

International Environmental and Development Financing

Stephan Schmidheiny Address to

Eminent Person's Meeting on Financing Global Environment and Development

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It is a great pleasure and a great honour to be asked to address such a distinguished gathering. I hope that I shall be able to make a meaningful contribution to the deliberations of the "Eminent Persons".

I am given confidence by the fact that I represent here today the 47 eminent business leaders who joined me in the Business Council for Sustainable Development and who helped draft our report to the UN Conference on Environment and Development - a report which will be published in a few weeks in several languages under the title Changing Course.

Maurice Strong asked me in mid-1990 to serve as his principal advisor for business and industry, with the specific tasks of presenting a global business perspective on sustainable development and in interesting business leaders in the concept. I invited chief executive officers and board chairmen from all regions of the world to help in this assignment. When I speak to you today, I am offering my own opinion, but it is an opinion formed by 18 months of consultations with some of the best business minds in the world. We covered a wide range of topics within the framework of sustainable development: market signals, trade, capital markets, energy, aid, development, and the responsibilities and very positive opportunities for business, to name a few.

We are agreed that sustainable development will require massive financing in all parts of the world. Such sums can only come from economic growth, savings and wise investment at the national and international level.

We are also agreed that many developing countries do not now have the capacity to generate sufficient funds to manage effectively their environmental resources, while at the same time lifting people out of poverty and providing for rapidly growing populations. Thus there is a legitimate need for increased development assistance for these countries. But the reality is that it may be some time before the donor countries understand the extent to which increased - and more wisely spent - development assistance improves their own security and expands their potential export markets. Another reality is that so much of our aid spending has been wasted on projects that have borne no or little return. Increased aid would be a disaster unless the nature of aid is first changed radically and it becomes clearly designed to reinforce investments of developing countries towards sustainable development goals.

Thus developing nations will want to take immediate steps to generate new funds for development by creating new policy frameworks, in particular new legal and institutional frameworks to strengthen the private sector.

I am not offering you theory, but possibilities for real growth. Look at Latin America. Net capital inflows into that region rose from \$9.6 billion in 1989 to \$18.4 billion in 1990, and then doubled again in 1991 to \$36 billion. This sharp upward trend continues in 1992. Such growth was achieved by new policy frameworks which created the promise of economic recovery; this attracted foreign direct investment and encouraged the return of flight capital. Policies included - varying from country to country - the elimination of most ownership restrictions on properties and other forms of deregulation, privatization, and the elimination of trade and tariff barriers.

Given the right signals and support, business will seek out long-term partnerships with foreign companies having similar interests, for in this way is competitiveness transferred across borders. And developing country governments will focus on capacity building to make all of the above happen faster and more efficiently.

But governments - in both industrial and developing nations - must clearly understand that business can be a force for sustainable development only where it is allowed to act as business, is not saddled with public sector chores, is not expected to operate on concessional terms, and is encouraged to internalize environmental costs.

We cannot avoid the issue of increased funding and new forms of funding. But from what I have said it should be obvious that we must first put in place the right policy frameworks - or much of any new money will be wasted. Many of the problems identified in Agenda 21 stem not from lack of money but from flaws in existing policies which have guided existing funds in the wrong directions. Reform is a precondition for the effective use of funds.

From a business perspective, the key areas of policy reform include the need to open up markets to encourage enterprise and competition and the technological innovation which accompanies both. Distorting market rigidities, which discourage innovation, must be eliminated.

Environmental costs must be internalised within market structures, generally along the lines of the "Polluter Pays Principle", which has long been policy, although randomly enforced policy, in the OECD nations. Our Council members were supportive of this principle, as it gives environmental resource management a market logic. Governments will want to establish an optimal mix of regulation, self regulation and market signals to improve the market's ability to reflect environmental, as well as economic, truth.

Subsidies and policies which actually encourage inefficient resource use must be eliminated. These include such things as **subsidised water, subsidised energy, and subsidised logging**. The World **Bank estimates that energy subsidies in the** developing world are the equivalent of 140 billion dollars yearly - considerably more than twice as much as annual overseas development assistance. This is a perverse policy from any sustainable development perspective.

Property rights must be clarified and made available to small farmers in a straightforward and streamlined manner. Clear property rights were also a key ingredient in Zimbabwe's maize miracle in the early 1980s. Clear titles have helped make the small farms of Indonesia and Thailand so productive.

There are policy reform chores - major ones - which must be done in partnership. I am thinking particularly of more open trade based on GATT rules which allow access to markets. Correct frameworks in both industrial and developing nations will encourage increased capital flows and more equity investment. To keep environmental regulations from becoming non-tariff barriers to trade, these regulations must be internationally harmonised - always allowing for the different needs and abilities of developing countries.

This is an ambitious agenda for governments, but these policy reforms are the only way of assuring the effective deployment of the considerable resources of the private sector to support sustainable development. And this deployment, based on more equity financing and happening within agreed framework policies that encourage efficient resource use and innovation, offers the best opportunity to achieve both the environment and development goals agreed to at UNCED. Thus the funding issue must be linked to the concept of an increased role - and increased responsibilities -for the private sector, and new forms of partnership between the public and the private sector.

As I emphasise policy reform, some of you may assume you are listening to a typical businessman trying to avoid increased public investment. That is NOT the case. But I AM trying to view the problem from a business perspective. When a company's investments have not been bearing reasonable returns, the officers of that company do not first seek to increase the amounts invested. They first analyze the problems. They set priorities for change, so that new money will be spent effectively. One cannot agree an agenda without first setting priorities. one cannot develop an investment strategy without first setting priorities. The sad truth is that our governments have yet to agree priorities or to seriously address the demonstrated ineffectiveness of so much of aid and other flows over the past 20 years.

To name only one type of investment, the record of overseas development assistance is so mixed that reasonable argument continues over whether it actually does more good than harm. It is a tangle of hidden and not so hidden agendas, such as the selling of industrial country products through "tied aid", the **inefficient dumping** of large amounts of agricultural surpluses, and the furthering of relatively short-term foreign policy objectives. Surely aid policies must change before it is reasonable to call for more aid. But once policies do change, then by all means there must be greater flows - private and public -from the industrial to the developed nations.

The policies of the World Bank, which is increasingly demanding it eco-efficiency" in the projects in which it invests, also need further examination and fine tuning. But then so do the policies of the commercial banks.

The question of banks raises the whole question of reform of capital markets, to which we devoted a chapter in our report. We have basically concluded these markets need little reform, at least until we have seen the effect of other reforms. For example, the internalisation of environmental costs will make eco-efficient companies even more competitive, and thus more valuable on the capital markets. Also, laws on financial liability for pollution are tougher now than ever before. Banks must now assess the ecoefficiency of companies in assessing their long-term credit worthiness.

Insurance companies are becoming more aware of companies' environmental liabilities. They are also becoming aware of the damage caused by unsustainable development, as climate change may make natural disasters such as floods, storms and droughts more frequent and more severe. Given the roles of banks and insurance companies in the capital markets, eco-efficient companies will become ever more highly valued on the capital markets.