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**ON BEHALF OF**

**ENVIRONMENTAL DEFENSE  
OXFAM AMERICA  
FRIENDS OF THE EARTH  
PACIFIC ENVIRONMENT  
INTERNATIONAL RIVERS NETWORK  
AMAZON WATCH  
BANK INFORMATION CENTER  
RAINFOREST ACTION NETWORK**

**CONCERNING THE REAUTHORIZATION OF THE  
OVERSEAS PRIVATE INVESTMENT CORPORATION**

**COMMITTEE ON INTERNATIONAL RELATIONS  
UNITED STATES HOUSE OF REPRESENTATIVES**

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## CONTENTS

<b>I.</b>	<b>Introduction</b>	<b>1</b>
<b>II.</b>	<b>OPIC’s Development Mandate</b>	<b>1</b>
<b>III.</b>	<b>OPIC’s Sustainable Development Record</b>	<b>4</b>
	A. OPIC’s portfolio	4
	B. Controversial OPIC projects—What has OPIC learned?	6
	C. OPIC’s “Development Matrix”	10
	D. Enron and El Paso	11
<b>IV.</b>	<b>Needed Reforms</b>	<b>13</b>
	A. Establish an independent compliance/ombudsman mechanism	14
	B. Statutory strengthening of environmental policy in the areas of: 1. tropical forests, 2. implementing the recommendations of the World Commission on Dams, and 3. accounting for, and reducing greenhouse gas emissions.	15
	C. Increase selectivity and transparency for large-scale fossil fuel and mining projects	16
	D. Establish new measures to fight corruption	17
	E. Call on GAO to review Enron and other problematic investments	18
<b>V.</b>	<b>Conclusion—OPIC’s Reauthorization is Not Justified Without Major Reforms</b>	<b>19</b>

## **I. Introduction**

Mr. Chairman and Committee members, thank you very much for the opportunity to testify today concerning the proposed reauthorization of the Overseas Private Investment Corporation. I am speaking today on behalf of Environmental Defense, and seven other national environment and development organizations: Oxfam America, Friends of the Earth, Pacific Environment, International Rivers Network, Amazon Watch, Bank Information Center, and the Rainforest Action Network. Together these organizations have over a half million members and supporters nationwide.

My statement will address three major questions: First, the policy justification for OPIC, particularly its international development mandate which has been a core justification for OPIC since its founding in 1969. Second I will examine aspects of OPIC's record in promoting development, and third, conclude with a number of specific recommendations which we think must be incorporated into OPIC's charter and operating procedures to justify any rechartering of what is an increasingly controversial entity. Many of the observations and recommendations of my statement either complement, or disagree with, the findings and recommendations of the recently released report of the Institute for International Economics (IIE) on "Reforming OPIC for the 21<sup>st</sup> Century."

## **II. OPIC's Development Mandate**

We note that OPIC's Congressionally mandated mission, established through a 1969 amendment to the Foreign Assistance Act, has always been "to mobilize and facilitate the participation of United States private capital and skills in the economic and social development of less developed countries and areas, and countries in transition from nonmarket to market economies, thereby complementing the development assistance objectives of the United States."<sup>1</sup> Indeed, after stating OPIC's mandate OPIC's Congressional charter reiterates that "The Corporation, in determining whether to provide insurance, financing or reinsurance for a project, shall especially-- (1) be guided by the economic and social development impacts and benefits of such a project and the ways in which such a project complements, or is compatible with, other development assistance programs and projects of the United States or other donors."<sup>2</sup>

Over the past decade in particular, OPIC has come under increasing scrutiny and criticism from the entire political spectrum from right to left as an entity that allegedly subsidizes large multinational corporations with little or even negative development impacts on poor countries—it has been called "an automatic teller machine for the Fortune 500" that supports projects with severe negative environmental and social impacts, some of which have also become the subject of major allegations of corruption. During OPIC's rechartering debate in 1997, organizations and individuals as diverse as

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<sup>1</sup> 22 U.S.C. 2191.

<sup>2</sup> 22 U.S.C. 2191 (1).

the Heritage Foundation, the Cato Institute, Friends of the Earth, and Ralph Nader, advocated OPIC's abolition.

Some supporters of OPIC, apart from its corporate clients, assert that OPIC remedies important market failures for promoting Foreign Direct Investment (FDI) and, in the words of Institute for International Economics (IIE), provides "positive externalities for both the developing world and the United States."<sup>3</sup> We can state no better than IIE the alleged positive externalities, apart from putative economic benefits to the U.S., that OPIC sponsored FDI is supposed to provide, if "appropriately structured," for developing countries: "economic growth, social welfare, good governance, and environmentally sustainable development around the world."<sup>4</sup>

It is important to note for the record that this policy justification is highly contested by some of the most prestigious economists in the world, who strongly disagree with the rationale for OPIC's very existence. Prior to an earlier reauthorization debate over OPIC, Nobel Prize economist Milton Friedman wrote the then Chairman of the House Budget Committee, Representative John R. Kasich (R-OH) the following on September 5, 1996:

*I cannot see any redeeming aspect in the existence of OPIC. It is special interest legislation of the worst kind, legislation that makes the problem it is intended to deal with worse rather than better<sup>5</sup>.*

Several years ago the Congress commissioned a study on reform of the World Bank and other international financial institutions, which was prepared by a bipartisan Congressional International Financial Institution Advisory Commission (IFIAC). The Commission, with six Republicans and five Democrats, was chaired by Allen Meltzer, professor of political economy at Carnegie Mellon University and visiting scholar at the American Enterprise Institute. In March 2000, the final 'Meltzer Commission' report advocated the abolition of the OPIC-like entity of the World Bank<sup>6</sup>, the Multilateral Investment Guarantee Agency (MIGA), stating that it did not find sufficient rationale for its existence.

In our view, in light of the controversy over OPIC's public policy justification for existence, the central issue of its record in promoting sustainable economic development that benefits the poor is all the more important and worthy of scrutiny. OPIC President Peter Watson states in the OPIC 2002 Annual Report that "we [OPIC] bring a better quality of life to populations that lack the health, the education, or even the access to life's basic necessities that enable them to contribute to--or benefit from--economic

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<sup>3</sup> Theodore H. Moran, **Reforming OPIC for the 21<sup>st</sup> Century** (Washington DC: Institute for International Economics, May, 2003), p. 3.

<sup>4</sup> Ibid.

<sup>5</sup> Milton Friedman, letter to Representative John R. Kasich (R-OH), Chairman, Committee on the Budget, U.S. House of Representatives, September 5, 1996.

<sup>6</sup> In fact, MIGA's creation and functions were partly inspired by, and modeled on, OPIC.

growth."<sup>7</sup> While OPIC may support a handful of smaller projects that have this goal, we do not think OPIC's overall record and portfolio justify such a claim.

Since OPIC's chartering in 1969, and indeed since its last reauthorization in 1996, much has been learned about economic development in poorer countries and what is needed to make that development sustainable over the long term. There is an evolving consensus that good governance (especially controls against corruption) and legal conditions favoring the development of free markets are critical, as well as incorporation of environmental, labor and human rights concerns, which, if not addressed, can undermine the political, financial and even physical viability of investments.

From this perspective of sustainable development, we think that OPIC's development record over the past decade has gone from bad to worse, in spite of the institution in 1999 of improved environmental procedures. The problem is that implementation of these procedures has been inadequate, and that OPIC's portfolio is increasingly weighted with projects supporting multinationals in the extractive sectors of oil, gas and mining; there is an increasing debate whether such projects deliver in many cases any net, lasting development benefits to poor countries, a debate that is now the subject of a independent review by the World Bank.<sup>8</sup> Moreover, OPIC support consistently goes to other projects of dubious benefit to the poor such as international five star hotels, luxury and adventure tourist facilities, and even insurance for outdoor billboard advertising (I examine OPIC's portfolio in more detail in the next section.) While the new senior managers of OPIC have stated a commitment to return to OPIC's core development mission, we believe that operational evidence is still mostly lacking that OPIC can be justified from a development perspective. There is an urgent need for much greater selectivity in OPIC's choice of investment projects, not a broadening and expansion of OPIC activities and clients (for example to extend OPIC insurance and loans to foreign companies and multinationals with only a few hundred U.S. employees, as some are advocating).

IIE, for example, advocates expanding OPIC's client base, citing the alleged 'positive externalities' that result for sustainable development in the social and environmental areas, while also acknowledging that "OPIC must redirect and expand its monitoring protocols to focus on this broader array of effects, both positive and negative (questions of human rights, workers rights, environmental practices and anticorruption provisions....)"<sup>9</sup> While we strongly endorse the latter recommendation, it makes no sense to expand the mandate and resources of OPIC to foreign corporate clients, when OPIC's record in carrying out its current mandate is so controversial and problematic.

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<sup>7</sup> OPIC, "Delivering on the Promise, Annual Report 2002," President's Message, p. 1.

<sup>8</sup> In fact, a major article in last Saturday's *New York Times* cites a number of academic development experts and a former World Bank senior economist recommending against any continued World Bank support for large oil projects. It quotes, for example, William Easterly, now Professor of Economics at New York University: "Mr. Easterly, who used to work at the Bank, said that given their poor record, the bank should not finance these industries. 'The bank can try to influence management of those natural resource revenues, but it doesn't have that much leverage,' he said. 'And its record on enforcing codes of conduct on the part of borrowing governments is dismal.'" Daphne Eviatar, "Striking it Poor: Oil as a Curse," *New York Times*, June 7 2003, pp. A17, A19.

<sup>9</sup> Theodore H. Moran, **Reforming OPIC for the 21<sup>st</sup> Century**, p. 7.

We maintain that OPIC should not be rechartered without important modifications of its charter to ensure that its development record improves. In a post 9/11 world, we cannot afford to support institutions that through negligent environmental and social practices increase the likelihood of instability in poor areas of the world rather than alleviating poverty in a sustainable fashion. This question is all the more urgent given OPIC's recent concentration of new projects in politically and socially highly volatile frontline countries such as Indonesia and Pakistan.

### **III. OPIC's Sustainable Development Record**

An examination of OPIC's portfolio over recent years reveals an alarming number of highly controversial projects, with allegations of environmental and social damage and corruption that have been featured on the front pages of the *Wall Street Journal* and *Washington Post*. There are unanswered questions about OPIC's massive support for companies that have been criminally indicted for corrupt practices in the United States and abroad, such as Enron and El Paso Energy. In some cases there are allegations that OPIC appears to have been to some degree captured by its clients, resulting in the bending of environmental rules, as with the OPIC-Enron Cuiaba pipeline project in South America. Most importantly from a development perspective, OPIC's portfolio has increasingly become weighted with huge oil, gas and extractive projects, at the very moment when the development benefits of such investments are increasingly questioned by academic studies, NGOs, and the World Bank.

OPIC has traditionally justified its development impact by attempting to estimate job creation and revenue flows to developing nations for individual projects, but, as the case of extractive industries shows (discussed below), the negative social, environmental and political 'externalities' can often outweigh the positive impacts, particularly, as the World Bank OED notes, in countries with weak governance. Even by OPIC's own calculations, we find that for the OPIC monitoring cycle completed in 2000, some 58 projects supported by OPIC in 1994-96 which generated \$7.2 billion in investment actually resulted in a "*net foreign exchange drain of \$171 million*" for the developing countries concerned.<sup>10</sup> Since many if not most developing countries are suffering from crushing debt burdens and desperately need more positive foreign exchange flows, this is a disturbing record.

#### **A. OPIC's portfolio**

OPIC has increased greatly the proportion of projects in the extractive sector--oil and gas in particular—at the very moment when extractive projects (oil, gas and mining) have become so controversial in terms of their development impacts that the World Bank, formed in 2001 an independent commission, the Extractive Industries Review (EIR), to review the development record of extractive projects and to decide whether the World

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<sup>10</sup> Ibid., p. 44, emphasis added.

Bank should even continue to support extractive projects. Already four of five regional workshops of the EIR have taken place (in Africa, East Asia, Europe and Central Asia, and Latin America) and in each case community representatives and NGOs have urged that the World Bank withdraw from any further support for the extractive sector, particularly oil and gas. The local groups cited example after example of severe environmental and social impacts, lack of local benefits, and increased corruption and lawlessness.

The World Bank commissioned an internal report from its internal audit department (the Operations Evaluation Department, OED) on extractive industry investment, and the draft OED report concluded earlier this year that many extractive projects even if financially successful had a "negative development impact," and recommended that the Bank not finance extractive projects in countries with weak governance structures, since experience shows in such countries such projects have perverse effects, fostering corruption and undermining needed structural changes in the economy to promote long term development. Among the Bank's conclusions:

“In fact, the evidence suggests that it [extractive industry investment] is more likely to lead to bad development outcomes when governance is poor. Because of the Bank's focus on poverty, and the links between poverty and poor governance, this means that increased EI investment is likely to lead to bad development outcomes *for many if not most of the Bank's clients.*”<sup>11</sup>

“The Bank should not support an objective of attracting increased EI investment in countries with weak core governance.”<sup>12</sup>

“Unfortunately, the quality of governance in countries with strong extractive industries is generally poor.”<sup>13</sup>

In this light, let's look at OPIC's portfolio. Historically OPIC's total outstanding exposure for its insurance and loans was, in September, 2000, \$15.316 billion. Of that, \$1.806 billion was in the oil and gas sector, about 11.8%.<sup>14</sup> If we examine the 2002 OPIC Annual Report, where there is much rhetoric about OPIC's allegedly “refocused” development mission, we find that over 57% of the FY 2002 new OPIC insurance and loan commitments went for giant projects by big multinationals in the oil and gas sector—certainly a huge refocus on big oil, some \$685 million out of total commitments of \$1.2 billion. This is up from 22.5% of total commitments going for oil and gas in 2001 (some \$360 million of \$1596.9 million in total commitments), the first year of OPIC's “refocused” commitment to its developmental mission. Almost 30% alone of the 2002 portfolio consists of a \$350 million loan for a huge UNOCAL operation for offshore oil

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<sup>11</sup> World Bank Operations Evaluation Department, “Evaluation of the World Bank Group's Activities in the Extractive Industries, Background Paper, Factoring in Governance” (World Bank Operations Evaluation Department, January 21, 2003), p. 20, emphasis in original.

<sup>12</sup> Ibid., p. 16.

<sup>13</sup> Ibid., p. 4.

<sup>14</sup> Theodore H. Moran, **Reforming OPIC for the 21<sup>st</sup> Century**, 107.

and gas development in Indonesia adjacent to an onshore oil and gas terminal in the province of East Kalimantan (Borneo) where UNOCAL operations have been the subject of massive non-violent protests over environmental and social abuses inflicted upon Indonesian community and human rights activists in a devoutly Muslim area (we discuss this controversy in more detail in the next section). There is another \$130.75 million for gas concessions in Pakistan, \$30 million to the Gordon Getty Family Trust for oil and gas exploration in Russia, \$25 for the Texas Overseas Gas Corporation for liquefied petroleum distribution in Guatemala, \$100 million to Pride International for oil and gas drilling in Chad,<sup>15</sup> and \$50 million to WilPro Energy Services for Gas Compression in Venezuela--\$685 million, 57% of the 2002 OPIC portfolio.

How about the other 43%? Here are some other examples from 2002: we find a \$15 million commitment to Diamond Fields International for mining of offshore diamond deposits in Namibia; \$168,000 to B&C Management Inc. for the operation of a gravel quarry in Ghana; \$250,000 to a Mr. Lee Cashell and his firm Mongolian Resorts for "Tourist Camps to provide adventure tourist activities" in Mongolia; \$600,000 for "Underwater submarine tourism" in Thailand; \$4.349 million for the development of the Marriot Tbilisi and Marriot Courtyard hotels in Georgia<sup>16</sup>; \$56 million to El Paso Energy (some of whose former management is under Federal indictment for fraud in the California energy trading debacle) for two gas power plants in Pakistan; \$1.219 million to expand the Wend-Rey restaurant franchise in Mexico; and \$150,000 to an advertising firm, Colite Outdoors, LLC., for "outdoor advertising, billboards" in Nicaragua.

It is difficult to see how many of these projects “bring a better quality of life to populations that lack the health, the education, or even the access to life's basic necessities that enable them to contribute to—or benefit from—economic growth.” We believe that OPIC's rechartering can not be justified without major changes in its charter to ensure it does a much better job of fulfilling its development mandate.

### ***B. Controversial OPIC projects—What has OPIC learned?***

A number of recent OPIC-supported projects have been the subject of highly publicized international controversies involving allegations of social, human rights, and environmental abuses as well as allegations of corruption and undue influence of corporate clients. These cases, such as the Indonesia Paiton thermal power plant in Indonesia, the Cuiaba pipeline running from Bolivia to Brazil, and the Sakhalin II project in the Russian Far East, have received the most prominent and credible international media attention, including front-page exposé stories highly critical of these projects in the *Wall Street Journal* and *Washington Post*. The India Enron Dabhol power plant, besides having been the subject of numerous recent news stories alleging undue influence, corruption, and possibly illegal financial misrepresentations on the part of OPIC's client

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<sup>15</sup> Part of the huge Chad-Cameroon oil development and pipeline project criticized in the June 7 *New York Times* article “Striking it Poor: Oil as Curse.” See footnote 8.

<sup>16</sup> Financial support for international five star hotel chains appears to be a constant theme for both OPIC and MIGA; in FY 2001 OPIC provided \$45.439 million to Marriott International for a ‘business/tourist hotel’ in Brazil and \$15.344 million, again to Marriott International, for a hotel in Armenia.

Enron, is also the subject of a 165-page book by the respected human rights organization Human Rights Watch. The book's title, "The Enron Corporation: Corporate Complicity in Human Rights Violations," speaks for itself. The reporters of the *Wall Street Journal*, *Washington Post*, and the researchers of Human Rights Watch have done a much more thorough analysis of the abuses in several of these projects than could be summarized in this statement. We have attached for the record articles from the *Journal*, *Post* and excerpts from the Human Rights Watch book.

In some our discussions and correspondence with OPIC management we have been surprised and disappointed at the defensive reaction of OPIC staff, who at times appear to justify the projects as environmentally, economically and socially sound decisions which only went awry because of "unforeseeable" events, for example the East Asia financial crisis in the Paiton example). In another case, described below, where there are serious environmental and social abuses caused by OPIC's client, OPIC's response is that the abuses occur in company operations not directly financed by OPIC, even though they are adjacent, and operationally linked to, OPIC financed infrastructure--yet OPIC claims it has no responsibility.

If such problems are to be avoided in the future, OPIC's screening processes for developmental impact, environment, human rights and corruption concerns need major improvements.

In the area of environmental and human rights abuses, and violations of host country law, three recent controversies involving OPIC supported projects deserve further mention. The first concerns the approval of \$350 million in loans by OPIC in February, 2002 for the construction of deep-water oil and gas production platforms, at least 40 production wells, and two 60-kilometer oil and gas pipelines for the expansion of Unocal's Indonesia East Kalimantan operations. Unocal's operations in the deeply Islamic East Kalimantan coastal region have been plagued by environmental and human rights abuses reported by Indonesian NGOs, spurring protests by over 300 local residents—from communities in a devoutly Muslim region—in October 2000. The protesters non-violently blockaded access to Unocal operations, resulting in the intervention of security forces who shot seven protesters and severely beat and injured sixteen others.

OPIC sent a due diligence team to the project area in January 2002, but claimed to find no way of ascertaining whether alleged environmental and human rights abuses had occurred. Indonesian groups are protesting OPIC's negligence of human rights and environmental abuses in UNOCAL's operations in coastal East Kalimantan. They assert that OPIC through its \$350 million support for UNOCAL's increased offshore production that is operationally linked to the UNOCAL coastal facilities has a direct responsibility to address these issues. In our view, it is particularly disturbing that OPIC has proceeded in such a fashion in coastal East Kalimantan, known for the devoutness of its Islamic population, where there are growing tensions concerning the behavior of OPIC's client in the midst of an ongoing situation of alleged human rights and environmental abuses.

OPIC's response to correspondence by Indonesian activists and ourselves is that OPIC has no authority or involvement in these abuses since its financing does not directly support the UNOCAL onshore terminal which has been the focus of protests, only expanded offshore oil and gas production and undersea pipelines which terminate in the facility:

“The impacts and incidents highlighted in your letter allegedly occurred near a UNOCAL on-shore facility that is not included within the scope of the OPIC-financed projects and pre-dated OPIC's involvement in the [East Kalimantan} West Seno projects. OPIC has no authority to influence the non-OPIC supported activities of companies that happen to use its services.”<sup>17</sup>

But that is precisely our point: In a recent meeting with OPIC management we noted that the increased off-shore production financed with over a third of billion dollars of OPIC support must flow through the on-shore facility in question, which already has been besieged by hundreds of angry local community members in the past. Violence has escalated. OPIC's entire investment may be at risk if the facility is blockaded again, or damaged or destroyed through political unrest unleashed through UNOCAL's allegedly negligent environmental and social practices. The inadequacy of OPIC screening and due diligence procedures led, we believe, OPIC to make an investment accounting for almost 30% of its 2002 portfolio dependent on a highly volatile, unstable political situation caused, in the view of local communities, by negligent environmental and social practices of OPIC's client, over which OPIC claims it has no authority or say.

We have attached for the record the exchange of our correspondence with OPIC on this issue.

The second controversy concerns the Philippine Casecan power and irrigation project, for which OPIC provided a \$100 million loan guarantee and a \$150 million insurance to California Energy in 1995. The Philippine Freedom From Debt Coalition is now urging the current Philippine government to rescind the power purchase and water use agreements associated with the project, alleging violations of various Philippine laws, undue influence and cronyism in the awarding of the contracts to OPIC's client, unmitigated adverse environmental and social impacts, excessively high power and water use fees, and corrupt practices adversely affecting the lives of local inhabitants. The recent report on the OPIC-supported Casecan Project of the Philippine Freedom from Debt Coalition is attached for the record.

The third project is the Sakhalin II off-shore oil and gas project in the Russian Far East. The waters off-shore Sakhalin Island are among the richest fisheries on the Pacific Rim, with abundant crab, herring and cod, and one of the few healthy wild salmon fisheries left in the world. It is also home to 25 marine mammal species, including 11 endangered species, most notably the world's most critically endangered gray whale, the Western

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<sup>17</sup> Harvey Himberg, Deputy Vice President Investment Policy & Director, Environmental Affairs Office of Investment Policy, letter to Mr. Bruce Rich and Ms. Stephanie Fried, Environmental Defense, April 21, 2003.

Pacific Gray Whale. Yet, Sakhalin II poses a major and unreasonable hazard through myriad impacts including construction disruption, seismic testing, potential catastrophic oil spills and ongoing discharge of production wastes into the delicate marine environment. Sakhalin II poses these risks in the absence of adherence to necessary safeguards in difficult climatic and seismic conditions (including high earthquake activity, heavy ice pack, frequent gale force storms, and fog).

Regarding the threats that Sakhalin II poses to the Western Pacific Gray Whale, the Scientific Committee of the International Whaling Commission (IWC) notes “that it is a matter of absolute urgency...to reduce various types of anthropogenic disturbances to the lowest possible level.”<sup>18</sup>

Instead, the Sakhalin II is increasing these disturbances by weakening environmental protections. On September 4, 2002, a front-page exposé in *The Wall Street Journal* documented that the Sakhalin II project utilizes much weaker environmental safeguard than those that are standard in many other places in the world, including Alaska and the North Sea. Meanwhile, oil company-funded research led to the downgrading of the area fisheries classification, clearing the way for Sakhalin II to dump drilling wastes into the seas, which had theretofore been illegal under Russian law. *The Wall Street Journal* quotes a chief Russian fisheries authority as saying, “I don’t believe we can get an objective opinion from scientists who are dependent on companies”<sup>19</sup> Opining on *The Wall Street Journal* article, a September 18, 2002 *New York Times* editorial characterized the Sakhalin II project’s view of Russia as “a cheap date.”<sup>20</sup>

Despite the project’s risks, and the cavalier attitude displayed by the project consortium’s original lead sponsor, Royal Dutch Shell, in 1997 OPIC financed Sakhalin II with \$116 million in loan guarantees. Non-Government Organizations in Russia and the US have protested OPIC support for the project, citing contradictions with U.S. foreign policy, alleging violations of the U.S. Foreign Assistance Act, the National Environmental Policy Act, OPIC’s own internal environmental policies, and violation of Russian law. OPIC continues its support for Sakhalin II, despite the fact that by the year 2000, the one remaining U.S. company in the project consortium, Marathon Oil, withdrew from the project. Sakhalin II has failed to deliver its promised development impact for Russia. According to estimates of the Auditing Chamber of the Russian Federation, due to provisions in the Production Sharing Agreement, the project sponsors will pay US\$ 19 billion less in taxes than they otherwise would have under normal Russian permitting procedures over the life of the project. Meanwhile, the Sakhalin II project contributes little in return to the U.S. Government, since it is registered in the tax haven of Bermuda.

We have attached for the record the September 4, 2002 *Wall Street Journal* article, and a short briefing paper by Pacific Environment on OPIC’s involvement in Sakhalin II.

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<sup>18</sup> Report of the Scientific Committee, International Whaling Commission, Section 10.7.5, July 22, 2001, p54.

<sup>19</sup> Jim Carlton, *The Wall Street Journal*, “Stymied in Alaska, Oil Producers Flock to a New Frontier,” September 4, 2003.

<sup>20</sup> *New York Times*, Editorial, “Risking Russia’s Fragile Coast,” September 18, 2002.

### **C. OPIC's "Development Impact Matrix"**

Earlier this year OPIC instituted a new development screen ("Development Impact Matrix"), which leaves much to be desired. Although OPIC says it is developing "a detailed guideline to these matrices to ensure consistency in scoring," we believe that the matrix in its current form will not do much to improve OPIC's record. As Jon Sohn, formerly an attorney with OPIC, now International Attorney with Friends the Earth, notes, "there are no teeth to this matrix." I would like to share with the Committee some of the major points of the analysis of the matrix of Mr. Sohn and Friends of the Earth, since we agree entirely with them. The matrix is merely a listing of a limited number of developmental impacts, with rating categories for "negative impact," "no impact," "some impact" and "strong impact." There is no indication of how many of these impacts must be positive versus negative for an investment to go forward. There appears to be no bottom line. Moreover, there are few objective, measurable criteria for these determinations. The impacts and criteria are extraordinarily vague and subjective. For example one development matrix impact is whether a project "benefits a poor region." Who in OPIC makes that determination and based on what criteria?

There is a single category for "Environmental Preservation." What if a project has a very negative impact on the environment but meets other criteria in this matrix?

Moreover labor and human rights standards are not even mentioned in the matrix. Why would a development impact matrix avoid any mention of local labor and human rights impacts, particularly when OPIC has statutory obligations in these areas? And then there is the question of what happens if the on the ground implementation of a project does not correspond to the evaluation of the matrix. Will OPIC view this as a breach of contract, with possible sanctions, including canceling its insurance or loans?

Finally, we understand that project specific data and the findings of that data after being run through the OPIC matrix will not be available to the public. This makes little sense from a policy perspective: First, if OPIC claims it is doing a better job of meeting its development mandate, than that information should be available to U.S. taxpayers and the Congress. Second, OPIC clients would benefit in terms of reputational risk from transparency on the positive development impacts of their investments; lack of transparency in controversial projects fuels uncertainty, conflicting claims, and potential litigation under the Freedom of Information Act. Third, OPIC management took a similar stance originally concerning public release of environmental assessments prior to project approval, resulting in public resentment and controversy, Congressional inquiries etc., but later, to the benefit of its own corporate reputation, opted for more transparency. While OPIC cannot force clients to release information in the development matrix, it can require the signing of a waiver on development impact data as a condition of project approval, just as it now already does for environmental assessments.

Thus, it is essential that the current OPIC development matrix should be publicly disclosed and improved through a public consultation process, including a public comment process via the Federal Register.

#### ***D. Enron and El Paso***

We believe that some of the environmental, worker and human rights, and corruption issues that appear to be present in too many OPIC projects may be a consequence of OPIC having been, to some extent, “captured” by some of its most powerful clients over the past decade. The May 6, 2002 front page expose of the OPIC supported Enron Cuiaba Brazil-Bolivia pipeline (for which OPIC approved \$200 million in loans in 1999) in the *Washington Post* makes this allegation: “Enron Pipeline Leaves Scar on South America: Lobbying, U.S. loans put Project on Damaging Past.”<sup>21</sup> According to the *Post*,

“The pipeline...and its service roads have opened the [Chiquitano] forest to the kind of damage environmental groups had predicted: Poachers travel service roads to log old-growth trees. Hunters prey on wild game and cattle graze illegally. An abandoned gold mine reopened and its workers camp along the pipeline right-of-way.

“Perhaps most stunning, however, to many federal employees who reviewed the project, was how Enron persuaded a U.S. agency, the Overseas Private Investment Corp., to support the pipeline, even though the agency was charged with protecting sensitive forests such as the Chiquitano.

*“It shouldn’t have been done,” said Mike Colby, a former Treasury Department senior environmental advisor and now a corporate consultant. ‘The forest has already been declared by the World Bank...one of the two most valuable forests in Latin America. And OPIC chose to ignore that. They were so driven to reach these unsupportable conclusions because they wanted to finance the project at all costs.’”<sup>22</sup>*

OPIC did withdraw its approval for loans to the pipeline in December, 2001, but its initial involvement and financial commitment at critical stages of the project helped promote and accelerate an undertaking that violated basic standards of international good environmental practice. The OPIC-supported Enron Dabhol gas fired power plant in India is another example, where a huge OPIC-supported (\$391.8 million in insurance approved in 1994 and 1999) Enron project involved major human rights and corruption abuses—in fact the Dabhol project is the only case in the more than thirty year history of the Foreign Corrupt Practices Act that OPIC has felt prompted to report to the Justice Department.<sup>23</sup> Besides these abuses, the project was a development albatross for India:

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<sup>21</sup> James V. Grimaldi, “Enron Pipeline Leaves Scar on South America: Lobbying, U.S. loans put Project on Damaging Past,” *Washington Post*, May 6, 2002, p. A1.

<sup>22</sup> *Ibid*, emphasis added.

<sup>23</sup> Theodore H. Moran, **Reforming OPIC for the 21<sup>st</sup> Century**, p. 11.

The World Bank advised against it, arguing that the plant would only add to excessive base-load capacity at excessive prices.<sup>24</sup>

Overall, according to research of the Institute for Policy Studies, OPIC provided some \$2.6 billion in loans and insurance for 14 Enron-related fossil-fuel projects between 1992 and the end of 2001.<sup>25</sup> This represents a very substantial proportion of OPIC's total commitments in that nine-year period, probably more than 15%.

El Paso Energy has been another major beneficiary of OPIC largesse in recent years. In 2001 nearly 10% of OPIC's total new commitments were to El Paso Energy. A quick, and incomplete research survey conducted by Environmental Defense found \$793.3 million of OPIC insurance and loans for El Paso-related projects from the mid 1990s through 2002.

Enron and El Paso have been the subject of increasing international visibility for allegations—and findings—of massive fraud at home and abroad. El Paso has been found by the Federal Energy Regulatory Commission to have illegally manipulated the energy market in California and is facing billions of dollars in law suits for fraud. OPIC has invoked the influence of the U.S. Government to pressure for repayment in investment disputes in Enron's Dabhol project in India and in an OPIC-supported El Paso investment in the Dominican Republic. OPIC has maintained that the overall safety of all U.S. investment in these countries was at stake in these disputes, and it was no doubt not aware of the allegedly fraudulent practices of Enron and El Paso when it originally approved its commitments. But we question what kind of development message OPIC's aggressive backing of its clients in these cases this sends to poor countries.

In a section examining OPIC's "long-term official protection of deal structure," the study of the Institute for International Economics raises this issue, observing that "the Dabhol case raises the question of whether projects structured like this may not be simply time bombs waiting to explode."<sup>26</sup> OPIC should learn from cases such as Dabhol and the Paiton power plant in Indonesia (subject of a front page story in the *Wall Street Journal* in 1998 also alleging corruption, lack of competitive bidding, and warnings by the World Bank that the project could not be developmentally justified). It should develop more rigorous procedures concerning the conditions of the contracts of its clients with host governments, when these contracts are so one-sided that they can pose future risks of investment disputes or represent a bad deal from the development perspective of the host country.

We do not think OPIC is furthering the best long-term foreign policy and development policy interests of the U.S. if it is perceived as consistently backing its corporate clients against impoverished developing countries in investment disputes where the original

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<sup>24</sup> Ibid., p. 86.

<sup>25</sup> Sustainable Energy and Economy Network, Institute for Policy Studies, "How Public Institutions Bankrolled Enron's Globalization Game" (Washington D.C.: Institute for Policy Studies, March 22, 2002), p. 18.

<sup>26</sup> Theodore H. Moran, **Reforming OPIC for the 21<sup>st</sup> Century**, pp. 84--86.

contract provisions are, as IIE questions, so one-sided and unfair that the OPIC-backed project is a political and financial “time bomb.” It is most difficult to understand, for example, how an institution that claims its mandate is development for poorer countries can rush ahead with very large financial commitments to projects that World Bank studies advise are developmentally unsound. If rechartering OPIC means more Dabhols and Paitons, we think it cannot be justified, at least from the perspective of development policy.

#### **IV. Needed Reforms**

OPIC is in dire need of reforms to improve the developmental quality of its portfolio, and in our view its reauthorization cannot be justified without these reforms. The facile syllogism that Foreign Direct Investment (FDI) is good for development, OPIC supports FDI, and therefore OPIC is good for development is not credible. We note that IIE states that “*painstaking cost-benefit analyses of individual investment projects show that a large proportion—24 to 45 percent in some studies—actually detract from host-country output and harm host country growth.*”<sup>27</sup> These figures do not even take into account more recent, evolving studies conducted by the World Bank and others on the overall negative development impact of investments in extractive industries (oil, gas, mining) in developing countries with poor governance—i.e., most developing countries.

We note that the IIE study calls for major transparency reforms in OPIC’s environmental and worker rights procedures, making public “internal and third-party inspection results, and remediation follow-up on the OPIC Web-site,” as well as making public information on its informal negative determinations on environmentally sensitive projects.<sup>28</sup> It also calls for “commonsense protocols to monitor economic and social effects—rejecting projects that rely on heavy protection subsidy to survive, that fail to provide training and protection to indigenous workers and managers, or that have health and safety standards in the workplace considerably behind industry practices.”<sup>29</sup> We strongly endorse these recommendations as far as they go; more transparency is absolutely essential, but we do not think the IIE recommendations alone will be adequate, given OPIC’s record and portfolio. OPIC already instituted stronger environmental procedures in 1999, but implementation has been weak, in some cases, linked we believe to OPIC’s apparent overall priority of pushing through deals with powerful clients.

##### ***A. Establish an independent compliance/ombudsman mechanism***

The above-mentioned cases and other examples clearly demonstrate that OPIC is not adequately implementing its existing environmental and labor standards. We believe that part of the problem is capacity, and part political will and priority setting. The

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<sup>27</sup> Ibid., p. 50, emphasis added.

<sup>28</sup> Ibid., p.98. For example, OPIC’s environmental procedures require a third party, independent audit at least every three years for “Category A” projects requiring full environmental assessments. These audits, now as with many other reports, are kept secret. They should be made publicly available.

<sup>29</sup> Ibid., p. 51.

involvement of OPIC in projects with major environmental, labor and human rights problems would indicate that OPIC's directors and management are not becoming apprised of such problems early enough or in the due diligence process. Moreover, even when OPIC is apprised of such problems, through protests or by communications from local or international NGOs, the political will and institutional priority to act in some cases appears to be lacking.

**We recommend the establishment, within OPIC, or based within an appropriate agency of one of OPIC's US Government Board Members such as USAID, the Department of Labor, or the State Department, of an independent ombudsman's office to address independently claims of environmental, social, labor and human rights abuses in prospective and ongoing OPIC operations. Such an ombudsman would have a dedicated budget separate from general management resources, would not be subject to direct control or replacement by OPIC management, and would report directly to OPIC's directors. One model for such an ombudsman function would be the IFC/MIGA Compliance Advisor Ombudsman in the World Bank Group. The Japanese Bank for International Cooperation, the Japanese Export Credit Agency, has recently implemented a useful model. This position would advise agency staff on compliance issues and also serve as a mechanism for non-governmental organizations and local communities concerned with the impacts of OPIC projects. Canada's EDC has established an independent mechanism too.**

OPIC has resisted this suggested, and the IIE study, while recognizing the need for "making a greater effort to inform locally affected people about projects under consideration and seeking input from them"<sup>30</sup> raises concerns about adding another bureaucratic layer "of investigation, delay, and uncertainty." This characterization of the Ombudsman function is a mischaracterization in our view. The Ombudsman's position would not be another bureaucratic layer; it would be a last resort for local communities, NGOs and other affected constituencies to call upon when there is evidence that OPIC is not carrying out adequately its own environmental and workers' rights policies—for which we believe there is ample evidence over the past few years.

Given the consistent pattern of OPIC involvement in controversial projects and across the board concerns of local communities and NGOs with the lack of impartiality by OPIC on sensitive matters, this instrument is absolutely necessary and should be incorporated into OPIC's charter.

***B. Statutory strengthening of Environmental Policy in the areas: of 1. tropical forests, 2. implementing the recommendations of the World Commission on Dams, and 3. accounting for, and reducing greenhouse gas emissions.***

***1. Strengthen categorical prohibition against projects in primary tropical forests***

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<sup>30</sup> Ibid., p. 73.

OPIC has a categorical prohibition against financing projects in primary tropical forests. However, the agency's approval of the controversial Cuiaba pipeline project in Bolivia show that the policy, and OPIC's implementation of it, need strengthening. Unfortunately, OPIC is currently considering backtracking from its existing policy, and implementing a weaker standard that falls short of the clear prohibition on projects in primary tropical forests. Congress should strengthen, not weaken, OPIC's policy by prohibiting the agency from supporting extractive or infrastructure projects in critical natural habitats and this determination must be based on transparent, objective criteria and processes via statute. Current OPIC drafts of a revised policy lack such objective standards. NGO staff are available to committee staff to provide more detail on this matter. World Wildlife Fund scientists are available to brief you on the technical aspects of this proposal.

2. *Implement the findings of the World Commission on Dams (WCD)*

The World Commission on Dams (WCD) was a multi-stakeholder process sponsored by the World Bank and World Conservation Union that incorporated input from industry, governments and NGOs, and whose recommendations provide international good practices for dam construction. OPIC has committed to adopting and implementing those WCD guidelines "that are within OPIC's capacity to implement". While this is positive, "within OPIC's capacity to implement" is too vague and can be subject to differing and conflicting interpretations. OPIC should adopt the WCD recommendations without ambiguity, in particular the requirement for prior informed consent of local communities. Combined with the agency's current dam policies, this would reduce the long-term social and political risks of OPIC's investment in dams. OPIC's current prohibitions concerning dam construction and a reference to WCD guidelines should both be placed in statute.

3. *Develop a plan to account for and reduce greenhouse gas emissions*

We note that one of the reasons for the U.S. not ratifying the Kyoto Protocol is that it requires no emissions reductions by the newly industrializing countries that will be responsible for the greatest growth of greenhouse gas emissions in the future. OPIC currently accounts for greenhouse gas emissions from power plants it finances on an annual basis. This methodology distorts the long-term emissions that result from oil and gas extraction projects the agency supports: for example, the emissions that result from a pipeline project after the oil is exported and consumed in the United States. Congress should require OPIC to account for these projects, where fossil fuels are exported to countries including the U.S. for consumption and subsequent emissions. There should be a declining cap placed on such emissions.

In addition, Congress should require OPIC to establish a schedule for increasing its support of clean energy projects, that mandates an increasing percentage of the agency's energy portfolio be directed toward energy efficiency and renewable energy. The arguments for such a mandate are all the stronger given increasingly volume of studies and information on the poor developmental record of large fossil fuel projects.

***C. Increase selectivity and transparency for large-scale fossil fuel and mining projects***

OPIC's support for large-scale oil and gas and extractive projects is particularly subject to scrutiny and skepticism concerning their positive development impacts. If OPIC wishes to improve its reputation as an agency promoting development, **a. it should seek to limit its support for such operations, and be much more selective in the projects it does support. OPIC should a priori refuse to fund projects where framework agreements and/or contracts between project sponsors and host country governments override environmental and social laws in those countries.** The World Bank itself has recognized that the development record of such oil, gas and extractive projects in developing countries is particularly poor.

In the words of George Soros, in a June 13 *Financial Times* editorial, "though blessed with valuable minerals such as oil, diamonds and gold, the ordinary people of Angola, Nigeria, Kazakhstan, and elsewhere, are mired in poverty while corrupt officials prosper.... There is a close connection between the exploitation of natural resources and the prevalence of corrupt and oppressive regimes." Soros cites a number of countries where OPIC operates and of corporations accused of abuses, including some OPIC clients. The situation is particularly acute in Africa and Central Asia. We support his affirmation that multinational corporations "cannot escape responsibility for what happens in the countries in which they operate," and, we would add, neither can official agencies that offer them support, such as OPIC.

By increasing transparency around its investments in fossil fuel and mining projects, OPIC can help ensure that governments are held accountable for their management of resource related funds.

We also urge OPIC to adopt as policy the recommendation that Soros, more than 30 international NGOs have recently put forth, now endorsed by the government of the United Kingdom and Tony Blair, that **b. all corporations involved in oil, gas and natural resource extraction projects in developing countries be required to make public disclosure of taxes, fees, royalties and other payments to governments. Making this information public for investments seeking OPIC support should be a condition for an OPIC commitment.** The companies already gather this information, and its public disclosure would be an important first step in fighting large-scale corruption and misappropriation of funds in host developing countries. We also believe that **c. OPIC should require its clients in extractive industry sectors to make production sharing, profit sharing, power purchase and other agreements between them and host governments transparent and subject to public consultation.**<sup>31</sup> These agreements greatly influence many of the environmental and developmental impacts of projects, and the development trajectory of many countries, and it is therefore incumbent

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<sup>31</sup> See *Caspian Oil Windfalls: Who Will Benefit*, Open Society Institute, Central Eurasia Project, 2003, for related recommendations.

upon OPIC to include them in its exchange of project information and discussion with civil society. OPIC should publish this information for each project on its website.

***D. Establish New Measures to Fight Corruption***

According to the World Bank, there are few things that undermine sustainable development more drastically than corruption and poor governance. According to Transparency International, the problem of corruption is endemic in much private direct investment and export finance in developing countries. According to a 1997 research paper by Shang-Jin Wei of Harvard University American investors are not “necessarily more adverse” to corruption in host countries “than average OECD investors...in spite of the US Foreign Corrupt Practices Act.”<sup>32</sup> The IIE report observes the following:

“In the more than 25 years since FCPA’s enactment, OPIC has taken this route [reporting a case of alleged corruption to the Justice Department] just once—in the Dabhol case in India in 2002. **Give the frequency with which allegations of corruption, favoritism and financial wrongdoing have been associated with projects in the sectors where much of OPIC’s business has historically occurred—especially mining projects, oil and gas projects, and energy infrastructure—it would seem entirely appropriate for OPIC to adopt procedures that are much more attentive to the possibility of malfeasance and place a lower threshold for turning cases over to the Department of Justice in the future than it has in the past.**”<sup>33</sup>

We agree.

We believe OPIC should adopt the following seven measures to more rigorously address potential corruption by clients or in the investments it supports. Measures two through seven reiterate the recommendations of Transparency International for publicly support export credit agencies and investment insurers.

First, OPIC should document in its Annual Report how for its clients it is monitoring and ensuring adherence to the Foreign Corrupt Practices Act; as IIE indicates, the threshold for reporting cases to the Department of Justice should be lower.

Second, every applicant for OPIC cover should be required to submit a no-bribery affidavit.

Third, if there is a bona-fide charge of bribery or any suspicion, OPIC should investigate and, while doing so, suspend all claims under this cover until the suspicion has been removed.

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<sup>32</sup> Shang-Jin Wei, Harvard University and NBER, “How Taxing is Corruption on International Investors,” paper delivered at Eighth International Anti-Corruption Conference, Lima, Peru, September, 1997, [http://www.transparency.org/iacc/8th\\_iacc/papers/jinwei.html](http://www.transparency.org/iacc/8th_iacc/papers/jinwei.html), Abstract, p. 1.

<sup>33</sup> Theodore H. Moran, **Reforming OPIC for the 21<sup>st</sup> Century**, p. 75.

Fourth, OPIC should introduce effective sanctions against applicants who have violated the no-bribery policy, including denial of indemnification on the ground of invalidity of the bribe-tainted contract, disqualification from access to ECA support for an appropriate period of time, and forfeiture of any fees already paid. A violation should be assumed not only, when a criminal conviction has occurred, but also when an explicit confession has been made or when convincing evidence for the violation exists and the violation is not convincingly contested.

Fifth, whenever an indemnification case arises, the company covered should be required to disclose all commissions, fees or other payments made by it or on its behalf to anyone in connection with the contract.

Sixth, OPIC should develop effective information and guidelines for its customers and its staff so as to assure full knowledge of its corruption policies and practices among its customers and staff. This includes clear information to all applicants about the consequences of bribery.

Seventh, OPIC should assure transparency and publish cases of confirmed violations and denials of cover or indemnification, through the Internet and its Annual Report.

***E. Call on GAO to review Enron and other problematic investments***

We have detailed in this statement OPIC's involvement in a number of financially, environmentally and socially risky investments; two of the most problematic, the Dabhol and Cuiaba projects, were with the Enron Corporation. We have also noted the remarkably high level of financial support over the better part of the past decade of OPIC to certain clients such as Enron and El Paso Energy, accounting for a significant part of OPIC commitments in recent years. In some cases OPIC either cancelled these loans or one case, referred the project for review at the Department of Justice. In other cases OPIC has intervened on the side of Enron and El Paso in investment disputes with host countries. As part of OPIC's reauthorization, Congress should call on the GAO to conduct a systematic review of the agency's support for Enron, and other large clients such as El Paso, with a goal of incorporating lessons learned into future lending practices, addressing issues raised in our testimony, the IIE report, and other sources. The review should provide oversight on other non-Enron investments that have been the source of controversy including the UNOCAL West Seno Project in Indonesia, the Sakhalin II Project in Russia and the Paiton Power Plant in Indonesia.

**V. Conclusion—OPIC's Reauthorization is Not Justified Without Major Reforms**

Both the World Bank and IIE have found that private direct investment in developing countries is in many cases **not** economically and socially beneficial for the host nation. In many developing countries large-scale extractive projects in the petroleum and mining sectors have left little long-term social and economic benefit, but have wrought

environmental and social damage that has economically and politically destabilized whole regions.<sup>34</sup> That over 57% of OPIC's 2002 new commitments went for such projects is, from a developmental perspective, disturbing.

There is an urgent need for greater selectivity in OPIC's choice of investment projects, not an indiscriminate broadening and expansion of OPIC clients and activities. We agree with IIE's call for both much greater public transparency in OPIC's environmental and workers' rights procedures and reporting, making public internal and third party inspection, audit and remediation follow-up reports. We also agree with IIE's finding that "OPIC must redirect and expand its monitoring protocols to focus on this broader array of effects, both positive and negative (questions of human rights, workers rights, environmental practices and anticorruption provisions)." But this second recommendation is vague, and given OPIC's record and portfolio, without stronger statutory measures there is not much likelihood that OPIC will adequately fulfill its development mandate.

We therefore urge the Congress to act on, and incorporate into OPIC's charter, the major needed reforms identified above. Only greater selectivity and demonstrated development effectiveness will garner wider political support for OPIC among constituencies other than the companies and financial institutions that benefit directly from OPIC financial services.

Without major reforms OPIC's reauthorization cannot be justified, in our view, from a development policy perspective.

Thank you very much for your consideration of these observations and suggestions.

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<sup>34</sup> To cite one more widely respected study documenting the widespread developmental failure of oil and gas development projects in poorer countries, see the work of Stanford Professor Terry Lynn Karl, **The Paradox of Plenty: Oil Booms and Petro-States** (University of California, 1997).