

## Encouraging Public-Private Regulatory Dialogue

### Premises for discussion:

- Transparent, predictable environmental standards help the private investors that governments hope to attract, they do not drive them away.
- The needs of both governments and investors are best met when they, along with other stakeholders, develop, adopt and consistently apply workable environmental standards addressing priority local issues.

### Challenge for participants:

Annual dialogue reviewing progress in a number of areas of shared interest, such as regulatory standards, trade and environment, environmental aspects of joint ventures, and high cost environmental infrastructure.

*Transparent, predictable environmental standards help the private investors that governments hope to attract, they do not drive them away.*

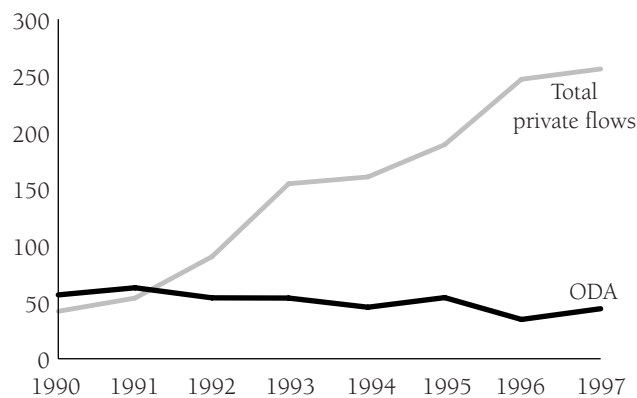
Continued private investment in productive operations—manufacturing, infrastructure and resource extraction facilities—is key to the economic recovery and future growth of East Asia (Figure 1). Such investments are particularly attractive to governments, as they are medium to long term in nature, and generate

both direct (employment) and indirect (demand for ancillary services) economic benefits. They have also made up the majority of the private capital flows to developing countries this decade (Figure 2).

Private investments to improve production operations are also key to addressing priority environmental issues in the region. New domestic or foreign direct investment in process equipment, environmental management systems, and environmental infrastructure ser-

**Figure 1. Private capital flows to developing countries versus official direct assistance (ODA), 1990–97**

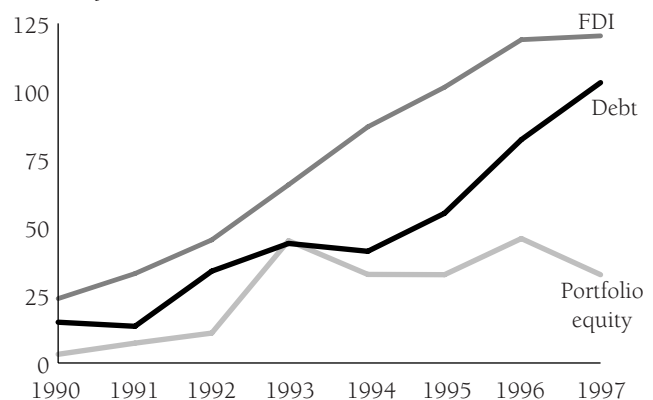
Capital flows  
(billions of U.S. dollars)



Source: World Bank, 1998, *Global Development Finance*, Washington, DC.

**Figure 2. Foreign direct investment (FDI) versus portfolio equity and debt, 1990–97**

Capital flows  
(billions of U.S. dollars)



Source: World Bank, 1998, *Global Development Finance*, Washington, DC.

vices can improve both competitiveness and environmental performance—particularly if effective regulatory and investment frameworks are in place (see Example 1 at the end of this paper). Nor are these benefits limited to large companies—local, small and medium sized enterprises (SMEs) can also combine improved productivity and environmental performance (Example 2).

Unfortunately, many government officials—particularly those in the investment promotion and finance ministries—believe that attention to environmental matters will drive private investors to competing countries. Concern is frequently expressed that effective national environmental programs always mean increased capital and operating costs. In an increasingly competitive world, the possibility of adding more cost to an investor’s production base is viewed with alarm.

As a result, there is resistance to effectively integrating investment promotion and environmental frameworks. In turn, this leads to charges by environmental advocates that governments are in a “race to the bottom” in lowering their environmental standards and that multinational investors are seeking out “pollution havens.”

If the goal is to promote medium to long term investment in productive operations, both the governments’ and the environmentalists’ concerns are overstated. In fact, both are missing opportunities to optimize private investment, efficiency and environmental performance.

What the vast majority of private direct investors value above all is predictability. They are investing for the medium to long term. Their operations have direct

environmental consequences in terms of land use, impacts on neighboring populations, air emissions, water consumption, and waste generation.

The lack of clear environmental standards, or their inconsistent application, is viewed by many such investors as an increased risk, not an inducement. Foreign direct investors fear being singled out by governments and the media in the event of an environmental incident (as described in the Issues Paper on Joint Ventures). Even in the absence of effective national environmental programs, companies operating in the global marketplace face a range of pressures to improve their environmental performance (Box 1). The predictability of the standards is usually more important than their severity.

The integration of predictable environmental standards into investment promotion frameworks reduces these risks and will not drive private direct investors away. They choose their investment locations for other reasons—access to labor, natural resources, local and export markets. While environmental costs can be significant in some sectors, they are not major competitiveness factors for most industries.<sup>1</sup> Interestingly, the World Bank’s 49 “Competitiveness Indicators” do not even include environmental regulation as a relevant factor.<sup>2</sup> In addition, strong environmental programs are not inconsistent with high levels of competitiveness—witness the fact that the top ten entries in the “World Competitiveness” rankings all have extensive environmental programs in place.<sup>3</sup>

As a result, there is little evidence that multinational investors are seeking out pollution havens and few reasons for national governments to “race to the bot-

#### **Box 1. Commercial advantages from improved environmental performance**

Companies that improve their environmental performance—even in the absence of stringent government enforcement—do so to capture the following major types of commercial advantage:

- *Improved access to export markets*, such as through the adoption of environmental management systems or the award of product “eco-labels” (as discussed in the Issues Paper on Trade and the Environment)
- *Increased productivity*, through more efficient use of raw materials and other inputs

- *Maintenance of a “social license” to operate*, in the face of local and international pressure from neighbors, environmental NGOs, shareholders and customers
- *Access to finance*, where international financiers increasingly require environmental risks to be addressed and, in some cases (such as the World Bank Group), separate environmental guidelines to be met
- *“Environmental” investments*, in water systems, cleaner energy and other projects.

Source: B. Gentry, ed., 1998, *Private Capital Flows and the Environment*, Aldershot: Edward Elgar Publishing Ltd.

tom” in developing or implementing their environmental programs.<sup>4</sup>

*The needs of both governments and investors are best met when they, along with other stakeholders, develop, adopt and consistently apply workable environmental standards addressing priority local issues.*

A large gap exists between the environmental laws now on the books in East Asia and their enforcement.<sup>5</sup> The result is bad for investors, bad for the environment and bad for governments.

The gap is bad for direct investors because it means that environmental expectations are unpredictable. Government attention is either absent or dramatic—such as facility closures in the face of local political pressure. In the absence of government attention, citizens are more likely to organize local demonstrations or other direct action to improve environmental conditions—actions that can create unnecessarily confrontational situations difficult to contain (see Appendix 1 to the Issues Paper on Joint Ventures).

It is bad for the environment because existing laws are largely ineffective in addressing priority local issues. Frequently, they do not fit the local context or needs, having been transplanted from one or more industrialized countries with limited opportunity for local review or adaptation. The result is poor implementation, either for lack of broader political support or fear of slowing economic development.

Finally, the gap is bad for governments both because it increases risks to private direct investors and it misses opportunities to improve local environmental conditions. Many foreign direct investors apply global environmental management programs—even in the absence of effective local programs—because it helps their business. As a result, many are also willing to work with governments, small firms and others on environmental training programs and infrastructure provision—if there is local interest (as shown in Example 3).

The time is ripe for increased public-private dialogue on closing this regulatory gap—by developing and implementing environmental frameworks that are both predictable and effective in addressing priority local issues.

Traditionally, the development of environmental rules have led to confrontational relationships among

governments, businesses, and environmental NGOs (as illustrated in Figure 3).

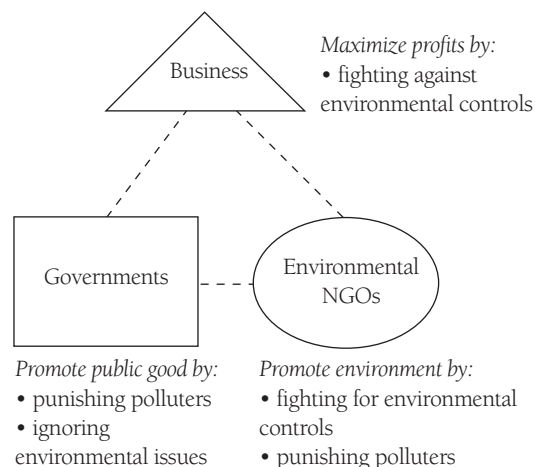
Global markets, changing financial flows, and increasingly shared concern over environmental issues, are all helping to create opportunities for new collaborations among these traditionally warring entities (Figure 4).

Any such collaboratively developed environmental frameworks need to address three major issues:

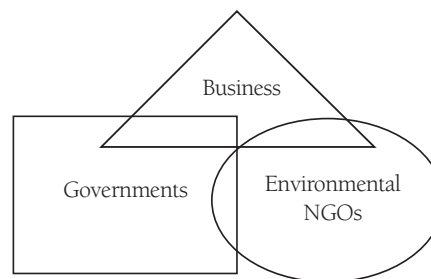
- What priority, local environmental issues should be targeted?
- What policy tools should be used?
- What process should be used to select the targets and tools?

The targets of environmental rules should be issues that raise broad local concerns—in order to increase the likelihood that the rules will be implemented and observed. For example, improved access to clean water and reduced urban air pollution are two examples of problems widely recognized as having major impacts on public health and welfare in the region.<sup>6</sup> Action should also be taken at the

**Figure 3. Traditionally confrontational relationships among governments, businesses, and NGOs**



**Figure 4. New opportunities for collaboration**



scale that mirrors the causes of the problem. For example, improving local water supplies can frequently be addressed on a watershed basis, while addressing urban air pollution from two-stroke engines needs to reflect both local and international considerations.

Many different policy tools are being used to address priority environmental issues around the world (Box 2)—and new ones are constantly being developed. To be most effective, the standards should be:

- *Workable*. The policy tools chosen need to fit the local circumstances, both in terms of political acceptance and their effectiveness in changing local behavior in the local context.
- *Cost-effective*. They also need to provide locally effective incentives to address the targeted issues efficiently and creatively.
- *Predictable*. Finally, they need to be both clear and popular enough to be consistently applied in practice, by government agencies, citizens and firms.

The process used to select the targets and the policy tools is also critical to success. If properly done, the process helps both to ensure that the framework meets local needs and to build coalitions supporting their implementation (Example 4).

If poorly done, however, the process used to develop environmental rules can further undermine public trust and increase risks to investors.

To be most effective, the process for adopting environmental standards should be:

- *Responsive to local needs*. While there are winners and losers in any effort to set rules, there has to be enough attention paid to the concerns of affected parties (busi-

nesses, community groups, environmental advocates and others) to give the rules a base for effective implementation.

- *Transparent*. Affected parties need to be aware that the rules are being considered, have access to information on the process, and understand how they can be involved.
- *Inclusive*. Affected parties need specific opportunities—such as public hearings—to share their goals and concerns with the decisionmakers.
- *Standardized*. Predictability is increased when a standard process—encouraging input from all affected parties—is consistently applied.

One example of a collaborative approach to setting environmental rules is provided in Example 5.

Targeting priority environmental issues and adopting locally effective environmental rules—using an inclusive and transparent process—is a new approach for many governments in the region. New capacities will need to be developed. New coalitions will need to be formed.

*Challenge for participants: Annual dialogue reviewing progress in a number of areas of shared interest, such as regulatory standards, trade and environment, environmental aspects of joint ventures, and high cost environmental infrastructure.*

The purpose of this meeting is to catalyze a collaborative effort among PBEC members and East Asian governments in support of this new approach. In order to be useful to both parties, it quickly needs to move beyond generalities to focused work on issues of shared concern.

### Box 2. Major types of environmental policy tools

Increasingly, environmental policy makers are combining different policy tools into integrated packages addressing priority issues in the local context. The major types of tools used include the following:

- Traditional “command and control” requirements, under which emission standards are set and enforcement action taken if they are not met. They include: emission and discharge standards; bans on the use of particular substances; and management standards for particular chemicals or activities.
- Liability for environmental damage, under which the persons who cause environmental damage are required to

pay compensation.

- Market mechanisms, under which market incentives are created to help improve environmental performance. Included are both price-based systems (such as environmental charges) and quantity-based systems (such as emissions trading programs).
- Information programs, under which the collection and dissemination of information on environmental issues creates new incentives to improve environmental performance. Included are environmental assessments, emission reporting requirements and product labeling systems.

The conference agenda offers four specific problem areas for discussion:

- Methods for the transparent development and implementation of predictable and effective environmental rules;
- Trade and environment issues, particularly international standards for environmental management systems (ISO 14001) and environmental labeling schemes for products;
- Environmental issues in joint ventures between local and international companies; and
- “High cost” environmental issues, particularly those associated with infrastructure development.

Many other issues could also benefit from increased public-private collaboration, ranging from product specific (standards for reducing emissions from two-stroke engines) to location specific (reducing water pollution in any number of cities in the region).

Whether and how the participants in this meeting decide to carry forward the dialogue on these issues is up to them. As an aid to focusing the discussion, however, one approach to follow-up is for the participants to:

- Choose at least three issues—in particular locations, sectors or product lines—in which they share concerns and on which progress can be made over the next 12 months;

- Establish working groups on each issue—co-chaired by and including representatives from both business and government—to continue the dialogue, including with other affected parties, and see what progress can be made; and

Meet again one year from now to hear reports from the working groups on progress made and recommendations for further action, if any.

### Notes

1. Environmental costs are in the 2% to 4% of production costs range for most industries. See Robert V. Percival, Alan S. Miller, Christopher H. Schroeder, and James P. Leape, eds., 1996, *Environmental Regulation: Law, Science and Policy*, New York: Little, Brown and Company.
2. See the World Bank Competitiveness Indicators at <http://wbln0018.worldbank.org/psd/compete.nsf>.
3. IMD 1998, *World Competitiveness Yearbook: New Frontiers of Competitiveness*. The top ten countries are: United States, Singapore, Hong Kong, Netherlands, Finland, Norway, Switzerland, Denmark, Luxembourg, Canada.
4. See André Dua and Daniel C. Esty, 1997, *Sustaining the Asia Pacific Miracle*, Washington, DC: Institute for International Economics.
5. See G. Hughes, R. Ackerman, M. Keene, K. Lvovsky, and T. Nielsen, 1997, *Can the Environment Wait? Priorities for East Asia*, Washington, DC: World Bank.
6. See World Bank (1997), note 5 above.

### Example 1: Improved Environmental Performance through Private Investment—Mexican Steel Privatization

In 1991, the Mexican government privatized its steel industry. Included was the largest integrated steel plant in the country, the “AHMSA” facility in Monclova, Northern Mexico. It was sold to a group of investors consisting primarily of Mexican companies, but also including a Dutch steel firm.

The environmental improvements since privatization have been remarkable. Air emissions have decreased by over 50%. Waste water discharges per unit of production have been reduced by over 70%, and changed from highly acidic to neutral. Solid waste generation has decreased and recycling rates have increased. All of this has been accompanied by

major improvements in competitiveness and exports.

The improvements are due to the integration of environmental factors into decisionmaking by both the government and the new owners. The government calculated that it would receive a higher purchase price if it addressed—and thereby reduced—environmental risks during the privatization process. So, it included an environmental compliance plan as part of the sale requirements. The new owners’ investments in more efficient production processes also significantly reduced emissions, while its entry into the export market (particularly to Germany) was aided by its adoption of advanced environmental management systems.

*Source:* B. Gentry, 1996, *Privatization, Foreign Investment and the Environment*, World Bank Discussion Paper, Washington, DC: World Bank.

### Example 2: Commercial Benefits to SMEs from Adopting ISO 14001—The Guadalajara Environmental Management Pilot Project

The World Bank and the Mexican Ministry of the Environment (“SEMARNAP”) are working with 11 major companies in Guadalajara to help 20 SMEs implement an environmental management system based on the ISO 14001 international standard. (A description of ISO 14001 is provided in the Issues Paper on Trade and Environment: ISO 14001 and Product Eco-labeling.) The large companies selected the SME participants from among their suppliers and clients.

The SMEs are finding that very real commercial benefits accompany their implementation of an environmental management system. They include:

- Reducing production costs by simple changes that increase the efficiency of raw material use (ranging from replacing gaskets to increasing the reuse of water);
- Meeting the requirements of major customers, often the mentor company, for adoption of an environmental management system; and
- Increasing their attractiveness to other customers through certification of their environmental management system.

*Source:* Kulsum Ahmed and Paul Martin, 1998, “The Guadalajara Environmental Management Pilot,” Information Brief, April, Washington, DC: World Bank.

### Example 3: Public-Private Collaboration on Environmental Training for SMEs—ISO 14000 and Eco-efficiency

Philips Electronics and other member companies of the World Business Council for Sustainable Development (“WBCSD”) are working with UNDP to provide training and mentoring programs for small and medium sized businesses in developing countries.

The training efforts build from the fact that an increasing number of multinational companies are sending environmental trainers around the world to work with their own facilities. Companies like Philips are happy to have their trainers stay an extra day or two and run the same training for interested local companies, technical institutes and government agencies. Already they have done so in India, China and Brazil.

*Source:* Yale/UNDP Public Private Partnerships Programme, 1998 (<http://undp.org/undp/ppp>).

### Example 4: Ilo, Peru—Developing Environmental Rules

Since the 1950s, the population of Ilo, a coastal city in southern Peru, has grown nearly 20-fold, to about 70,000 people. Lack of urban planning, in-migration and industrialization led to uncontrolled and chaotic development. Over time, a high level of animosity developed between the residents of the town and the largest industrial concern, Southern Peru Ltd.

In the late 1980s, an Environmental Management Committee was set up to diffuse this tension and develop a comprehensive plan to solve the problems. The committee included representatives of Southern Peru Ltd., the fishing industry, universities, municipal officials, residents, and the health department.

One of the first aims of the committee was to establish clear pollution norms. Working with all of the stakeholders, the committee was able to obtain central government acceptance of its norms, as well as to persuade local industry to undertake environmental clean up. In return, community members agreed to channel their protests through municipal organizations, and both sides agreed to conduct future negotiations with transparency and pragmatism.

*Source:* B. Gentry and L. Fernandez, 1998, “Evolving Public-Private Partnerships,” in *Globalisation and the Environment*, Paris: OECD.

### Example 5: Collaborative Standards Setting in the Netherlands

In 1993, 130 chemical companies (and their national trade organization) signed an agreement with several Dutch Ministries (Environment, Economic Affairs and Water Management) under which they committed to meet quantitative targets for reducing their principal emissions (air, water, and waste).

Under the agreement, the companies are required to prepare a Company Environmental Plan in which they describe how they expect to meet the agreed targets. The Plan is then reviewed by the government and, if acceptable, is used as the basis for the firm’s new permit. Industry benefits because the agreement allows them to develop responses which meet national standards, while also meeting their long-term objectives (including cost effectiveness).

*Source:* Benedict Latto, 1998, *Environmental Agreements: Lessons for Public-Private Partnerships*, New York: UNDP (<http://undp.org/undp/ppp>).