“Think Piece” on US Foreign Policy Coherence

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I. INTRODUCTION AND SUMMARY

Since the Rio Conference in 1992, many countries, especially in Western Europe and Scandinavia, have expressed great dismay with regard to the US's apparent reluctance to integrate environmentalism and foreign policy, provide global leadership in this sector, or even support major multilateral initiatives. As UNEP's first *Global Environmental Outlook* (1997) report makes clear, human-generated environmental degradation and scarcity generally have worsened worldwide, in spite of the promises made at various international fora to tackle these problems. Many environmentalists have suggested that the Clinton Administration has been an obstacle to making progress at the global level.

Seeking to counter this impression, the Administration is attempting to integrate environmental concerns into its broader policy initiatives. In April of 1996, former Secretary of State Warren Christopher first signaled these efforts by announcing the Clinton Administration's commitment "to put environmental issues where they belong: in the mainstream of American foreign policy." This position has been strongly endorsed by his successor, Madeleine Albright. And, after an initial hesitation, President Clinton chose to make global warming and the Kyoto environmental conference of December 1997 a focus of his environmental and foreign policy efforts.

The renewed focus on environmental issues coincides with a flurry of attention being given by researchers and policy makers to recent dramatic increases in private investment flows into developing and transitioning economies. Since the end of the Cold War a large part of the world suddenly has opened to private capital, attracting steadily increasing amounts of foreign direct investment, commercial bank lending, and portfolio investment. At the same time, a number of political and economic factors have made areas of the developing world more attractive (and dangerous) to private capital than they had been in the 1980s. Some observers – including World Bank President James Wohlfenson – have suggested that these private capital flows will have a significant impact – for better or worse – on the environments of recipient countries and their neighbors, and ultimately, perhaps, the entire planet.

All of this raises a set of interesting questions: Are there ways in which the United States government can take advantage of the dramatic increase in private capital flows to promote its environmental objectives? What opportunities to integrate environmental, economic and other foreign policy objectives – if any – are being lost? What tools – if any – can the government use to link private capital flows to its broader environmental and foreign policy objectives? What stands in the way – conceptually, institutionally, or politically – of moving in this direction?

In the following pages we offer preliminary answers to these questions. At least *in principle*, it is possible to integrate our national environmental and economic objectives more fully than has so far been the case. And, at least *in principle*, the various entities involved in US foreign policy have enormous assets and prestige that might be used – alone or in concert with other actors – to promote private capital flows that are linked to, and achieve profits from, environmentally favored activity. The institutional and political obstacles, however, are considerable. Progress is likely to be severely constrained by the vagueness of our environmental agenda, especially when compared to the high level of coordination and support evident among those who are skeptical of this agenda. The lack of a set of priorities shared by various agencies in the foreign policy process undermines policy coordination and leads to policy incoherence and contradictory actions. This, in turn, makes it difficult for the US government to establish clear links between environmental objectives and US foreign policy goals.

In addition to these political constraints, US foreign policy is hampered by misunderstandings about the impact of private capital flows on the environment (in comparison to other factors), combined with a lack of understanding about the ways in which different forms of private capital (foreign direct investment, commercial bank lending, portfolio management) are relevant to our environmental objectives and priorities. The environmental impacts of private capital vary enormously, and different conceptions of what we should be using as our environmental baseline make it difficult to assess these impacts. Furthermore, the link between individual actors and the environmental impact of their investments is often unclear or unrecognized. While the impact of a small number of large polluters and investors is easy to identify, the impact of many others in this process is not always recognized by the concerned analyst, much less by the individual polluters or investors themselves. The pathways between individual investment decisions and the environment may be quite direct but they are often quite complicated, without a straightforward or recognized link between individual choices and US national environmental priorities.

Equally important, different actors are receptive to different pressures, incentives and arguments. Therefore, the most effective approach to influencing private investment flows will vary depending on a variety of factors, and the US government will not always be the most able or appropriate actor to influence these flows.   Instead, in many cases, the optimal approach will likely be a cooperative one involving some mix of government agencies, international institutions and private sector actors working to (a) establish a common set of environmental objectives and standards to evaluate those objectives, and (b) shape the outcomes in specific cases by intervening at various stages in the investment process based on their expertise and comparative advantage.

Current Contradictions and Lost Opportunities

Failure to recognize and address these constraints or to apply the appropriate tools for promoting US environmental objectives almost certainly has led to missed opportunities in US foreign policy. Of course, assessing missed opportunities is rather speculative, even when significant empirical research is available, which is not the case here. Nonetheless, we believe important opportunities have been lost. For example:

– *Kyoto*

The Administration attached special significance to the Kyoto meetings as a hallmark of its environmental commitment. But it was unable to take full advantage of this opportunity because it failed to develop a framework that would unite the public, business, industry and Congress in support of a strong U.S. position. The Administration gambled that it could mobilize support by publicizing controversial scientific evidence of climate change and its long-term social implications. But without a problem solving framework attractive to business and industry, an opportunity to use climate change negotiations as a vehicle for integrating foreign policy objectives and private investment was lost.

The US government and US automakers, for example, missed an opportunity at the Kyoto environmental conference to promote the technological leadership of the US automobile industry. While Toyota took advantage of the Kyoto summit to advertise its fuel efficient electric car, the Prius, US automakers GM, Ford, and Chrysler missed this extraordinary marketing opportunity and are now struggling to publicize their own, even more fuel efficient, hybrid vehicles. US automakers failed to coordinate their environmental objectives with those of the Administration and neither group succeeded in publicizing the opportunities that the Kyoto accord offered to American firms – such as increased efficiency, the comparative technological expertise of US firms, etc. Consequently, the American public fell prey to a well orchestrated advertizing campaign by opponents to the environmental accord who argued that virtually any environmental agreement would threaten the US economy. In the absence of a persuasive and coordinated response by the Administration, Congress responded immediately to this public sentiment by passing legislation that precluded ratifying a treaty with any alleged negative implications for the US economy.

The Administration also missed an opportunity at Kyoto to demonstrate leadership at home and abroad. Rather than taking advantage of a groundswell of domestic and international public opinion in favor of environmental action, the US administration hesitated – entering the negotiations with an incomplete policy position, and doing so with its primary people responsible for its environmental activities absent.

– *Three Gorges Dam*

Construction of the Three Gorges Dam is going ahead without US government input in part because OPIC lacked sufficient economic clout to influence the flow of private capital into the dam project. US government funding is not likely to be able to compete with private funding on projects of this magnitude. There are, however, various ways in which the US government could influence the impact of the project on the environment by focusing its efforts on upstream and downstream industries, sewage treatment plants and so on. We will suggest a variety of ways of doing this – from influencing the flow of various forms of private capital into the PRC, to helping the PRC develop a banking system that takes environmental concerns into account. Unless the government develops a viable strategy that goes beyond dam construction to encompass areas in which it could have an influence, it is likely to miss broader opportunities to minimize the negative environmental impacts of the dam.

– *The G-8*

It is important to recognize that the vast majority of private capital comes from a very small number of advanced industrialized countries that are members of the G-8 and OECD. Establishing a common set of environmental objectives and standards in these relatively small groups would be far easier and have a potentially much larger impact on the global environment, than trying to expand environmental initiatives in the World Trade Organization and other global fora. As opposition at the Kyoto conference suggests, distributional concerns between advanced industrialized and developing countries in large fora can easily short circuit a mutually beneficial agreement. Negotiations in the G-8 and other similar fora can avoid this problem. Unlike global fora, these smaller fora provide an ideal opportunity for like-minded, similarly situated countries to promote global ecological modernization. If they succeed, developing countries will follow their example – by pursuing the most profitable and environmentally sustainable strategy they can. If, however, a handful of advanced industrialized countries miss the opportunity to demonstrate the economic benefits of environmentally sustainable development, it is highly unlikely that they will be able to convince the world's lesser developed countries to do so. Yet, despite placing environmental issues on its agenda, the United States government failed to take advantage of its prominent position at the G-8 meetings in 1997 to promote any serious discussion of environmental issues. Similarly, ongoing MIA negotiations have failed to seriously address environmental concerns. At this time the US is in a unique economic and political position to exercise leadership in these small fora. The US should not miss these opportunities to put environmental issues on the agenda.

– *Environmental Diplomacy*

In April 1996 former Secretary of State Warren Christopher promised an annual report identifying the US's environmental foreign policy objectives. The first report, Environmental Diplomacy, published a year later, did little more than reiterate the need to address a familiar set of general environmental problems. The US missed the opportunity to clarify and publicize its environmental priorities and link these to private sector activities, even though Christopher earlier had stressed the importance of government-business partnerships in this area. The US might have made greater progress had it adopted the European strategy of promoting ecological modernization, which focuses on specific ways in which environmental initiatives can build human capital, promote technological leadership, and offer opportunities for both short and long-term profit.

As these missed opportunities suggest, linking private capital flows to US foreign economic and environmental objectives has not been as successful as it might have been. We have developed a six step strategy for linking environmental objectives and private capital flows to US foreign policy so that future opportunities like these will not be missed. In designing this framework we sought to avoid two outcomes: (a) operating at such a general level that the conclusions reached merely reiterate conventional wisdom, or (b) being excessively narrow such that the conclusions are valid only for a very small number of cases. On this basis, in order to establish coherence in US foreign policy regarding the environment and private capital, the US government must:

1. **Define US Environmental Objectives.** Problem: There is a lack of well-defined objectives making it difficult to establish clear links between environmental objectives and other US foreign policy goals. This results in missed opportunities to promote linkage between various components of U.S. foreign policy.

2. **Establish a specific set of National Environmental Priorities (NEPs).** Problem: There is a lack of clear priorities shared by the various agencies central to the foreign policy process. When priorities are defined too broadly, as is currently the case, potential constituencies may fail to recognize the link between their activity and the environmental outcome. They also may fail to appreciate potential opportunities and incentives to alter their behavior.

3. **Determine the impact of private capital flows on NEPs in comparison to other factors.** Problem: Existing research linking private capital and specific US environmental objectives is highly preliminary and fragmentary.

4. **Determine the precise ways in which different forms of private investment (foreign direct investment, commercial bank lending, portfolio investment) are relevant to the NEPs.** Problem: same as number 3 above.

5. **Identify the actors and policy tools that can be used to influence the relevant form of private capital flows. Identify pressure points in the investment process where influence is most likely to be effective. Develop appropriate U.S. foreign policy strategies.** Problem: While the opportunities for this are fairly clear in theory, in practice the obstacles, discussed in some detail later in this paper, are considerable.

6. **Publicize Recommendations.**

How, then, do we overcome the problems identified at each step? Three strategies need to be adopted:

A) First, it is vital that the US government identify and prioritize its environmental objectives. Lack of a common environmental framework is sending mixed signals from the US government. Consequently, individual investors are often unaware or misinformed about the implications of their behavior for US interests. This is particularly true of portfolio investors, who represent the fastest growing component of private capital flows (through pension funds, mutual funds, etc.). The US Government must provide information that explicitly identifies both the link between individual actions and US NEPs, and the incentives each individual has for making environmentally informed decisions. Lack of this information has provided opponents with the opportunity to raise often unrealistic fears that linking environmental objectives to individual activity and US foreign policy will lead to economic decline and personal loss. To counter this problem, the US government must present and fully explain a common environmental framework in US foreign policy.

B) Second, it is critical that the US policy makers recognize the incentive structure that motivates private capital flows. Ample evidence exists demonstrating that in every part of the world some environmentally informed choices are sound investments no matter what time horizon one uses; however, lack of this knowledge is a major problem. The US government and the NGO community must coordinate information campaigns at home and abroad that identify profitable, environmentally sound investments related to NEPs. The provision of information is critical because it is the most viable and the least controversial tool available to influence portfolio investment – the fastest growing form of private capital. Alternatives like the enforcement of national regulations over these transnational flows of private capital will be inherently difficult and problematic, and the use of economic incentives for environmentally sound investment or economic penalties for environmentally unsound investment (through tax breaks, investment insurance, etc.) will be interpreted as protectionist and may undermine economic relations with US trading and investment partners.

C) Third, the US Government should lead by example by integrating its environmental foreign policy objectives and private capital flows. The United States is the largest source of private capital in the world; it thus has the capacity to have a considerable impact on global sustainable development. This impact could be magnified given the influence of the US in multilateral fora such as the G8, OECD, WB, and IMF whose members together account for the lion's share of private investment flows to developing and transitioning economies. As the following report suggests, there are a number of areas in which the US could lead by example.

The US Government should also lead by advocacy in multilateral fora. At the Rio Conference in 1992, Maurice Strong demanded an additional $125 billion to assist the Third World in developing sustainably. This request was met with a fair amount of skepticism. Official development assistance totaled only $60 billion at the time and ODA has declined since then. But private capital flows have increased some $200 billion in the past six years. Harnessed to sustainable development, private capital flows could far exceed what Strong requested in 1992.

II. INTEGRATING ENVIRONMENTAL FOREIGN POLICY AND PRIVATE CAPITAL FLOWS

To date, the US Government has largely failed to integrate its environmental objectives into trade and investment policy in a coherent manner. In order to assess the feasibility of doing so, as well as the nature and magnitude of current contradictions/lost opportunities of not doing so, it is critical that the US government begins by evaluating its national environmental objectives and establishing a set of national environmental priorities.

Step 1: Define US Environmental Objectives

The first step is to define US environmental objectives. This critical step has not been achieved in part because of five basic problems, none of which is easy to resolve:

1. Environmental change tends to pose a **long-term threat** to human welfare, freedom and security. The tremendous wealth of the US probably extends this time frame in comparison to poorer countries. The foreign policy apparatus – the priorities it is familiar with, the mind set that directs its activities, and the activities themselves – is poorly equipped to address long-term issues. It is unclear to many where and how the environment fits in with other objectives, and there is a tendency to regard it as a drag on defense, trade and so on.

2. **Evidence** developed in the natural and social sciences regarding the causes and consequences of environmental change is often **controversial**, which encourages the adoption of a wait and see attitude by policy makers.

3. Environmental issues tend to catalyze **conflicting and highly competitive interest sets**. Once the scientific assessment of environmental sustainability has been completed, the more sensitive decisions regarding the allocation of user rights, and the distribution of benefits and costs associated with environmentally

prudent activity must be made. Political decisions about allocation – about deciding who gets what and who pays – often conflict with the ideal of liberal economics that market forces alone should determine the outcome. Managing the mixed interests associated with the collective benefit of environmental sustainability, with the individual interests of profit maximization in a competitive market is not the forte of the foreign policy community. Unlike the doctrine of containment that unified diverse actors through much of the past five decades, the conflicting interests of individuals competing in a global market are very dynamic and not easily unified.

Current efforts by the Administration to develop a climate change initiative demonstrate the impact conflicting interests have on policy coherence. The current debate involves a variety of players including the Vice President and the chairman of the White House Climate Change Task Force, as well as concerned officials in the State Department, Agriculture, Commerce and Labor that all have their own particular agendas. In addition, the issue has divided two of the Democratic party's primary constituencies: labor and environmentalists. Both have a wide range of lobbyists behind their positions, with labor supported in the opposition by the Global Climate Coalition (including API, the American Automobile Manufactures Association, the America Far Bureau Federation, and the National Mining Association), the AFL-CIO, and the United Mine Workers; while the environmentalists are supported by the Environmental Defense Fund, the Environmental Information Center, the National Resources Defense Council, and the Union of Concerned Scientists, as well as the National Religious Partnership for the Environment, the Business Council for Sustained Energy, and pragmatic support by the Business Round Table.

A similar set of competing interest sets in foreign countries must be satisfied before multilateral environmental accords can be implemented effectively. The degree of potential disagreements over the means and ends of environmental policy at home and abroad is compounded by the lack of a common framework and lack of a coordinated explanation for and justification of potential policy objectives.

4. Although the past three administrations have expressed strong commitments to addressing environmental issues, **leadership has not emerged** in this sector. Absent strong and visionary leadership and long time horizons, scientific uncertainty and mixed interests will tend to limit action.

5. Finally, the **inability of various government agencies to cooperate** poses further problems. Today the US government faces constant – albeit waxing and waning – pressure to act from a variety of directions: bureaucratic elements, a fraction of Congress, the Vice President and his team, NGOs, the public, foreign states and international institutions. Moreover, the end of the Cold War created a huge

> foreign policy vacuum while elevating the US to the unprecedented position of world's only superpower. Elements of both the private and public sectors have been attempting to ensure that the vacuum is filled with a set of objectives that include environmental concerns. The various components of the foreign policy community are responding to this pressure and opportunity, but they are doing so in a largely uncoordinated fashion. Thus the Department of Defense is integrating environmental concerns into its activities based on its appreciation of the problem and its interests; the intelligence agencies are doing the same thing; and so are the international divisions of entities such as the Department of Energy and the EPA. The State Department is not working well with other agencies, let alone at the intra-departmental level; the EPA does not have an environmental vision it can sell to other agencies; and yet everyone wants to do something. The result is messy and uncoordinated – leaving it extremely vulnerable to the Administration's critics and opponents of environmentalism.

In short we have a long-term problem, buffeted by uncertainty and competing interests. Leadership has not emerged, probably because leadership will not be easy. Agencies that are acting are moving in a variety of directions. A certain amount of messiness is probably a healthy feature of a democracy, but at a certain level of magnitude it translates into costly policy contradictions and lost opportunities. Can the President and his Secretary of State gain control of this activity and guide it in a fruitful direction? The recent evidence is not promising – unless US environmental objectives are identified and a set of national environmental priorities are established and actively promoted at home and abroad, progress is likely to be slow, uncoordinated and driven by crises.

Let us assume that the foreign policy objectives of the United States include: (1) protecting the quality of the US environment; (2) maintaining US access to important environmental goods worldwide; (3) anticipating and responding effectively to environmental crises especially in areas where US interests may be jeopardized; and (4) promoting environmentally sustainable development worldwide. The next question is, which environmental issues should be regarded as priorities within the framework of these policy objectives?

Step 2: Establish a Set of National Environmental Priorities

According to the Department of State's 1997 Report, *Environmental Diplomacy*, its current environmental priorities are:

Global Priorities

* climate change
* the use of toxic chemicals and pesticides
* loss of biological diversity
* deforestation
* ocean pollution and over-exploitation.

Regional Priorities

* water resources
* air quality
* energy resources
* land use
* urban and industrial growth.

In particular, the Administration focused considerable effort on climate change in preparation for the conference in Kyoto held in December of 1997. As laudable as this and the other priorities are, they are far too general and ambitious to be of much utility. They do describe America's (and the world's) environmental interests at the most abstract level, and it is important not to lose sight of the pervasiveness, magnitude, and universality of the environmental challenge. But to date, the US government has identified only very general environmental objectives. The next vital step in terms of US foreign policy is to identify, as concretely as possible, our national environmental priorities (NEPs). Without these we cannot identify the other two key elements of policy – strategies and resources.

Recent efforts by the Department of Defense to clarify its environmental priorities and integrate these into its activities suggest that this is likely to be a difficult, controversial and lengthy process unless strong, coalition-building leadership is forthcoming. However, based on our knowledge of this area, it would seem plausible that our NEPs would include the following:

Proposed National Environmental Priorities

* Assessing and responding to specific aspects of climate change that will affect US vital interests. Possibilities include focusing on drought, severe weather events, and coastal flooding;

* Managing border pollution issues with Mexico, Canada and the Arctic nations focusing in particular on air and water problems;

* Redressing over-exploitation of Atlantic and Pacific fisheries;

* Managing nuclear contamination issues especially related to the activities of Russia and former Soviet bloc countries;

* Assessing and limiting the environmental consequences of economic development and related activities in environmentally pivotal states, especially China, Russia, Brazil, Mexico, and Indonesia;

* Assessing, supporting and strengthening multilateral environmental agreements (MEAs) and initiatives, especially when relevant to other US national environmental priorities;

* Assessing and developing appropriate policy responses for areas –

especially in the Middle East and West Africa – where environmental scarcity and/or degradation are likely to trigger, generate or intensify violence and/or instability that will lead to pressures for US resources and involvement for economic, strategic and/or humanitarian reasons.

Only when a specific and well specified set of US NEPs has been established will it be possible to move to the next phase of assessing the extent to which private capital flows are relevant. Above we have begun this process – the objective should be to bring these NEPs into the clearest focus possible while remaining flexible and open – indeed, NEPs ought to be subject to regular review. At the same time, NEPs need to be situated in the context of other US foreign policy goals such as expanding trade, promoting democracy, managing nuclear weapons, ensuring national security and so on. Each of the above can be clearly linked to other policy objectives, especially the promotion of economic growth, protection of public health, continuing leadership in world affairs, and the promotion of stability in strategically important regimes. Although in the following pages we focus solely on their relationship to private investment flows, gaining acceptance for the general objective of integrating environmental concerns into US foreign policy is vitally important and requires a lot of groundwork and marketing. But, if successful, it will make more specific initiatives easier.

The NEPs we have identified enable us to advance to the next step in this "think piece" – assessing the relative impact of private investment flows on our national environmental priorities. Obviously, private capital flows might affect local and regional environments in ways that are not clearly related to US NEPs. This does not mean these cases are unimportant, but rather that they are not likely to get on the US foreign policy agenda. If, however, private flows do have a relatively important impact on US NEPs, then it is important to identify the policy tools that the US government, alone and in conjunction with others, can use to green the flow of private capital.

Step 3: Determine the Impact of Private Capital Flows on US NEPs

The next step is to determine the impact of private capital flows on our national environmental priorities. To do so, it is important to understand the parallel trends in the rise of private versus public capital flows to developing countries, and increased environmental degradation in those countries.

Between 1990 and 1996, private investment flows to developing and transitioning economies increased from $44.4 billion to $243.8 billion while aid and official public flows declined from $56.3 billion to $40.8 billion.[1] Not only have private flows out paced official public flows to developing countries since 1990, but the make up of private flows to developing

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[1]World Bank, *Private Capital Flows to Developing Countries* (New York: Oxford University Press, 1997), p. 5.

countries is changing. Private capital flows include foreign direct investment (44.9% or $109.5 billion, 1996), commercial bank lending (36.3% or $88.6 billion, 1996), and portfolio or "institutional" investment (18.7% or $45.7 billion, 1996).[2] In the 1970s private flows were dominated by commercial banks lending and foreign direct investment. With the end of the debt crisis, commercial bank lending and foreign direct investment have regained ground that they lost in the 1980s, growing approximately five-fold in the 1990s. Yet, while substantial, this increase has been out paced by the dramatic fourteen-fold rise in portfolio flows between 1990 and 1996, from a meager $3.2 billion to $45.7 billion. These trends are likely to continue into the foreseeable future because they are driven by the globalization of markets and technology, reinforced by a number of political factors such as liberalization measures adopted in advanced industrial as well as developing and transitioning economies, the decline of Cold War political constraints on global trade and investment flows, and the stabilization of the debt crisis.

In parallel, environmental degradation increased between 1990 and 1996 throughout the developing and transitioning world in all key areas: land degradation; deforestation; pollution and depletion of fresh water; pollution of marine and coastal zones; air and atmosphere pollution (including ozone depletion and climate change); and urban and industrial pollution. There are potential links between the sectors into which private investment is flowing and the sources of environmental degradation. Moreover, many of the countries experiencing the most severe rates of environmental degradation are also the largest recipients of private investment. One obvious explanation may be that private investment is attracted to areas with less stringent environmental regulations.

While the increasing significance of private capital and environmental degradation are taking place at the same time, additional research is needed before a specific causal link between them can be determined. The evidence developed at the national and multilateral level on the causes and consequences of environmental change is controversial, and little work has been done to examine the specific link between the wide ranging impacts of private capital and environmental degradation. As a result, the temptation to posit a general link between private capital flows and environmental problems, or to see private capital controls as a panacea for environmental problems, should be avoided.

It is useful to point out that single variable assessments of environmental impacts are of limited utility beyond very well defined cases. In other words, private investment flows are related in complex ways to other forces driving environmental change and the social responses to it. For example, some evidence suggests that population growth is related to poverty, and poverty is related to environmental degradation and scarcity. If private investment alleviates poverty – as it does in some cases – and this in turn reduces population growth, it may have a positive long-term environmental impact. On the other hand, if it also lures people into Third World mega-cities, this positive impact might be offset by the problems associated with rapid urbanization and overcrowding. Again, private investment might bring with it more environmentally sensitive

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[2]World Bank, *Global Development Finance*, Volume 1 (Washington, D.C., 1997), p. 3.

technologies and management practices – or very destructive ones. It might save rainforest and biodiversity by supporting the establishment of a tourist trade – or destroy them by accelerating the pace of logging. Clearly, it would be unwise to suggest that private capital investment flows into developing and transitioning economies have a uniform impact on local, regional and global environments. Instead, it is critical to begin by identifying US national environmental priorities and determine how they will be evaluated, then to systematically identify how much of an impact private capital flows have on the problem at hand, identify what specific forms of private capital are relevant, and then devise a policy focused on the relevant actors in the investment process.

Step 4: Determine What Forms of Private Capital are Relevant to US NEPs

While individuals interested in foreign direct investment, commercial bank lending, and portfolio investment share some common financial incentives, they are likely to affect US NEPs in different ways. Furthermore, they are likely to respond to different forms of pressure by the government and other sources to change the way they do business to better reflect environmental objectives. Consequently, effective policy linking diverse private flows and the environment must be targeted appropriately.

- *Foreign Direct Investment*

Approximately 44% of all US direct investment goes to the manufacturing and energy related industries. Similarly, approximately half of all FDI from all countries goes to these sectors. These sectors are clearly related to both US global and regional NEPs. For example, FDI in the manufacturing sector along the US-Mexican border can have a significant impact on cross-border pollution problems; while FDI in the energy sector in China and Russia can have a significant impact on limiting the environmental consequences of rapid industrialization in these pivotal states.

Most importantly, 85% of all private investment flows came from the 29 wealthiest countries in the world in 1995; the five largest (the US, Japan, Germany, France and the U.K.) accounted for two-thirds of the total.[3] And 174 of the world's largest 200 firms are located in these five. The top 100 firms held over $1.4 trillion in assets overseas and consistently accounted for approximately one-third of private investment throughout the 1990s. The largest companies are in the petroleum, electronics and automobile industries, led by Royal Dutch Shell, Exxon, Ford and General Motors. This suggests that if the US were able to establish environmental standards for private investment in cooperation with Japan, Germany, France and the U.K., two-thirds of FDI could be harnessed to environmental priorities. Therefore, establishing a multilateral

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[3]John Cavanagh and Sarah Anderson, *International Financial Flows: The New Trends of the 1990s and Projections for the Future*, A Briefing Paper for the C.S. Mott Foundation (Washington, D.C.: International for Policy Studies, April 1997), p. 5.

agreement on investments among the G-8 or the OECD countries should take priority over organizing such an agreement within the WTO or UN.

- *Commercial Bank Lending*

Commercial lending may have an impact on US NEPs in a variety of ways, ranging from the provision of loans to purchase fishing boats that may perpetuate overfishing of coastal stocks, to loans used to promote infrastructure or industrial expansion. However, unlike the WB and other MDBs, which have begun to establish green guidelines for their portfolios, very little has been done to integrate environmental concerns into domestic commercial banking regulations and practices. The only significant exception to this involves the increasing sensitivity of commercial banks to potential liability resulting from environmental devastation or waste associated with the activities of loan recipients. Consequently, the impact of this form of private capital flow needs to be monitored on a case-by-case basis. Like FDI, the bulk of bank lending comes from the United States and a relatively small number of OECD countries. This suggests that implementing green banking legislation domestically and coordinating green banking regulation through the Basel Committee and other limited membership fora would go a long way towards linking this component of private investment and the environment.

- *Portfolio Investment*

The relationship between portfolio investment and the US's environmental objectives is difficult to determine because of the complex nature of portfolio investment. Portfolio investment vehicles are extremely variable and involve the very fast movement of capital across numerous national borders. This limits the effectiveness of domestic regulation and oversight, and it makes multilateral regulation and oversight extraordinarily difficult. Equally important, the link between the stocks and bonds that individual investors purchase and the environmental practices of the companies these investments support is generally not recognized or considered by the consumer or the fund manager. Even if US NEPs were clearly defined, the impact of portfolio investment on them would be difficult to determine without reference to a specific case at hand. But, clearly, money invested into foreign stocks and bonds may be used to promote a wide range of economic activity – from manufacturing, to energy exploration, to infrastructure development – that may affect US NEPs in a wide variety of ways.

This suggests that linking portfolio investment with environmental objectives will require increasing transparency regarding the environmental practices of investment recipients. Without this information, portfolio managers and individual investors will remain uninformed about the link between their investments and the environment. Given the complexity of portfolio investment, information provision and public awareness campaigns provide the most cost effective and viable strategies for promoting a link between this form of private flows and the environment.

Step 5: Identify the Actors and Policy Tools to Influence Private Capital Flows

Once the impact of private capital on the environment is determined, it becomes important to determine what the US government has done or can do to influence the relevant flow of capital. It is critical to recognize from the outset that the US government has a relatively limited capacity to influence private activity in the marketplace, and that policies promoting overt intervention are likely to be highly contentious. Given these constraints, there are two general types of strategies that the US government can employ: the first involves creating financial incentives for environmentally friendly investment; the second involves agenda setting and environmental education.

A first type of strategy is to create incentives for actors to pursue environmentally productive investment by making environmentally productive investment relatively more profitable than environmentally unproductive investment. This can be done through a variety of means ranging from the use of tax incentives, investment guarantees, and subsidies; the encouragement of private capital exports or imports; promises of increased aid or trade; or the offer of preferential access to government contracts for environmentally beneficial investment. Funding from the Clinton Administration's "Partnership for a New Generation of Vehicles" to support domestic clean-car research is a good example of a government subsidy to promote environmentally productive investment.

The US Government can also create financial incentives for environmentally friendly investment by making it easier for individuals to buy and sell environmental goods for profit. Because of their complexity, quantifying problems such as air pollution is very difficult for the market to do on its own. By assigning value to things such as air pollution, the government makes it possible for the market to operate effectively in these areas. The creation of a carbon-emission trading system and new regulations allowing competition among power utility companies in the United States are prime examples of this technique. These are good policies because they demonstrate how markets can be harnessed to environmental ends with minimal government involvement. Cutting federal subsidies for oil, coal and petroleum based fertilizers could provide opportunities to make further progress along these lines. At the international level, the emissions trading system promoted by European states at Kyoto represents an opportunity to apply the same mechanisms at the global level. However, unless the Administration is able to identify and rally support for clear objectives, and quell concerns about multilateral enforcement mechanisms, the opportunity to do so may be missed.

Alternatively, rather than using positive incentives, the US government could strengthen negative incentives by using its political and military clout to enforce compliance with environmental regulation. Domestically, the EPA can monitor and enforce environmental regulation. Internationally, the United States could threaten to use (or deny) its political and military capabilities to those countries that fail to uphold environmental standards (set either by itself or multilaterally as in Kyoto). Short of military action, the US can freeze assets, impose controls on imports or exports, suspend aid, expropriate foreign held property, increase taxes on environmentally destructive investment, and deny access to government contracts or federal funding. While such a “Global Policeman” role would likely face stiff opposition from the American public and its allies abroad, the US government could very easily use its economic, military, and political clout to assist other governments in implementing and enforcing EPA-like guidelines in their own countries.

A second type of strategy involves agenda setting and education. The goal of this strategy is to increase the salience of environmental issues by making them an essential part of the foreign policy agendas of other countries and institutions, as well as making them part of the decision-making processes of private investors and consumers. Raising the awareness and importance of environmental issues, and setting standards against which behavior can be evaluated, can go a long way towards promoting environmentally productive activities. For example, even though domestic pressure may prevent the Kyoto accord from being ratified in the United States, the conference increased consumer awareness of environmental issues to the extent that GM, Chrysler, and Ford are opening the annual North American International Auto Show with their “clean car” presentations. International conferences, advertising, and public awareness campaigns that succeed in increasing public awareness of the environmental impact of various products and investments can create a value in environmentally cooperative behavior. Once a standard has been established against which environmental behavior can be evaluated, consumer and investor behavior will begin to change. Then enforcing environmental practices is no longer necessary. The viability of this strategy, however, depends on successfully carrying out the actions identified earlier in Steps 1 to 4.

- *Foreign Direct Investment*

The form that these should strategies take will vary depending on the type of private capital in question. In terms of foreign direct investment, OPIC and the ExIm Bank are the primary institutions through which the US government can offer incentives to promote the flow of environmentally sensitive private capital abroad. OPIC does so, for example, by financing businesses through loans and loan guaranties, supporting private investment funds which provide equity for U.S. companies investing in projects overseas, insuring investments against a broad range of political risks, and engaging in outreach activities designed to inform the American business community of investment opportunities overseas. Substantial progress has been made in integrating environmental concerns into OPIC’s operating procedures (specified in the OPIC Environmental Handbook) and some movement in this direction is evident at the Ex-Im Bank reflected in its Environmental Exports Program. These organizations are both financially viable, with OPIC generating a profit in every year of its operation.

The integration of environmental concerns into these organizations’ activities has, however, created three problems. First, critics (e.g. FOE) have argued that adherence to these guidelines has been inconsistent. Second, in several prominent cases (e.g. Three Gorges Dam) applicants for export credit agency (ECA) support withdrew their requests rather than accept environmental oversight of their activities. Third, ECA support to investment in several environmentally pivotal countries is constrained by other foreign policy objectives. The lessons from these experiences are that (a) the incentives offered by ECAs are not sufficient to compensate for the perceived costs of environmental oversight given the availability of commercial lending and insurance; and (b) a multilateral effort by major ECAs might create the conditions for increasing the incentives.

To address these problems, the Administration should be encouraged to increase the funding for OPIC and Ex-Im Bank so they can offer larger incentives while simultaneously requiring that they strengthen the monitoring of their environmental guidelines. It is important to emphasize that this need not be a costly effort given the profitability of these institutions. Second, the Administration should work to reevaluate restrictions on OPIC and ExIm support to investment projects in environmentally pivotal countries based on other foreign policy objectives in light of its environmental priorities.

In terms of pursuing the second strategy of agenda setting and environmental education, the Clinton Administration also has an opportunity to influence environmentally friendly FDI by exercising its ability to set the agenda in a variety of bilateral and multilateral fora. Since two-thirds of FDI comes from G8 countries, the coordinated integration of environmental guidelines into their respective ECAs ought to be a priority. Given the high level of concern for the environment in Canada and Europe, such an initiative should be easier to orchestrate than one directed at a broader multilateral level. Furthermore, there are various initiatives at the broad multilateral level either to develop standards for private investment (OECD's MAI) or to integrate environmental concerns with investment policies (e.g. WB's GEF, IFC and MIGA). An appropriate approach to supporting these processes by the US would involve presenting an expanded and enhanced OPIC and Ex-Im Bank as models. In addition, the government should coordinate public awareness campaigns with the NGO community to draw attention to major FDI projects that either pose significant threats to the environment or have been designed and implemented according to environmentally sound criteria. While this may sound like a daunting task, in fact one-third of FDI comes from only 100 companies; highlighting their activities could have a substantial impact.

- *Commercial Bank Lending*

In the commercial banking sector, the government has a variety of options in promoting environmentally profitable lending. One of the best examples of this is the Tropical Forest Conservation Act of 1998 that authorizes $400 million over three years to cover the costs of restructuring debt of extremely poor countries that contain the biologically rich forests at the great risk of destruction.[4] Like the "debt-for-nature swaps" launched during the Bush

[4]Peter Seligmann, "Protecting the Rain Forests," *Washington Post*, (January 6, 1988), p. A13.

Administration, this program would provide funds to enable debtor countries to restructure their loans in exchange for establishing funds in their local currency to pay for conservation programs, thus creating a very explicit financial incentive to protect tropical forests. While it does not directly affect commercial banking activity, paying to reschedule the loans greatly assists the US banking industry by enabling them to regain otherwise lost assets, thus enabling them to lend more money, while rewarding environmentally supportive behavior.

While the debt-for-nature arrangement is ideal in some cases, it is only viable for a small number of countries. Consequently, the greatest opportunity for influence in the commercial banking industry rests with the US ability to place environmental concerns on the banking agenda. As stated above, very little has been done to integrate environmental concerns into domestic and international commercial banking regulations and practices. Advancing this objective requires:

A) Incorporating environmental guidelines into domestic banking legislation;

B) Establishing global guidelines through the Basel Committee. Coordination on a multilateral level is critical because establishing environmental guidelines in the US alone would promote an environmentally-based preferential allocation of credit that would motivate some borrowers to look elsewhere.

C) Establishing model banking practices for developing and transitioning economies that are seeking to establish or improve domestic banking systems that include environmental considerations. For example, China is in the midst of reforming its banking system. When this happens private investment flows into China are likely to increase enormously. There is an immediate window of opportunity to influence these reforms and hence private investment into China in the long-term.

D) It is important to evaluate the extent to which the guidelines developed by the WB might serve as a model for the domestic regulation of commercial banks.

- *Portfolio Investment*

The principal problem here is that the vast majority of the many individuals who invest in stocks, bonds and other securities do so through institutional investors who manage retirement accounts, mutual funds and the like, rather than by selecting individual companies on the basis of their financial and/or environmental performance. Consequently, most individual investors have little or no awareness of the environmental impacts of their investments and thus no incentive to change their behavior. With the exception of a very limited number investors who seek out explicitly “green investments,” environmental impact does not enter into individual investment decisions.

The ideal solution would be to require all recipients of private investment capital to behave in accordance with environmental standards and regulations. This would be a very difficult strategy to implement successfully, given the wide and expanding range of transnational investment vehicles. In the absence of a shared global environmental framework it is virtually impossible. A step in this direction, however, was signaled by former Secretary of State Warren Christopher in his April 6, 1996 address in which he promised that the US would host a multilateral meeting to develop mechanisms for improving compliance with international environmental treaties and agreements. One of the most important mechanisms for greening private investment is domestic legislation. But after an international treaty has been created, states are often lax in enacting and enforcing national legislation. The US could encourage and pressure states to respect their international obligations. Encouraging the State Department to follow through on its commitment to host a conference on this problem is important. At the same time, this discussion could also take place within the context of the next annual G8 summit and the ongoing MAI negotiations in the OECD.

Backing up the investment chain, another likely target is the portfolio managers and institutional investors. They could be encouraged to report environmental performance along with the financial performance of funds within individual companies on a monthly or quarterly basis. This would promote awareness on the part of individual investors about the environmental impacts of their investments. It would also make companies aware that their environmental performance was a matter of public record and might affect investor decisions. Obviously, the availability, quality and reliability of this information would be questionable at least in the short term. However, as the case of Amnesty International demonstrates, once such an effort has been initiated, the quality of information can improve quickly and dramatically. As the quality of its information has improved, for example, AI has had a greater impact on the human rights practices of a growing number of countries.

Finally, individual investors have an extraordinary amount of power that can affect macrolevel processes if they coordinate their activities. The provision of environmental impact information with financial information in regular portfolio reports, or through other mechanisms such as green labeling, would provide individual investors with the knowledge base needed to coordinate their behavior. Motivation and leadership to promote the coordination of individual investors could be promoted directly by the government and NGO community.

Ultimately, insofar as this crucial Step 5 is concerned, one has to ask: How much leverage does the US really have to influence private investment flows into developing and transitioning economies? Frankly, the US government has little capacity to affect the character of private capital flows directly because (a) they are complex, transnational and often extend beyond the jurisdiction of the US (making regulation and enforcement difficult), and (b) direct intervention in the market runs counter to widely held beliefs about the role of government (making it difficult to reach consensus on policy).

The government does, however, possess tools that it can use to promote its environmental objectives in the private sector. As noted above, it can create positive and negative incentives, alone or in concert with other states, to influence investor behavior and enable the market to operate more effectively in this area. Working alone or with the NGO community it can increase investor and consumer awareness of the environmental effects of private capital flows, and place this issue on the agenda in international fora.

III. Assessment of Feasibility

In order for these strategies to be effective, US policy makers must overcome a set of conceptual, institutions, and political barriers.

- *Conceptual Barriers*

The biggest conceptual barrier to linking private capital flows and the environment concerns the competing incentive structures of private capital and environmental policy, the assessment of environmental impact, and the viability of regulation. The incentive structures for private investment and environmental rescue differ significantly. Investors seek to externalize environmental costs; environmentalists seek to internalize environmental costs. Investors and the recipients of private capital seek short-term gains; environmentalists seek long-term gains. Investors seek minimal and decreasing regulation and governmental oversight; environmentalists often seek a high level of regulation and oversight, and are concerned to strengthen both. A primary benefit of privatization is the high level of efficiency that derives from the freedom actors have to make choices in an open and competitive market; this contrasts with government efforts to safeguard the environment using restrictive standards.

The assessment of environmental impact presents a conceptual problem because the impact of private investment flows is likely to be measured differently depending on whether one adopts a global, regional or local perspective on environmental problems. The impact of private investment flows on the environment is also likely to vary depending on whether the objective is to emphasize pollution control through source reduction by changing or modifying production processes and products, or to focus on "end of the pipe" mechanisms such as adding dust and particulate scrubbers to smokestacks.

Establishing and implementing effective regulations also present a conceptual puzzle. The liberalization of private flows, beginning with FDI and commercial banks and later expanding to include portfolio investment, reveals a vast increase in the number of actors and opportunities for investment, making their behavior much more difficult to control. Policies linking environmental objectives and trade are often perceived as protectionist. Concerns about protectionism are, however, less likely to be sparked by integrating environmental concerns into private capital flows because recipients often vie to attract foreign sources of capital rather than try to limit foreign access to domestic markets as in trade.

- *Institutional Barriers*

The most significant institutional barriers exist within the US government itself. First, as noted earlier, there is very little interagency coordination. This can be explained in part by the lack of a shared environmental framework to guide analysis and decision making, and in part by the effects of bureaucratic self-interest (discussed in the following section). Second, there is not enough regular communication between government, business and industry on environmental issues. It is crucial to improve communication in order to avoid the misunderstandings and missed opportunities that characterized the Kyoto process. Third, short-term economic interests invariably outweigh long-term environmental interests in the decision-making process.
And fourth, the government has a strong preference for unilateral and bilateral approaches rather than multilateral ones. The first three points are covered in detail elsewhere in this paper, so here we limit our comments to the fourth point.

Many environmentalists prefer multilateral over unilateral or bilateral solutions to environmental problems because of the transnational nature of environmental problems, and the belief that resolving them will require coordinating the activities of actors who differ significantly in terms of cause, effect and capacity. During last year's assessment of the Rio Conference, this position was strongly advocated by the EU and others. The US is often accused of resisting multilateralism.

Although in the long-term multilateralism may be preferable, especially in terms of legitimacy and equity, at present there are two fundamental obstacles to this institutional approach: lack of well specified NEPs and a common global environmental framework, and difficulties associated with negotiating agreements among large numbers of actors with different sets of objectives and priorities.

In the economic realm, negotiations are guided by commonly shared liberal principles regarding the benefits of openness in trade and financial exchange. Indeed, one can argue that these principles are universally accepted today. Unfortunately, the same cannot be said about the environmental arena – here a foundation and shared understanding equivalent to that provided by liberal economic theory does not exist to guide negotiations. The common global economic framework provides a shared frame of references that identifies a set of incentives by which actors operate as well as a shared language for solving problems. Virtually everyone today recognizes the relationships between economic liberalization and growth. This means that multilateral and bilateral agreements that respect these relationships will tend to succeed whereas those that don't will tend to fail. Although concern about environmental change has grown and spread dramatically in the past twenty-five years, and the concept of sustainability is widely endorsed, environmentalism has yet to generate a clear set of NEPs in the United States, much less a globally accepted referential framework guiding the decisions of large numbers of actors on a par with that supplied by liberal economic theory. In the absence of a clear set of NEPs and a common environmental framework, investors will assess environmental policies in terms of liberal economic theory. Efforts to link the two that do not appreciate that this is how they will be assessed will be very difficult to coordinate and costly to enforce.

Second, while it is true that global multilateralism offers the potential for greater legitimacy and fairness, the risk is high that the agreement reached will be weak. As a general rule, the smaller the number of players the easier it is to reach and enforce a complex and demanding agreement. This suggests that the smallest number of parties involved in the negotiation is to be preferred from the standpoint of effectiveness. In the realm of private flows, this suggests that it may make sense to attempt to integrate environmentalism and FDI through the G8 or other small fora of advanced industrial states because they account for two-thirds of it. In contrast, portfolio investment involves a much wider range of players. This suggests that larger multilateral fora may be necessary, but that agreements will be more difficult to reach and enforce. Thus it may be more effective to adopt information campaigns and other non-regulative approaches to influencing this aspect of private capital flows. This is where NGOs are likely to be as effective – if not more so – than the US government.

The institutional barriers that plague international negotiations suggest that there are two simultaneous and mutually supporting approaches to integrating environmental concerns into private investment flows.

1. Establish a set of NEPs and create a Common Environmental Framework. The preferred long-term strategy is to expand the knowledge base so that, ultimately, decision-making will take place within a widely accepted environmental framework. This might involve public awareness campaigns, building on the Rio process, and a major role for the NGO community.

2. In the absence of a common environmental framework, it is critical that the US be prepared to adapt its environmental objectives to the incentive structure and knowledge base that guides decision-making in the economic realm. This implies linking environmental issues to existing economic institutions related to investment such as the IFC and MIGA under the WB, and ECAs such as Ex-Im Bank and OPIC. To succeed, the environmental conditions ought to be harmonized with the objectives of those institutions rather than constructed as environmental add-ons.

- *Political Barriers*

Winners and losers depend on the strategy being pursued. Efforts to transform US foreign policy by developing a set of NEPs would likely benefit the EPA, and the environmental NGO community. Promoting these NEPs globally creates long-term gains for the entire world but is insufficient because investors may gain (at the expense of the environment) before this initiative is able to influence decision-making. While economic and environmental incentives are largely mutually compatible, losers in this effort will be those who will suffer losses as a result of incompatibilities between the common environmental framework and the common economic framework.

Efforts to adapt environmental objectives to the existing liberal economic framework are likely to benefit the Commerce Department and the State Department if it is able to use its regional opportunity hubs to support this process, and cause splits in the NGO community between those willing to sacrifice ideals and those opposed to doing so. In both cases, agencies such as USAID are likely to lose unless they are able to maintain their budgets while shifting their focus to countries unable to attract private investment. The greatest beneficiaries of this strategy will be the 10-12 developing countries currently receiving the lion's share of private investment. If private flows lead to a decline in public flows, then the greatest losers will be those countries that cannot attract private capital. This includes countries in sub-Saharan Africa and the Arab world in particular. It is critical, therefore, to refocus USAID and IDB efforts towards those poorer countries that would not be able to attract private capital and would not benefit from the privatization of development efforts.

Another sort of political barrier relates to the difficulties of transforming well-entrenched bureaucratic cultures. Historically, the key players in the foreign policy arena include the President and his advisors, State, Defense and intelligence. In each case there is a fair amount of resistance to attempts to integrate environmental priorities into well-established objectives and action sets. For example, some early assessments of State's regional opportunity hubs, designed with a strong environmental focus, suggest that progress on this front is slow and uncertain. Some observers contend that many career bureaucrats are not supporting this initiative, convinced that it will die after the next election. In theory, bureaucracies do what democratically elected leaders tell them to do. In practice, they often resist change on the grounds that they have the expertise and experience, they provide continuity in a given sector, and politicians and their agendas – often ill-informed and event driven – come and go.

A final political barrier has to do with the extent to which political behavior is driven by perceptions. Thus decline in support for environmental NGOs may reflect a public perception that the government is addressing this issue area effectively – something that is difficult to know given the long-term nature of many of the problems. Ironically, as public pressure decreases, so may the commitment of the government. The political challenge here is to find a way to maintain pressure until environmentalism has been fully institutionalized, at a time when public interest is drifting towards other issues, without being alarmist. Information and awareness are probably key here – clear, well-publicized reports of opportunities being lost, and of the real character of environmental degradation and scarcity may help in this regard.

- *Lessons Learned from other Issues*

The importance of establishing a specific set of NEPs as well as promoting a common understanding of the individual incentives and opportunities actors have for promoting them is reflected in the successes and failures of a variety of other issues including:

– *Drug certification*

Linking drug certification to economic issues in US-Mexican relations faced several problems. First, the logic of linking drug certification and trade status was unclear and not agreed to by both parties. Consequently, Mexico protested strongly on the grounds that these two realms should not be linked. Second, this linkage is bound to be of limited value because the incentive structures of trade and illegal drugs are not coordinated by this policy. Mexico's trade status will not affect the flow of illegal drugs into the US. As long the incentive of a huge US market exists, drug dealers will continue to supply this market. Third, when it became clear that the US was going to enforce this linkage, Mexico then took a number of highly visible short-term actions to demonstrate its support of the war on drugs. It is not clear, however, that these actions were motivated by anything other than the desire to retain its trade status or that they will be of much benefit in reducing the flow of illegal drugs. The lesson learned here is that forcing a linkage between two very different incentive structures can lead to cosmetic rather than substantive outcomes.

– *Montreal Protocol*

The Montreal Protocol has been applauded as a great success in reconciling environmental goals and economic and development practices. The AISs agreed to phase out CFCs very quickly and provide financial assistance to LDCs so they could phase out CFCs at a later date and then continue to develop without CFCs. As new scientific evidence of ozone depletion arrived, the protocol was strengthened. However, it has faced several problems: an adequate, low cost alternative to CFCs has not been identified leading countries to stockpile CFCs prior to the phase-out dates, and knowledge of future restrictions has led to the creation of a substantial black market in the sale and distribution of CFCs and other ODSs. This demonstrates that if the integration of environment and economics begins to unravel (here because of the failure to develop a cost-effective alternative to CFCs), then the economic incentive structure is likely to win out over the environmental incentive structure.

– *NAFTA*

NGOs were able to affect the structure of NAFTA by getting the three countries to attach labor and environmental side agreements to the trade agreement. This approach to integrating labor, environment and trade has influenced negotiations elsewhere (e.g. APEC). There is much disagreement over how effective the environmental component of the NAFTA package has been. It is too early to reach a definitive conclusion. The common complaint today is that Mexico attracts investors by being lax in enforcing environmental standards. What is clear is that for this linkage to succeed, all parties have to accept that certain groups and financial interests may be adversely affected by compliance. They must be both willing and able to enforce the terms of the agreement domestically. To date, the US has demonstrated a lack of will and Mexico has demonstrated a lack of capacity.

– *Canada/Spain Fishing Dispute*

Canada made headlines by electing to use force to enforce NAFO quotas on the North Atlantic Fishery. When Canada fired upon and seized a Spanish trawler, Spain argued that this was an act of piracy, especially since it did not recognize NAFO quotas. The dispute was resolved peacefully when Spain agreed to accept NAFO quotas in return for a larger share than it had originally been granted. To make this possible, Canada gave Spain part of its share. The lesson here is that when economic incentives outweigh environmental ones, as they did for Spain, force and/or bribery may be required to advance environmental goals.

– *Human Rights Reporting*

In the absence of a common framework for understanding human rights, efforts to link human rights practices to trade status have not been very effective (e.g. China and MFN status). This suggests that forcing a link between practices with different incentive structures is not likely to succeed. In contrast, efforts to create linkages that acknowledged the common economic framework have been more successful. For example, strategies linking compliance to legal rules such as those pertaining to IPRs and trade have been more successful in part because the incentives are compatible.

It is interesting to compare the case of HR and China to that of apartheid in South Africa. Efforts to link apartheid to investment were controversial and are widely regarded as having had little impact for over twenty years. In contrast, decades long efforts to delegitimize the practice of apartheid ultimately succeeded such that the South African regime was universally shunned and condemned, forcing it to change in order to gain acceptance in the world community. Once the principle was accepted that apartheid could never be legitimate, then linkages to investment were strengthened and companies began to disinvest. Furthermore, the success of Amnesty International and other NGOs in building a global consensus against the inhumane treatment of political prisoners using letter writing and other public awareness campaigns suggests that creating a global environmental consensus framework can be an effective means for mobilizing public opinion and successfully promoting environmentally sound behavior.

Two further questions can be raised about these five cases. First, did government involvement raise public awareness of these issues? Second, were the objectives identified by the governments achieved? In all of these cases, government efforts to integrate economic objectives with other foreign policy goals (that is, combating the drug trade, protecting the environment and promoting human rights) did succeed in raising the profile of these issues. It is not clear, however, that raising the profile of these issues always helped in resolving them. Increasing public awareness of Spain's exploitation of the North Atlantic fishery was effective because it enabled the government to identify a clear target and mobilize support for the use of force, which catalyzed the resolution of the problem. Similarly, increasing public awareness of human rights violations in South Africa was effective because it identified a clear enemy that could be targeted effectively. Having a clear target – and hence a clear objective – makes it easier for individuals and groups to mobilize and coordinate their behavior .

In the other three cases, however, raising public awareness has not–as of yet–promoted the successful resolution of these problems. In the Mexican case, the strategy of linking Mexico's trade status and drug trafficking was unpersuasive to many actors in the private sector. In the cases of the Montreal Protocol and human rights in China, even though the targets are clear, the threat is great that economic incentives will outweigh environmental objectives in the short to medium term. Finally, in the case of NAFTA, it is too early to determine whether economic and environmental goals have been integrated successfully. If they are, then this could serve as a model for other trade agreements.

Step 6: Recommendations: Lead by Example and Lead through Advocacy

Since environmental issues were placed on the global agenda at Stockholm in 1972, the level of environmental consciousness has increased worldwide, developed through a variety of international, state and NGO activities (e.g. Brundtland Report, Rio Conference). However, the US government has failed to develop a set of NEPs and a consensual environmental framework comparable to the liberal economic framework has not yet solidified to guide the decision-making and behavior of actors on a global level. The acceptance of a common framework for interpreting and implementing sustainable development and environmental management would create the conditions for the integration of environmental objectives into private investment. In the long-term this strategy, involving the steady expansion of a shared global knowledge and value base, is necessary for the full integration of environmental concerns into domestic and foreign policy and the world economy.

In the short- and medium-term there are a number of strategies that can be pursued to promote the creation of such a framework. Promoting public awareness and environmental education is essential because of the widespread lack of understanding of or concern for the link between private flows of capital, especially portfolio investment, and environmental change. The success of such an effort requires the coordination of several different groups, notably NGOs, the EPA and equivalent organizations, as well as multilateral entities such as UNEP and the environmental divisions of WB, UNDP, the WTO. To date, these groups often have acted independently creating a great deal of confusion with regard to the guiding principles and objectives of sustainability. Coordination among these groups is critical in order to create a common global framework.

Here the United States can lead by example by promoting domestic energy efficiency and waste reduction; lending a higher level of support to multilateral initiatives, especially those associated with the Rio process; and demonstrating a commitment to multilateral environmental efforts by fulfilling and even increasing US financial commitments to the UN and GEF. It also can lead through advocacy by following through on its promise to host a multilateral conference on improving compliance with international environmental law. Also, the US should use the recently created regional opportunity hubs as a basis for providing regional leadership and support in areas that have been identified as especially vulnerable to environmental change.

On the more specific agenda of integrating environment and private investment, the US could provide leadership in several ways. It can lead by example by acting to encourage its commercial banks, ECAs and institutional investors to develop, follow and make public environmental guidelines. The most receptive group is likely to be the ECAs (OPIC and Ex-Im Bank) especially if efforts are made to expand rather than reduce their budgets.

Given the incentives that drive private capital flows, it would be a mistake to believe that these could ever fully replace official development assistance. 72% of private flows went to 10 developing countries in 1996. Thus, integrating environmental concerns into private investment capital will have little impact on much of the developing world, which still relies on ODA (e.g. USAID) and MDB lending. Therefore, in parallel with the greening of private capital, USAID should be encouraged to focus its assistance on those countries which do not receive much private capital but are important from an environmental perspective. In this way, the US would demonstrate to the world both the gains to be generated through integrating environmental concerns and private investment flows where possible and appropriate, and its willingness to provide leadership on the environment in areas where the market is unlikely to do so.

In addition to these primarily unilateral initiatives, the US could also be more assertive in multilateral fora. Specifically, in the context of the G8 the US should promote environmental standards for FDI through the strengthening and coordination of ECA activities perhaps modeled on the OPIC and Ex-Im Bank. In the OECD, the US should take a leadership position in the MAI negotiations by putting environmental issues on the agenda. In the WB, the US should use its influence to promote the adoption of ECA type standards in the IFC and MIGA. Finally, in the context of multilateral meetings, the US should attempt to work more closely with Canada, Scandinavia and the EU to put the issue of linking environmental concerns and private capital on the global agenda.

IV. AVENUES FOR INTEGRATING ECONOMIC AND ENVIRONMENTAL OBJECTIVES IN US FOREIGN POLICY

Promoting Interagency Cooperation and Dialogue

– The Administration has to develop an environmental policy framework, including a set of clear objectives and priorities, so that each government agency can see where its activities fit into a larger process.

– Mechanisms need to be established to promote regular interagency dialogue. In particular, it is important that State, Defense, intelligence, the EPA and USAID are fully aware of each other's activities and coordinate their efforts to avoid redundancy and countervailing initiatives.

Linking Public and Private Sectors

– The State Department should produce the environmental status reports described by Christopher in his April 1996 speech.

– The Administration should encourage relevant agencies to produce regular reports on international environmental activities and objectives.

– The regional hubs established last year have been very ineffective to date. There mandates need to be clarified and their profiles raised. They should produce regular reports on relevant activities and opportunities in their regions and host meetings that bring together business people, environmental specialists, and government officials.

– Within the US, regular meetings, perhaps modeled on the Woodrow Wilson Center's Environmental Change and Security Project, should be instituted among key actors in business, labor, the NGO community, the academic world and government to promote dialogue and understanding.

– Broader public awareness campaigns should be initiated by the government, NGO community and other concerned parties to ensure that the public is fully appraised of (a) the US's environmental objectives and activities, (b) the financial and other incentives that exist for environmentally sound investment, and (c) the environmental performance of different investment vehicles and projects.

Global Activities

– The US should take advantage of upcoming opportunities such as the fiftieth anniversaries of the GATT and the Declaration of Human Rights, and the follow-ups to the Kyoto accords, to promote global environmental concerns and awareness of the linkages between these and private capital flows.

– The US should take advantage of its leadership position in small multilateral fora such as the G-8 and ongoing MAI negotiations to focus attention of the potential environmental impacts of expanding private capital flows, and of ways in which multilateral initiatives might mitigate negative impacts.

Policy Research

- *Establishing NEPs and Creating a Global Environmental Framework*

  – As numerous studies have indicated there is an immediate need to fund research that will improve the quality and distribution of national, regional and global environmental data sets so that opportunities and incentives for individuals to change their behavior to reflect US NEPs become clear. As a first step, it would be tremendously useful to identify the priorities for data collection and standardization.

  – At the same time, it is equally important to promote research and dialogue aimed at clarifying and reaching consensus on US NEPs. As a first step, a series of focused discussions involving representatives from government, business, academia and the NGO community should be organized. One of the major problems evident inside the beltway is the lack of interagency dialogue and the lack of regular engagements with the business sector. A model for this type of activity might be the Woodrow Wilson Center's Environmental Change and Security Project.

- *Integrating US Environmental Objectives and Private Investment Flows*

  – In developing a successful strategy here, it is important to obtain a clearer sense of the attitudes towards this linkage that currently exist in the private sector. Once the level of interest and concern in commercial banks, companies seeking to promote FDI, and institutional and individual portfolio investors has been ascertained, then a marketing strategy can be developed to promote the environment/private investment linkage.

  – Interviews and focus groups with TNCs and fund managers should be conducted in order to assess their motivations and receptiveness to environmental concerns.

  – Further research on the actual and potential impacts of the various forms of private investment on the environments of developing and transitioning economies should be undertaken. This should be done on a country/regional and sectoral basis.

  – Further research on political means to influence the various, increasingly complex forms of private investment should be undertaken.

– A comparative analysis of ECA initiatives, successes and failures within the G8 and OECD should be undertaken.

V. CONCLUSION

This report has focused on how to integrate environmental concerns into US foreign policy in a manner relevant to rising private investment flows into developing and transitioning states. It outlines a six step process:

- *Clarify environmental objectives within the context of other foreign policy objectives*
- *Establish NEPs*
- *Assess the relationships between private investment flows and NEPs in comparison to other factors*
- *Identify, preferably on a case by case basis, the real and anticipated impact of different forms of private investment flows*
- *Identify key actors and pressure points, assess the potential for US foreign policy to affect outcomes in these cases, and develop appropriate policies*
- *Publicize all of the above*

At each step in this process, we have pointed out gaps that need to be filled, obstacles that need to be overcome, and approaches that might be taken. As information and experience increase, the requirements for success will be clarified.

Insofar as the NGO community is concerned, this leaves two further questions unanswered. First, given limited resources, Is this a battle that can be won? On the one hand, there does appear to be a “window of opportunity.” US foreign policy lacks direction and the current administration has signaled that it wants to include an environmental agenda in its efforts to fill this vacuum. But the level of receptivity to this in the foreign policy community is uncertain and may be weak.

Second, given limited resources, Is this a battle worth waging? The answer to this question depends on how the gaps identified above are filled. If the government can identify concrete NEPs, and strong linkages between these and private investment flows can be demonstrated, and these NEPs make a significant contribution to addressing environmental problems, then the battle is certainly worth waging. In a very real sense, however, the ultimate stakes depend on the early initiatives undertaken. In other words, this battle can be made more or less worth waging. On the basis of the imperfect information available, we believe this is an avenue with great potential that merits further exploration.