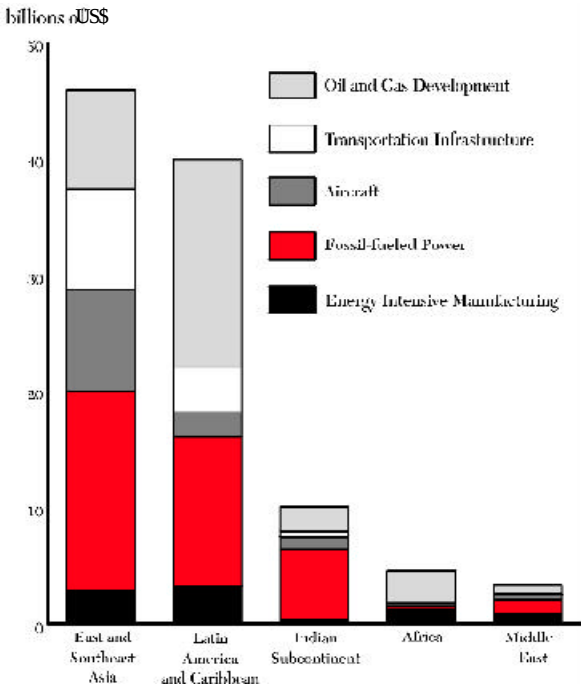
ECA financing, guarantees, and insurance accounted for roughly $44.4 billion or 20 percent of all the financing supporting energy-intensive sectors and exports in developing countries from 1994 through the first quarter of 1999. The majority of this financing consisted of insurance and guarantees for capital projects ($34 billion) with the remainder ($10.4 billion) being loans for projects or export trade.[20] If the leveraging effect ECAs exert is considered, however, their reach is even greater. The total value of the energy-intensive projects or exports for which ECAs provided some form of financing exceeded $103 billion, demonstrating that every dollar of ECA financing draws in more than two dollars of private capital. This $103 billion accounts for just under half of all trade and project financing going to energy-intensive sectors in developing countries.[21]

A closer look at this $103 billion in projects and exports *(see Figure 1)* reveals extreme concentrations in fossil-fueled power, and oil and gas development. These concentrations are both sectoral and geographic. Upstream and downstream oil and gas development projects account for $40.5 billion and fossil-fueled power $33.3 billion; together they equal 71 percent of the above total. ECA-supported projects also favor rapidly growing emerging market economies. Over three-quarters of ECA-supported fossil-fueled energy and power project financing in East and South Asia went to just five countries: China ($6.2 billion), Indonesia ($5 billion), Pakistan ($3.6 billion), the Philippines ($3.6 billion), and India ($3.3 billion). Likewise, over two-thirds of project financing for oil and gas development in Latin America went to four countries: Venezuela ($9.6 billion), Mexico ($2.5 billion), Colombia ($2.2 billion), and Bolivia ($2.2 billion). Not surprisingly, the most important destinations of ECA export credits and project financing for energy-intensive activities include developing countries with some of the largest GHG emissions. *(See Figure 2.)*

Rather than decelerating developing countries' dependence on fossil fuels, ECAs appear to be investing heavily in their long-term consumption and ultimately the associated greenhouse gas emissions. A recent report by the Insti-

tute for Policy Studies, Friends of the Earth-US, and the International Trade Information Service looked at thermal power, and oil and gas projects in developing countries that received support from the Export-Import Bank of the United States (Ex-Im Bank) and the Overseas Private Investment Corporation (OPIC) between 1992 and 1998. The authors estimated that these projects will release 29.3 billion tons of carbon dioxide (CO_2) over their lifetimes, an amount roughly equal to global CO_2 emissions in 1996.[22]

Figure 1 **Project and Trade Finance for Energy-Intensive Sectors in Developing Countries Supported by ECAs, 1994-99**



Source: *Project FinanceWare*, Capital Data Ltd., Copyright 1997-99.

ECAs and Policy Perversity

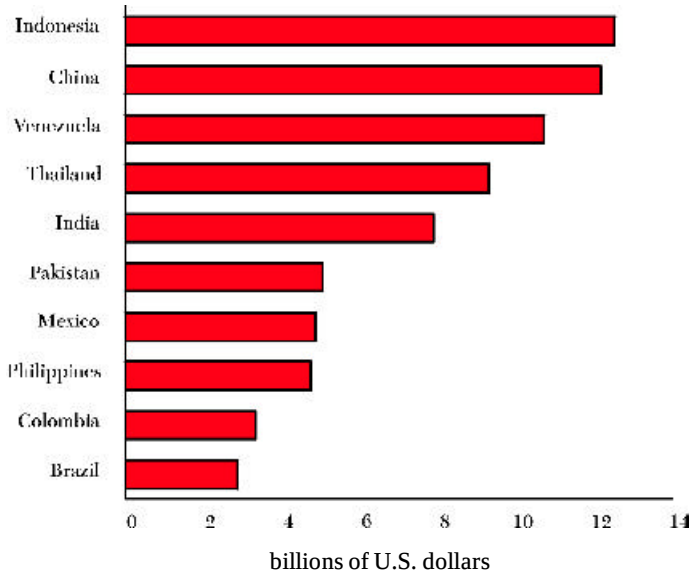
Public funds or institutions that support private activities should generate wider social and economic benefits such as increased domestic employment, development of new markets, equitable economic growth, and pollution abatement. Most ECAs claim that they generate these benefits, and justify their financing and banking services to private clients on this basis. From a climate perspective, however, ECAs appear to be doing more harm than good. ECA financing to energy-intensive sectors is even more concentrated in oil and gas development (39 percent) than total trade and project financing flows (29 percent) to these sectors.[23] Furthermore, such lopsided investments are not balanced by financing for cogeneration, renewable energy, or energy efficiency technologies in any significant volumes (ECAs supported about $2 billion in financing for hydroelectric and geothermal power projects).[24]

Data gleaned from *Project FinanceWare* indicates that ECAs directly undercut the climate commitments and concerns of their own governments. This is particularly true of the governments from the G7 countries. In June 1999 at the annual summit meeting of the G8, these countries agreed to work toward a set of common environmental guidelines by 2001.[25] They greatly emphasized the problem of climate change, giving equal importance to making progress domestically and increasing the participation of developing countries in limiting greenhouse gas emissions. The communiqué specifically states: "We welcome the action already taken by developing countries and stress the need to support their efforts through financial mechanisms, the development and transfer of technology, and capacity building."[26]

The January 2000 meeting of World Economic Forum in Davos, Switzerland, which brought together government, business, and civil society leaders from around the world, also stressed the urgency of addressing climate change. Leaders at the Forum voted climate change the biggest challenge of the new millennium. Yet, most of the wide-ranging discussions on economic globalization did not examine how international finance might assist or limit global efforts to meet this challenge.[27]

Of greatest concern, however, are the contradictions between ECA financing and the commitments under the UNFCCC. Under this Convention (primarily Articles 4.5, 4.8, and 4.9), industrialized countries agreed to facilitate the transfer of environmental technologies to developing countries and develop the financial mechanisms necessary for such transfers.[28] The principal financial mechanism functioning to date is the Global Environment Facility (GEF), which provides complementary funding that helps developing countries to assess climate change risks and remove barri-

Figure 2 **Top Developing Country Recipients of ECA-Supported Financing for Energy Intensive Sectors, 1994-1999**



Source: *Project Finance Ware*, Capital Data Ltd., Copyright 1997-99.

ers to renewable energy and energy efficiency technologies. Between June 1991 and June 1998, the GEF approved $1.9 billion in total financing.[29] If additional government and implementing agency funds (estimated at a third of GEF financing) as well as private sector financing (an estimated $1.2 billion at the end of 1997) are factored in, the GEF mobilized roughly $3.8 billion for all global environmental problems in this seven-year period.[30] About 40 percent of this went to climate change projects, but even these figures reflect commitments rather than disbursements (the GEF disbursement to commitment ratio was close to 50 percent as of June 1998).[31] Thus, GEF funds, together with the additional financing they have leveraged, represent only a small fraction of the resources ECAs mobilize. The reason for this disparity is that most technology transfer and technical change occurs through market or private transactions. In effect, the failure to align ECAs with climate objectives represents a lost opportunity to influence technology transfer, a major objective of the UNFCCC and its signatories.

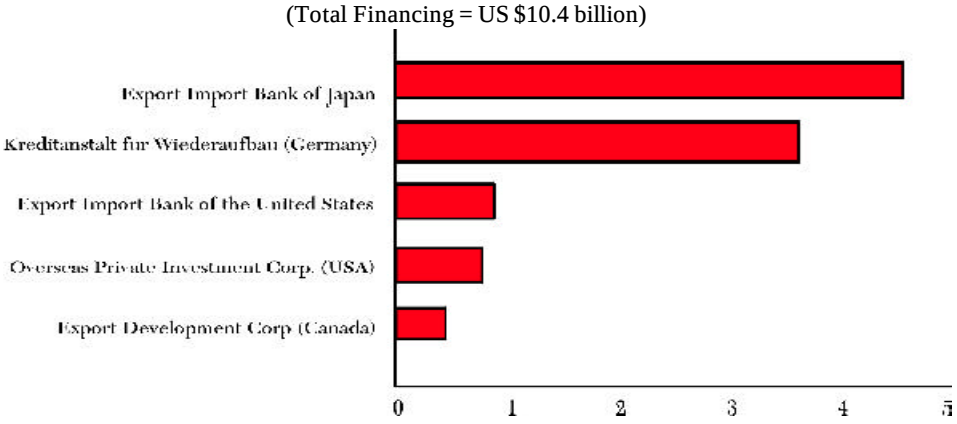
The G7 countries account for the largest volumes of ECA financing for energy-intensive exports and projects in developing countries. Figures 3 and 4 rank ECAs on the basis of the largest cumulative flows of financing to energy intensive sectors from 1994 to 1999. The leading ECAs in order of importance are the Japan Export Import Bank (JEXIM),* Germany's Kreditanstalt für Wiederaufbau (KfW), the two U.S. export credit agencies, Ex-Im Bank and OPIC, and Canada's Export Development Corporation (EDC). In terms of guarantees and insurance, the biggest players in the field are Ex-Im Bank followed by COFACE (France), Hermes (Germany), the Export Credits and Guarantees Department (ECGD) of the United Kingdom, and JEXIM.

The ultimate irony is that in the ongoing negotiation of the Kyoto Protocol, a number of these countries are pushing for developing countries to take on voluntary commitments to reduce GHG emissions. In the United States, the Congress is conditioning its ratification of the Kyoto Protocol on commitments by developing countries to emission reduction targets. Industrialized countries are asking developing countries for one thing (action to address emissions increases) while their ECAs do quite another in these countries (facilitate energy-intensive development). Unfortunately, actions speak louder than words.

Developing country governments and civil society groups will have different perspectives on the implications of this wave of ECA-supported investments from the north. Some developing country delegations and negotiators under the UNFCCC may emphasize the importance of aligning these flows with industrialized countries' commitments to support technology transfer and leapfrogging in developing countries. Civil society groups in developing countries are likely to stress the importance of reducing the contradiction between these flows and a number of international commitments made by governments since the 1992 Earth Summit in Rio de Janeiro, Brazil. But policymakers in other arenas, particularly trade and economic planning ministries, are likely to perceive any initiative to redirect ECA financing as limiting their own latitude for policy and decisionmaking.

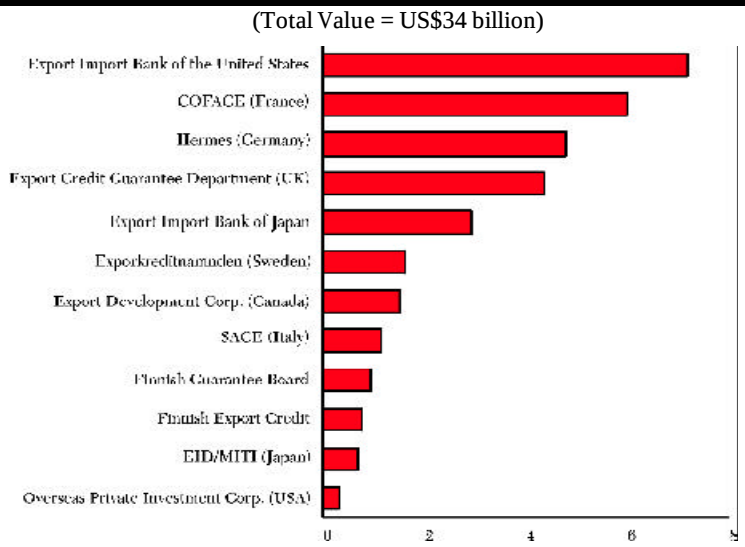
* In August 1999, the Export Import Bank of Japan merged with Japan's Overseas Economic Cooperation Fund to form the Japan Bank for International Cooperation (JBIC). The data contained in these figures relate only to JEXIM lending and financing before this merger.

Figure 3 **Leading ECA Suppliers of Direct Financing for Energy-Intensive Projects and Exports in Developing Countries, 1994-99**



Source: *Project FinanceWare*, Capital Data Ltd., Copyright 1997-99.

Figure 4 **Leading ECA Guarantors and Insurers of Energy-Intensive Projects and Exports in Developing Countries, 1994-99**



Source: *Project FinanceWare*, Capital Data Ltd., Copyright 1997-99.

The Roots of Policy Perversity

The policy perversity discussed above does not result from governments deliberately undermining climate commitments. The roots of this perversity lie in a number of institutional problems related to how trade and investment policies are set and how ECAs operate. These problems are discussed below.

No Policy Coherence: The first problem is the lack of coherence among different policy arenas at national and international levels. In most industrialized countries, trade and finance policies are set apart from environmental and development assistance policies. The result is that trade and finance ministries, including the majority of ECAs that play within their arenas, argue that addressing environmental, human rights or equitable development concerns are outside their defined competencies.[32] But this argument ignores the process of reform that bilateral aid agencies and multilateral development banks have undergone. In the last 10 years, the latter group of institutions, in which OECD governments are major shareholders, recognized the need to address social and environmental impacts in their development financing. Most of these institutions (including the World Bank Group and the OECD's Development Assistance Committee) have since adopted environmental standards and practices.

Most of the OECD governments that supported the above reforms, however, did not include their trade and export agencies in a similar process. The magnitude of this omission is becoming evident given the growing role of foreign trade and investment in developing country economies. Not surprisingly, multilateral initiatives to expand common trade and investment regimes are foundering on the rocks of environmental and social opposition. The recent OECD failure to negotiate a Multilateral Agreement on Investments (MAI) and public protests at the meeting of the World Trade Organization (WTO) in Seattle are cases in point.

The globalization of the world economy and the growing role of bank financing, underscore the need for greater policy coherence between trade, investment, and development. In the last ten years, commercial investment banks have entered the dozen or so emerging markets where most ECAs concentrate their lending. As a result, ECAs are now using their leveraging power to benefit industries or markets with growing access to commercial financing and insurance: aircraft, oil and gas, and telecommunications, among others. This begs the question: Are ECAs fulfilling their original purpose of supporting markets and projects that commercial banks are reluctant to finance or underwrite on their own?

No Transparency in ECA Decision-making: The second fundamental problem that contributes to the contradiction between climate policies and commitments and ECA investments is the lack of transparency that characterizes most ECA financing decisions. A review of the environmental information that the leading ECAs of the OECD countries make available and whether they engage external stakeholders *(see Table 1)* explains why policymakers and civil society groups have not taken note of ECAs. As of February 2000, only four out of twelve leading OECD ECAs made details of their environmental guidelines publicly available. Only two ECAs routinely shared environmental information with outside parties, solicited public comment on their environmental assessments, and reported some CO_2 emissions.

ECAs generally argue against greater transparency, citing the need to protect their clients' business confidentiality. But two analyses of information disclosure policies in the banking and power sectors indicate that transparency contributes to better decisionmaking and does not significantly affect a company's or bank's private interests.

The Institute of International Finance (IIF), a global association of financial institutions with more than 300 members from 50 countries, convened a working group on transparency in emerging market finance. This group examined the need for timely, reliable statistics on capital flows, external debt, and international reserves. It highlighted the need for published financial audits and information to permit more accurate assessments of market risks in emerging markets.[33]

Another report assessing the U.S. Energy Information Agency's proposed confidentiality policy in the context of reporting requirements for utilities, emphasized the importance of adequate environmental information to support informed consumer choices, assess the performance of private and public policies, and encourage market competition in deregulated energy markets. This report points out that in most cases, information disclosure requirements can be designed to minimize any potential competitive harm to individual firms, and that disclosure of power plant performance usually has little competitive value.[34]

No Credible Environmental Guidelines that Assess Climate Change Impacts: Closely intertwined with the problem of limited transparency is the failure of ECAs to adopt a credible set of common environmental guidelines. When the G8 countries' heads of states called for common ECA environmental guidelines, they set a deadline for developing them by 2001 and decided to work within the OECD Working Party on Export Credits and Credit Guarantees (ECG) to meet this commitment. Furthermore, at the1999 OECD Council Meeting at the ministerial level, all OECD countries asked the ECG to work toward common environmental approaches among their ECAs. To date the ECG (which excludes ECAs that market investment insurance) has limited the access of outside stakeholders to its decisionmaking process, setting conditions on the environmental advocacy groups they will engage and agreeing only to informal meetings.[35] At a late February 2000 meeting on environmental matters, the ECG agreed that each country would continue to develop its own methods for assessing environmental impacts, refine a previous agreement to share environmental information between ECG members that co-finance a project, and consider how to synthesize best practices related to environmental reviews and assessments.[36] There are few ways to monitor whether and how the ECG and its members are advancing these agreements, and no formal mechanism for outside stakeholders to contribute to this decision-making process. Even farther behind the ECG is the association representing ECAs that market investment insurance: the Berne

Table 1 **Environmental Information Disclosure by Leading ECAs and The World Bank Group (February 2000)**

	Publish Environmental Guidelines	Disclose Screening Criteria	Publish Env. Assessment Rules	Release Project Env. Assessment	Solicit Public Comments	Disclose Projects Approved	Report some CO_2 Emissions
COFACE (France)							
ECGD (UK)							
EDC (Canada)							
EFIC (Australia)							
EID/MITI (Japan)							
EKN (Sweden)							
Ex-Im Bank (United States)							
Finnvera (Finland)							
Hermes (Germany)							
JBIC (Japan)							
Leonia Corp. Bank (Finland)							
KfW (Germany)							
OPIC (United States)							
SACE (Italy)							
World Bank Group							

Legend: Shaded areas reflect the positive position of ECAs on the indicated environmental criteria.

Sources: ECAs' own webpages, annual reports, and other published reports analyzing ECAs. In a number of cases, NGOs that track the environmental performance of these ECAs were also consulted. A detailed list of sources is available from WRI's Institutions and Governance Program in the form of a technical note.

Union. This group has yet to acknowledge the need for, or any intent to, developing common environmental guidelines or standards for its members.

A deficiency that plagues most ECAs' individual environmental guidelines is the absence of any criteria or rules to assess potential impacts on global commons: international waters and oceans, climate and atmospheric resources, forests, and biological diversity. The wave of financial flows entering emerging markets has important implications for the general trajectory of GHG emissions in these countries. With two lone exceptions, Ex-Im Bank and OPIC which publicly report some project-based CO_2 emissions, no other ECA reports on the GHG emissions.[37,38]

A number of ECAs argue that a defined set of common environmental standards is inappropriate given their organizational differences, the need to consider host country priorities, and the variations in the nature and quality of business activities they finance.[39] While these concerns are legitimate, the same set of challenges has not prevented ECAs from negotiating a common set of rules in other areas. The degree of harmonization negotiated by ECAs under what is an OECD-supported but nonbinding gentleman's agreement, *Arrangement on Guidelines for Officially Supported Export Credits*, is quite impressive.[40] The agreement, which has been in place since 1978, establishes minimum parameters for export credits and project finance, mixed credits, and tied aid. It also details requirements for evaluating the quality of projects for which development aid is provided, along with specific terms for financing for ships, nuclear power plants, and civil aircraft.

Moving From Perversity to Coherence

It is tempting to conclude that the perversity outlined above inevitably lead ECAs to do more harm than good from an environment and development perspective. Based on this pessimistic assessment, one might recommend that governments extricate themselves from the investment insurance and export credit business. But the phenomenal growth in the volume of private capital flows, as well as the dearth of positive policy instruments available to influence these flows, means that reform rather than elimination of ECAs should receive priority. Major elements of such a reform agenda are suggested below, with a particular focus on aligning ECA activities with the climate commitments of both industrialized and developing countries.

- ***Institutionalize consultation and information disclosure, including reporting of greenhouse gas emissions.***

One of the chief obstacles to harmonization of ECA activities with climate and development assistance is the absence of timely and meaningful information on ECA decisionmaking and financing. Without access to such information, it is impossible for policymakers in other arenas, banking institutions, or advocacy groups to evaluate the environmental merits of ECA-supported projects or exports.

The first basic step ECAs can take toward improving their transparency is to open up the ECG process for defining common environmental approaches and guidelines. To date, this process has consisted largely of an internal debate among members of the ECG. Formal consultations with environmental and social advocates, development banks and bilateral aid institutions that have environmental policies and guidelines in place, and environmental specialists, would help the ECG make more robust and technically sound decisions. If the process continues to be closed, the final guidelines or common approaches will have little credibility outside of the ECG. In the case of the Berne Union, a commitment to discuss common environmental standards or guidelines for ECAs that are investment insurers is a first priority.

Another step that should be considered is to include transparency and disclosure requirements in any common environmental guidelines that are ultimately adopted. This could take the form of publicly disclosing environmental assessments and screening exercises, allowing periods for public comment on pending financing decisions, requiring project environmental assessments to include consultation with governments and potentially affected populations, communicating mitigation measures adopted, and reporting basic environmental indicators for projects receiving ECA support. In this context, assessing the impacts of a project on the global commons would help to put ECA activities in perspective and promote stronger policy coherence.

A minimum action that ECAs could take to address climate change impacts would be to estimate and report on the annual and cumulative emissions associated with projects or exports receiving ECA support. It could be made manageable by requiring reporting only for projects in key sectors: oil and gas development projects; fossil-fueled power plants; transportation infrastructure or equipment; and the most energy intensive manufacturing, such as cement, iron and steel, chemicals, pulp and paper. The methodology for such project-based reporting is not yet in place, but it could be established by building on work already completed by the IPCC National Greenhouse Gas Inventories Programme (NGGIP). This program has looked at calculating emissions from specific sectors, including energy, transportation, and industrial processes; as well as research on performance benchmarking and baselines under the Kyoto Protocol's Clean Development Mechanism (CDM).[41]

Legitimately, ECAs along with other financial institutions are concerned that reporting project emissions will unfairly saddle them with responsibility for the climate impacts of the whole of a capital or development project.[42] This argument ignores the fact that climate change results from the cumulative build-up of emissions produced by individual activities. Unless mechanisms are found to inform individual decisions, the threat of global climate change will never be addressed. For this reason, adequate reporting of emissions by ECAs is vital, even though it does not conform to country-based reporting under the UNFCCC.

Business groups and nongovernmental organizations are increasingly recognizing such public reporting as a tool to improve accountability and to aid management and decisionmaking. A clear example of such a shift is the Global Reporting Initiative (GRI), established in late 1997. The GRI seeks to design globally applicable guidelines for multinational corporations to measure and report on their economic, social, and environmental sustainability. The Coalition for Environmentally Responsible Economies (CERES) convenes the GRI with the active participation of nongovernmental organizations, international organizations, United Nations agencies,

consultants, accountancy organizations, and corporations. Through a multi-stakeholder process, the GRI is working to establish reporting practices that are equivalent to, and as routine as, financial reporting, and to promote a standardized reporting format with core metrics for specific sectors that are applicable to all enterprises.[43]

Another example of the growing interest in reporting tools is the collaboration between the World Resources Institute and the World Business Council for Sustainable Development on a common corporate greenhouse gas emissions measurement and reporting protocol. This collaborative effort is developing modules for individual sectors, attempting to resolve key questions, such as who owns emissions, the relation of corporate reporting to national inventories, and how to define a reporting entity.[44]

Reporting is also becoming a binding requirement on the part of governments. In June 1998, 35 member countries of the UN Economic Commission for Europe (UNECE) signed the Convention on Access to Information, Public Participation in Decision-Making, and Access to Justice in Environmental Matters, known as the Aarhus Convention. A total of 23 countries have indicated they will ratify the convention; it will come into force when 16 countries complete ratification, probably before the end of 2000.[45] This Convention sets out requirements for governments to disclose environmental policies, environmental aspects of institutional performance, progress toward compliance with international environmental agreements, and state of the environment reports. It will also require public institutions to establish systems that ensure information reaches the public and outside stakeholders. With the exception of Canada, Japan, and the United States, governments of the remaining countries responsible for the most significant volumes of ECA financing (Finland, France, Germany, Italy, Sweden, and the United Kingdom) will all be bound by the Aarhus Convention.[46]

- ***Adoption of ECA environmental guidelines that conform to international best practice for environmental assessment and that evaluate potential climate impacts.***

Environmental assessment has been codified and routinized in almost all OECD countries where public and private entities are required to evaluate and mitigate the potential environmental impacts of new development activities.[47] Among international and development finance institutions, the World Bank Group, the Inter-American Development Bank (IDB), and the European Bank for Reconstruction and Development (EBRD) have codified standards of good practice. A few ECAs, principally the two from the United States, have unilaterally adopted similar standards of environmental assessment practice. What these standards have in common are a set of procedural requirements to evaluate social and environmental impacts, quantitative standards for categories of exports or projects, exclusion of particular activities, and elements of public consultation and information disclosure.[48] But even the highest standards of good environmental assessment practice do not yet include assessments of problems of global commons.

A number of approaches for integrating climate change into a broader set of environmental guidelines should be considered. One option is to identify a set of project categories with important climate change implications and then define threshold quantitative standards for GHG emissions or energy efficiency within each of these categories (the same ones identified for CO_2 reporting). This option would conform to the current best practices for environmental assessment that set environmental quality or emission standards for water and air. An alternative to this quantitative approach is to require project environmental assessments for selected categories to identify the best available technologies or best management practices for reducing or preventing GHG emissions, and to report on the economic and technical feasibility of incorporating these technologies and practices into a project. The most favorable financing terms possible within the *Agreement on Guidelines for Officially Supported Export Credits* could be offered to those projects that incorporate best available technologies or best management practices, or improve on quantitative standards. For example, under this agreement, certain technologies are granted 12-year payback periods. Similar flexibility could be granted to projects that include GHG emission reduction measures. This would help to capture low-cost reductions, and make more costly mitigation measures more attractive.

- ***Facilitate investments in renewable energy and other climate-friendly technologies.***

ECA staff point out that there is no great demand for financing energy efficiency and renewable energy projects.[49] In general, ECAs respond to existing commercial and political demands, so projects and exports in mature industrial sectors tend to dominate. Another obstacle that renewable energy and climate-friendly technologies face is that project finance granted by ECAs is non-recourse in nature. That means that a loan or guaran-

tee for a project is given on the basis of the revenues that it will generate to permit repayment. Renewable energy projects are often not suited to this type of financing because they are usually smaller in scale, require longer payback periods to recoup investments, and natural phenomenon (climatic conditions or availability of sufficient biomass, for example) can affect the revenues they generate.

This means that ECAs must develop other mechanisms to attract and finance these kinds of investments. Some innovative financing alternatives are already being tested *(see Box 3)* and could be more widely emulated by ECAs. These programs invest equity funds or establish more flexible financing terms to compensate for the smaller scale, lumpy revenue streams, and the relatively early stage of commercialization of many of these projects.

In the past, ECAs frequently combined their own financing with official aid or even commercial lending, which is called tied aid. This practice often distorted debt markets and resulted in the transfer of technologies that were not necessarily the most appropriate or the best for developing countries. The problems generated by tied aid led ECAs to negotiate an agreement—the *OECD Ex Ante Guidance on Tied Aid*—that governs how and when it can be provided. The guidance ensures that tied aid targets the least developed economies and less commercially viable projects without distorting commercial debt markets.[50]

Under the terms of the guidance, any ECA financing or commercial credits must be combined with a minimum amount provided in the form of grants (35 percent). As a result, most governments have moved away from providing tied aid because it means giving a third or more of any tied aid package away. Even with these restrictions, however, some renewable energy and climate technologies qualify for tied aid because they are not yet commercially viable. If such opportunities for tied aid are pursued, the grant elements should go to capacity-building or applied research that will advance the commercialization and long-term viability of the technology.

- ***Dialogues between developing country governments and ECAs on investment and export priorities that are supportive of sustainable development goals.***

Developing countries have many policy instruments they can use to influence the environmental quality of investments or exports entering their economies, such as environmental regulation, technology policy, inclusion of performance requirements in public tenders, and tariff and tax laws. As already discussed, industrialized countries, in many cases through their ECAs, also influence the destination and character of investments and exports to developing countries. Capital flows respond to forces that both pull (host country conditions and policies) and push (source country conditions and policies). For this reason, more systematic dialogues between ECAs and developing country governments are necessary to explore how the investments and exports facilitated by the former can better support the sustainable development objectives of the latter. Such dialogues should be designed to produce action plans or commitments by both sides that will permit closer alignment between an industrialized country's export and job creation priorities and a developing country's development interests.

Such exchanges are particularly important in the context of the commitments both industrialized and developing countries have made to enhance and improve technology transfer under the UNFCCC. Because technology transfer occurs largely under the auspices of private markets and transactions, ECAs, through their leveraging capacity, can help to increase the volumes of private capital and exports that generate clear climate, and other sustainable development, benefits.

One example of such a cooperative effort is Ex-Im Bank's joint initiative with the U.S. Department of Energy, the China Development Bank, and China's State Development Planning Commission. *(See Box 3.)* This initiative, the China Clean Energy Program, will encourage U.S. exporters to supply China with technologies that clearly support its own development priorities.

Potential collaboration could also touch on another area of concern to developing countries, adaptation to climate change—for example, investments in coastal developments designed to meet the threat of rising sea levels, or exports of irrigation technologies that work with reductions as well as fluctuations in rainfall.

- ***Reassessment of ECA missions***

ECAs need to differentiate themselves from commercial and private financial houses with a growing presence in emerging markets. The best way to accomplish this is to sharpen the mission of ECAs so that they effectively support long-term national competitiveness and sustainable development objectives. Currently, ECAs provide support to mature industries with considerable penetration in emerging markets. The short-term benefits of this approach are numerous (domestic jobs, favorable trade balances, reduced ECA losses, and support for politically influential indus-

Box 3 **Innovations in Private Financing for Sustainable Energy and Greenhouse Gas Mitigation**

China Clean Energy Program. The Export-Import Bank of the United States (Ex-Im Bank), the U.S. Department of Energy (DOE), the China Development Bank, and China's State Development Planning Commission have signed a Memorandum of Understanding to carry out a clean energy program in China. Under the program, the Ex-Im Bank and the DOE will encourage U.S. private industry to work with Chinese authorities to support the identification, assessment, and implementation of projects that use wind, solar, and geothermal technologies, industrial co-generation, energy efficiency building technologies, low nitrous oxide burners, and sulphur dioxide reduction technologies.

Energy Efficiency and Emissions Reduction Fund. The European Bank for Reconstruction and Development, the Dexia Project and the Public Finance International Bank have created a private equity fund to support investments that reduce energy consumption and greenhouse gas emissions in Central and Eastern Europe. The Fund will invest across a range of sectors, including district heating, public lighting, and industry. Investors are offered the opportunity to earn emission or carbon credits as part of the investment and trading mechanisms under the Kyoto Protocol.

Renewable Energy and Energy Efficiency Fund for Emerging Markets (REEF). The International Finance Corporation (IFC) has established REEF as a commercial investment fund to mobilize new financial resources for investments in privately sponsored projects in the renewable energy and energy efficiency sectors in developing countries and economies in transition. The Fund, which has a target capitalization of $100 million and is supported by associated debt and grant facilities, is now in operation. Projects supported by the Fund will generate global environmental benefits as a result of avoided greenhouse gas emissions. The Fund will also help catalyze further private investment by helping to introduce proven technologies and project structures in new markets, supporting new types of projects, and engaging new sources of commercial financing.

Small and Medium Enterprise Program. The Global Environment Facility (GEF) provided $4.3 million to the IFC to administer a program designed to stimulate greater involvement of private small and medium enterprises (SME) in addressing GEF biodiversity and greenhouse gas mitigation objectives. Six experienced SME institutions (e.g., banks, venture capital companies, and nongovernmental organizations) selected by IFC to act as intermediaries for the program have received or will receive a low interest loan from the program. The intermediaries in turn will provide debt or equity financing to SMEs for the incremental costs of GEF eligible projects. To encourage the intermediaries to participate in the program, they may retain up to 50 percent of all capital recovered from the SMEs. The intermediaries and IFC will monitor and evaluate financial and global environmental aspects of the program.

Solar Development Group (SDG). The IFC, the World Bank, the GEF, and several U.S. charitable foundations collaborated in the development of the Solar Development Group project. This project will provide finance and business advisory services with the objective of accelerating the growth of private sector businesses involved in the delivery of solar photovoltaic systems to off-grid areas of developing countries. The Solar Development Group is designed to have a substantial development impact. The objective is to increase the use of photovoltaic solar home systems—which convert sunlight into electricity—and thus bring environmentally clean electricity to rural households.

tries), but the long-term competitiveness or development benefits are less clear. To better serve the latter objectives, ECAs could narrow financing to exports or projects that

- establish or expand nascent markets and industries;
- target exports and investments to the least developed countries;
- complement development priorities of donor organizations and host country governments; or
- incorporate innovations that address threats to global commons.

If ECAs refocus their missions on the above priorities, they could develop niches that are not well served by commercial banks. A downside is that such projects involve higher risks and could affect ECAs bottom lines if claims and defaults increase. But ECAs were originally created to assume these risks in order to encourage private investors and exporters to enter riskier markets. Managing the tension between profitability and risk is not new to ECAs. Nevertheless, governments need to decide which objective takes priority: reduced losses and lower risk for ECA balance sheets and reserves or accepting near-term financial costs to gain long-term development advantages.

Fulfilling the G8 Mandate

The G8 decision on ECA environmental guidelines establishes a clear mandate: harmonize ECA environmental policies and help developing countries address the challenge of climate change. Fulfillment of the first part of this mandate has been extremely limited, largely because of the relatively closed debate within the ECG, and a failure to include ECAs that are investment insurers in any development process. If this state of affairs continues, the likely result is a set

of guidelines that descend to the lowest common denominator of ECA environmental practice, and also fail to reach a significant subset of ECAs.

The political reality is that developing credible ECA guidelines and better aligning ECA objectives with climate policies will require decisionmakers at much higher levels to take an active role in determining how the G8 mandate is fulfilled. This means that finance ministries and ministers must assert the importance of defining guidelines through a transparent process and the relevance of climate and other environmental concerns. Decisionmakers in other arenas, particularly development assistance and climate, will need to push for greater coherence between ECAs and their own policy concerns. Finally, policymakers will need to agree to eliminate the ECG's current monopoly over the debate on what should constitute ECA environmental practice. A decsionmaking process that addresses the concerns, and incorporates the experience of external stakeholders, holds the greatest promise for producing technically credible and politically feasible environmental guidelines for all ECAs.

About the Authors

Crescencia Maurer is a senior associate in the Institutions and Governance Program and **Ruchi Bhandari** is a research analyst in the Climate, Energy, and Pollution Program.

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Notes

1. The World Bank. *Global Development Finance: Analysis and Summary Tables* (Washington, D.C.: The World Bank, 1998), pages 57-59.
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3. Ibid.
4. United Nations Conference on Trade and Development, *World Investment Report 1998: Trends and Determinants* (New York and Geneva: United Nations, 1998), page 13.
5. The World Bank, *Global Development Finance: Analysis and Summary Tables* (Washington, D.C.: The World Bank, 1998), pages 57-59.
6. A general explanation of export credits was obtained from the European Commission's Directorate of Trade. Their Web page explains export credits on the following site www.europa.eu.int/comm/trade/miti. Explanations of guarantees, insurance, and project finance were drawn from Michelle Chan, *The Anatomy of a Deal: Introduction to International Project Finance* (Washington, D.C.: Friends of the Earth-US, 1996); and Genaro G. Fullano, *Introduction to Transactional Project Finance* (Washington, D.C: Nixon, Hargrave, Devans & Doyle, LLP, 1997).
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11. *Finance & Development*, "Developing Countries Get More Private Investment, Less Aid," June 1997: 36-37.
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13. Lawrence Berkeley National Laboratory, Environmental Energy Technologies Division. *International Network for Energy Demand Analysis: Industrial Sector*. Unpublished paper. November, 1998, page 24.
14. Aircraft are exempted from reductions mandated in the Kyoto Protocol, but a recent analysis of their impacts on the atmosphere estimates that by 2050 they will account for between 4 to 15 percent of the global greenhouse effect. The following is the reference for this report: Intergovernmental Panel on Climate Change, *Aviation and the Global Atmosphere: Summary for Policy Makers*, a special report of Working Groups I and III. Presented at the joint session of these working groups in San José, Costa Rica. April 12-14, 1999.
15. To arrive at these figures WRI conducted a database search of *Project FinanceWare*. The search parameters were set to include all signed project and finance transactions from 1994 through the first quarter of 1999 going to developing countries (not including the transition economies of Eastern Europe or the former Soviet Union) for the sector and subsector groups indicated in the text.
16. Duncan Austin, José Goldemberg, and Gwen Parker, "Contributions to Climate Change: Are Conventional Metrics Misleading the Debate?" *Climate Notes*. (Washington, D.C.: World Resources Institute, October, 1998).
17. Kevin A.Baumert, Ruchi Bhandari, and Nancy Kete, "What Might a Developing Country Commitment Look Like?" *Climate Notes*. (Washington, D.C.: World Resources Institute, May 1999).
18. Lawrence Berkeley National Laboratory. *International Network for Energy Demand Analysis: Industrial*. Draft analysis. (Environmental Energy Technologies Division. November 1998).
19. Ibid.
20. To arrive at these figures, the *Project FinanceWare* search on trade and project finance flows to energy-intensive sectors was further refined to select for ECA participation in two banking roles: guarantor and provider. First, a league analysis was carried out of guarantors involved in project transactions to determine the amounts of guarantees or insurance ECAs provide. In the second search, all institutions playing a "provider" role in bank transactions were selected and ECAs were then identified from this list to determine amounts of ECAs' trade and project financing.

21. To determine the leveraging effect of ECAs, a third search was carried out to calculate the total value of projects where there was some form of ECA participation.

22. Institute for Policy Studies, Friends of the Earth-US, and the International Trade Information Service. *OPIC, Ex-Im, and Climate Change: Business as Usual?* (Washington, D.C., April 1999).

23. Oil and gas projects that receive ECA support account for $40.5 billion (39 percent) of the total value of energy-intensive projects receiving ECA support ($103.32 billion). By contrast, financing for oil and gas development projects ($64.2 billion) represents 29 percent of all flows going to energy-intensive sectors ($216.6 billion).

24. This total was determined by searching the renewable energy sector category of projects in *Project FinanceWare* for ECA participation in any bank role and as a guarantor. A number of renewable energy projects were incorrectly coded as conventional power projects within *Project FinanceWare*. These were removed from our list of projects used to estimate project financing for fossil-fueled power, and those with ECA involvement were added to the list of renewable energy projects.

25. Paragraph 32 of the G8 communiqué. The text of the communiqué is available on the Web at www.usia.gov/topical/econ/g8koln/20commun.html.

26. Paragraph 33 of the G8 communiqué. The text of the communiqué is available on the Web at www.usia.gov/topical/econ/g8koln/20commun.html.

27. Details of the climate change vote on January 27, 2000 by leaders at Davos as well as the texts of discussions on trade and economic globalization are summarized on the Forum's Web page at www.weforum.org.

28. The full text of these articles are available on the UNFCCC Secretariat's Web page at www.unfccc.de/resource/conv/conv_006.html.

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38. Estimates of OPIC power project emissions of CO_2 are available on the Web under OPIC and the Environment at www.opic.gov.

39. OECD Working Party on Export Credits and Credit Guarantees. Unpublished memorandum titled, "Subject: Export Credits and the Environment," August 1999.

40. The text of this agreement is available on the Web at http://www.oecd.org//ech/docs/xcr.htm.

41. For further information consult the IPCC's National Greenhouse Gas Inventories Programme (NGGIP) Website at www.ipcc-nggip.iges.or.jp.

42. United States Export-Import Bank, *Ex-Im Bank's Role in Greenhouse Gas Emissions and Climate Change*. (Washington, D.C.: Engineering and Environment Division, revised on August 31, 1999).

43. Janet Ranganathan and Alan Willis, "The Global Reporting Initiative: An Emerging Tool for Corporate Accountability." *Perspectives*. Management Institute for Environment and Business, The World Resources Institute. Washington, D.C. July 1999. Additional information was also taken from the GRI Website at www.globalreporting.org.

44. Information was drawn from the Website that details the collaboration at www.ghgprotocol.org.

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