

# Conflict-Sensitive Project Finance: Better Lending Practice in Conflict-Prone States

September 2006



## **About International Alert**

International Alert is an independent peacebuilding organisation working in over 20 countries and territories around the world. Our dual approach involves working directly with people affected by violent conflict as well as at government, EU and UN levels to shape both policy and practice in building sustainable peace. Our regional work is based in the African Great Lakes, West Africa, the Caucasus, the Andean region of South America, Sri Lanka, Nepal and the Philippines. At both regional and international levels, our thematic work focuses on the role of business, humanitarian aid and development, gender, security and post-conflict reconstruction in the context of building peace.

International Alert is grateful for the support of our core donors: Irish Aid (Department of Foreign Affairs Ireland); Danida (Danish International Development Agency); DFID (UK Department for International Development); Ministry for Foreign Affairs of Finland; the Netherlands Ministry of Foreign Affairs; Sida (Swedish International Development Cooperation Agency); and SDC (Swiss Agency for Development and Cooperation).

© International Alert 2006

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without full attribution.

Layout by D. R. Ink, [info@d-r-ink.com](mailto:info@d-r-ink.com)

Printed by Jason Print and Design

Front cover images: Clockwise, from top: Trader at her desk © REX Images; pipeline © International Alert; Workers demonstration © G.M.B. Akash/Panos; Executives around world map table © Dennis O'Clair/Getty.

# Conflict-Sensitive Project Finance: Better Lending Practice in Conflict-Prone States

## Acknowledgements

This briefing paper is based on a longer study published by International Alert in January 2006, authored by Jessica Banfield and Corene Crossin. It forms part of a broad programme of research and field activities aimed at promoting a positive role for the economy and business in conflict zones (see [www.international-alert.org/our\\_work/themes/business.php](http://www.international-alert.org/our_work/themes/business.php)). International Alert is grateful to the many individuals within various financial institutions, NGOs and research organisations who took the time to talk over the analysis and to provide written feedback on earlier drafts of this paper, as well as those who attended a policy seminar on conflict-sensitive project finance in London in February 2006. Special thanks go to Michelle Chan-Fisher at Friends of the Earth for her written contribution (Annex 2), and Darren Spain who helped with drafting of this final version.

This work has been funded by the UK Department for International Development, the Germany Ministry for Development Co-operation and the Swiss Department of Foreign Affairs.

## Contents

1.	<b>Introduction</b>	<b>3</b>
	<b>Box 1: Costs of conflict</b>	4
2.	<b>Understanding conflict</b>	<b>5</b>
	<b>Box 2: Key terms</b>	5
2.1	Causes and triggers	6
	<b>Box 3: Causes of conflict</b>	6
3.	<b>Project finance and conflict</b>	<b>7</b>
	<b>Box 4: Conflict risk in Guatemala – the Marlin gold project</b>	8
4.	<b>Conflict-sensitive project finance</b>	<b>9</b>
4.1	Conflict risk and impact assessment	9
	<b>Figure 1: Conflict-risk analysis and mitigation strategy</b>	10
4.2	‘No-go’ criteria	11
	<b>Box 5: Legal risk to companies in conflict-prone states</b>	11
4.3	Improved conflict-risk management by project sponsors	12
4.4	Policy coherence	12
4.5	Strengthened regulatory environment	13
Annex 1	Limitations in current risk assessment and management practice	14
Annex 2	Financial services and conflict	17
	Endnotes	19
	References	22

# 1. Introduction

Violent conflict presents a serious challenge for businesses operating abroad. A large body of evidence shows that investments in conflict-prone countries, and the interaction with the dynamics of violent conflict at local and national levels that frequently follows, often lead to operational, reputational and even legal costs.<sup>1</sup>

Political risk analysis and environmental and social impact (ESIA) standards as well as other approaches to managing risk have been evolving since the 1980s, complemented by increasingly sophisticated understandings of the appropriate relationship between business and host societies, and of ‘corporate social responsibility’ (CSR). Despite this, understanding of the interrelationship between particular investments and violent conflict has been limited.

Annex 1 provides a fuller discussion of the limitations inherent in current practice. Major gaps exist in:

- Capacity to understand accurately any existing or potential conflict in a country, its actors and their perspectives, and its causes and consequences.
- Ability to appreciate the spectrum of influence that an investment can have on such conflict, directly, indirectly and at varying levels.

Conflict risk – defined as the risk that a project’s development, construction or operations may impact negatively on and be negatively impacted by violent conflict – poses a major threat to an investment’s creditworthiness and viability. Demonstrations and blockades by local communities; sabotage of project installations or facilities; kidnapping or assault of staff; outbreak of violent clashes between armed groups; demands of payments by armed groups to project sponsors – all of these can impose direct costs on an investment.

At the same time, no project located in a conflict-prone area will be neutral in terms of its own impact on conflict. The interaction between a company investment and conflict is best understood as a two-way process: just as a project may be adversely affected by violent conflict at local or national levels, the project itself will have an impact on the conflict context within which it is located. Even where conflict appears to be geographically far from a project, the investment may become part of the conflict dynamic. If a government is party to a conflict, for instance, then payment of taxes, royalties, or profit-sharing with the government (if it is a partner) can be seen to support the state by boosting its access to resources to continue the conflict. The business’s mere presence can attract attention of warring parties, representing an influx of resources to an otherwise isolated region, stirring ambitions for autonomy or independence. And the business may become a source of heightened competition locally.<sup>2</sup>

Decisions that project sponsors take regarding project location, design and management have the potential to impact and affect the severity and dynamic of the conflict. The way the company operates – in recruiting staff and distributing employment opportunities and community benefits, arranging security, interacting with political actors – has an impact. Each of these actions can, and often have, provided the trigger which may spark violence, due to pre-existing structural causes and proximate conflict factors. Understanding pre-existing tensions, and how a project may impact upon them, is thus central and fundamental to improved management of conflict risk. Yet while companies are increasingly aware of the conflict-related costs that can accrue to them, the impact of project activities themselves on conflict dynamics remains only partially understood.

Direct costs clearly affect the project's viability; indirect costs also have an impact, and banks supporting controversial projects may themselves face reputational risks.<sup>3</sup>

### Box 1: Costs of conflict

<b>Direct costs</b>	
Security	Higher payments to state/private security firms; staff/contractor time spent on security management
Risk management	Insurance, loss of coverage, reduced mobility and higher transport costs
Material	Destruction of property or infrastructure
Opportunity	Disruption of production, delays on imports
Personnel	Kidnapping, killing and injury; recruitment difficulties; higher wages to offset risk
Reputation	Consumer campaigns, risk-rating, share-price, competitive loss
Litigation	Expensive and damaging law suits
<b>Indirect costs</b>	
Human	Loss of life, health, intellectual and physical capacity
Social	Weakening of social, political and economic capital
Economic	Damage to financial and physical infrastructure, loss of markets
Environment	Pollution, degradation, resource depletion
Political	Weakening of institutions, rule of law, governance

Some companies have actively engaged in the debate on business and conflict, which has climbed international policy agendas over the past decade. This is particularly true of companies in the extractive industries, who have participated in multi-stakeholder processes such as the Kimberley Process Certification Scheme<sup>4</sup>, the Extractive Industry Transparency Initiative (EITI)<sup>5</sup> and the Voluntary Principles on Security and Human Rights (VPs)<sup>6</sup> in order to seek out shared solutions to problems. To date, the financial sector has had limited involvement in these discussions and processes, although several leading banks have adopted the Equator Principles,<sup>7</sup> and the UN Global Compact has had a special focus on finance.<sup>8</sup>

Large-scale investment to build infrastructure, construct dams, or prospect for oil, gas of mineral resources is made possible because lenders, insurers and promoters come together and pool risks. The field of project finance is therefore well-placed to develop new and innovative approaches to assessing and managing risks associated with major investments in conflict-prone countries.

This briefing paper proposes better lending practice in conflict-prone states – defined as ‘conflict-sensitive’ project finance – is in the interests of all stakeholders. Such an approach would enable financial institutions to:

- Understand the conflict context in which a project is developed
- Recognise the two-way process that characterises the interaction between investments and conflict and assess the impact between the project activities and the conflict context
- Mitigate negative impacts that may result from such an interaction
- Harness opportunities to encourage project sponsors to contribute to a more secure operating environment

A conflict-sensitive approach to lending and insuring can provide project sponsors and investors with increased confidence that cash flow, reputation and relations with host countries and other actors will not be negatively affected by violent conflict. In turn, this approach may also assist multilateral development banks (MDBs) and others to improve their track record of supporting

those projects that further developmental goals, as well as projects which ‘do no harm’ and contribute to the building of peace.

## 2. Understanding conflict

Conflict occurs when two or more parties believe their interests to be incompatible, express hostile attitudes, or take actions that damage the other’s ability to pursue its interest. Non-violent conflict is essential to social change and development, and a necessary component of human interaction. Conflict becomes violent when parties no longer seek to attain their goals peacefully, but instead resort to violent means. That signifies a profound breakdown in social relationships with destructive, long-term and far-reaching effects.

Since the end of the Cold War, civil conflict has been a persistent feature of the international political landscape. From 1990 to 1992, the number of armed conflicts rose from 56 to 68. From 1990 to 1999 there were 118 armed conflicts, 100 of which were largely, primarily or exclusively internal conflicts.<sup>9</sup> Some conflicts have ostensibly ‘ended’ with peace agreements, but the incidence of intrastate violent conflict overall has continued to increase.<sup>10</sup> Indeed, half of all countries coming out of violent conflict revert to war within five years; peace agreements do not necessarily alter the factors that led to conflict in the first place.<sup>11</sup> Since 2001 the situation has become more complicated because of the security threat posed by terrorism and the international response to acts of terror, such as the US-led military campaigns in Afghanistan and Iraq and the internationalised hardening of approaches to security. Violent conflict is more common in societies with weak institutions and chronic poverty. Of the 32 countries in the low human development section of the United Nations Development Programme Human Development Index table, 22 have experienced conflict at some point since 1990 and five of these experienced human development reversals over the decade.<sup>12</sup> Furthermore, conflict gives rise to chain reactions: a slowing economy, weak rule of law, corruption and an uncertain security setting represent powerful disincentives for investment.<sup>13</sup> Conflict can take place at the macro-level, for instance violence between two warring parties contesting the political *status quo*; or at more localised levels.

### Box 2: Key terms

**Actors** are individuals, groups or institutions who contribute to conflict; and/or are affected by conflict (in a positive or negative manner); and/or are engaged in dealing with conflict.

**Conflict-sensitivity** refers to the ability of any organisation to: understand the context in which it operates; understand the interaction between its own activities and the context; and act upon the understanding of this interaction, in order to avoid negative and maximise positive impacts.

**Context** refers to the political, economic and social operating environment, which ranges from the project level to the macro level (e.g. community, district/province, region(s), country and neighbouring countries).

**Development** refers to long-term efforts aimed at bringing improvements in the economic, political and social status, environmental stability and the quality of life of all segments of the population.

**Impacts** (positive or negative) describe an interaction in terms of its contribution to exacerbating or mitigating violence or the potential for violence.

**Peacebuilding** consists of measures designed to consolidate peaceful relations and to strengthen viable political, socio-economic and cultural institutions capable of mediating conflict, and to strengthen other mechanisms that will either create or support the necessary conditions for sustained peace.

## 2.1 Causes and triggers

Companies often view conflict as an issue that can be addressed in isolation from other issues such as human rights, the environment or sustainable development. However, conflict is a cross-cutting context – it is a violent manifestation of tensions that may have arisen for a variety of reasons (e.g. human rights abuses, environmental scarcity or degradation, unjust governance, economic insecurity).

Research institutions, international organisations and others have made attempts at modelling individual risk factors that lead to the outbreak of violent conflict. To understand conflict and how a project might interact with conflict, analysis can focus on:

1. Structural causes
2. Proximate causes
3. Triggers

### Box 3: Causes of conflict

	Description	Correlates of conflict - examples
<b>Structural/root causes</b>	Pervasive factors that have become built into the policies, structures and fabric of a society. Structural causes of conflict are inevitably the most complex and long-term but constitute an ever-present threat	<ul style="list-style-type: none"> <li>• Poor governance and corruption: related to government's responsiveness to citizens' concerns</li> <li>• Poverty: proxy for weak government and correlated with incidence of intra-state violence due to absence/ inequality in distribution of economic benefits</li> <li>• Uneven spread of ethno-nationalist groups across different regions: conflict can correlate where population distribution significantly skewed</li> </ul>
<b>Proximate causes</b>	Factors that are symptomatic of root causes and may heighten the risk of violent conflict, or exacerbate and perpetuate existing conflict. Proximate causes take on a particular importance at the local level	<ul style="list-style-type: none"> <li>• Availability of light weapons: even when easy access to weapons does not lead to conflict, it increases the risk of violence and suggests weak or corrupt security structures</li> <li>• Human rights abuses: a history of violations can leave a legacy that fuels conflict and indicates poor governance or repressive regime</li> </ul>



		<ul style="list-style-type: none"> <li>Objectives of political actors: armed groups and others may seek violent solutions to long-term historical grievances</li> </ul>
<b>Triggers</b>	Single acts, events or their anticipation that may set off or escalate violent conflict	<ul style="list-style-type: none"> <li>Elections</li> <li>Increased food scarcity</li> <li>Environmental disasters</li> <li>Security arrangements of companies</li> <li>Project resettlement and compensation policies</li> </ul>

The presence of these correlates in a particular country does not mean violent conflict is inevitable. Likewise, violent conflict may break out when these illustrative correlates are not present. However, a sound overview of a country's conflict correlates (and conflict context) can assist in understanding the overall level of conflict risk.

### 3. Project finance and conflict

Different financial services can interact with conflict in different ways – including through facilitating the enrichment of corrupt and repressive regimes; providing financial facilities for trade in weapons; and trading in ‘conflict commodities’. These are discussed in further detail in Annex 2. While these linkages suggest a comprehensive effort to address conflict across the financial services sector may be required, this briefing paper is directed specifically at the project finance industry for the following reasons:

The activities typically supported by project finance – natural resource extraction, construction of power plants, hydroelectric dams and other large-scale infrastructure projects – are often linked to violent conflict due to their strategic significance. Unless properly managed, revenues from natural resource extraction create adverse consequences for societies, according to the phenomenon known as the ‘resource curse’, which has often hastened underdevelopment or conflict.<sup>14</sup> Large projects may require resettlement of communities, or otherwise affect groups who feel neglected by their government or the project. The environmental, social and revenue ‘footprint’ is large and projects often need to protect their assets with security forces.

While the project sponsor bears the direct risks of operating in a conflict-prone region, its financiers are also exposed, given that finance is paid back based on revenue from the project, and not from the assets of its principals. Furthermore, the financier's risk increases because the loan it provides is specifically meant for the project. This means the bank can be held accountable for supporting a project that has become controversial or led to conflict. Activists and NGOs have targeted leading banks, private and public, calling on them to withdraw from financing projects they oppose, such as the Narmada dams in India, the Ilisu dam in Turkey, the Three Gorges dam in China, and the human resettlement programme in Qinghai.<sup>15</sup> Some banks have also been sued under the Alien Tort Claims Act of the US.<sup>16</sup>

Many infrastructure projects in risky environments proceed due to the diffusion of risks made possible through project finance deals, and associated aggregation of resources which helps discourage default on loans.<sup>17</sup> Often these syndicates include international lending organisations

such as IFC and EBRD or export credit agencies which provide political cover to protect the project's viability. Two major recent pipeline projects – the Baku-Tbilisi-Ceyhan pipeline and the Chad-Cameroon pipeline – were made possible because multilateral development finance institutions played an active role in providing support and seed finance. Developing country governments may also like project finance deals because they facilitate the entry of big foreign investors, delivering large-scale projects without increasing public debt.<sup>18</sup>

However, public sector lenders such as IFC or export credit agencies have the added consideration of needing to operate consistently with the wider international objectives and mandate of their institution. As they report to their board and members, which include sovereign governments, they are expected to operate within the framework of the international obligations of the member-states or wider government. They are especially likely to come under criticism where projects get caught up in conflict dynamics precisely because large projects are seen by critics to undermine the development, poverty reduction and global security concerns of many taxpayers, reflected in government policy.<sup>19</sup>

#### **Box 4: Conflict risk in Guatemala – the Marlin gold project**

From 1960 to 1996 Guatemala suffered a civil war between Mayan insurgents and the US-backed national army. It is estimated that over 200,000 people were killed or went missing during the war. Since then, the government has been criticised for a failure to uphold human rights and implement key components of the Peace Accords.<sup>20</sup> Guatemala's rural population is very poor, and the country is plagued by organised crime. The Western Highlands of Guatemala have historically seen violent clashes between the government and Mayan communities.

In June 2004 the IFC approved a US\$45 million loan in support of the US\$261 million Marlin gold project in Guatemala's Western Highlands, to be developed by Glamis Gold (via its subsidiary Montana Exploradora de Guatemala S.A), a Canadian mining company. In addition to providing the loan, IFC assisted in 'effective planning and implementation of... environmental and social programs by working closely with the company, NGOs, local municipalities, and community members'.<sup>21</sup>

In January 2005 local communities protesting against the mine clashed with security forces, resulting in one death and several injuries. Later, in March 2005, an off-duty employee of the company providing security to Glamis shot and killed one local villager. The same month, local anti-mine activists received death threats.

In February 2005 a formal complaint was lodged with IFC's Compliance Advisor Ombudsman (CAO) by a Guatemalan environmental NGO. The organisation alleged that the mine damaged the environment, that local indigenous peoples had not been adequately consulted about the mine, and that the mine's existence exacerbated social tensions, violence and insecurity.

Investigations carried out by the CAO in May 2005 led to criticism of IFC's assessment, in particular, about the government's capacity to effectively mitigate conflict and regulate the project, and insufficient meaningful consultation with local groups.<sup>22</sup>

Significantly, the CAO found that IFC and Glamis had no policy on conflict assessment and failed to take into formal consideration security concerns and the potential for local violent conflict. The report also stated: 'IFC should have considered more systematically the potential risk to human rights at the project level, should have taken appropriate measures to mitigate these risks, and should have provided clearer directives to the company with respect to both issues'.<sup>23</sup>

Conflict-related risk requires special attention from the project finance industry. At the same time, the sector is well-placed to take steps both to protect its own investments and ensure that business is not impacting negatively on those affected by violent conflict or the wider objectives of its own institutions, as will be discussed in further detail.

## 4. Conflict-sensitive project finance

As discussed above, investors have a two-way relationship with conflict. They have attempted to address conflict's impact on their own operations by developing risk analysis and mitigation processes. These however, are inadequate, as ongoing clashes between investments and violence testify, and as discussed in Annex 1. This calls for a conflict-sensitive approach to project finance that is based on recognition of the two-way process that characterises the interaction between investments and conflict dynamics, enabling investors to 'do no harm' and at the same time contribute to more secure operating environments.

This briefing paper recommends five steps toward conflict-sensitive project finance:

1. Conflict risk and impact assessment
2. 'No-go' criteria
3. Improved conflict risk management by sponsors
4. Policy coherence
5. Strengthened regulatory framework

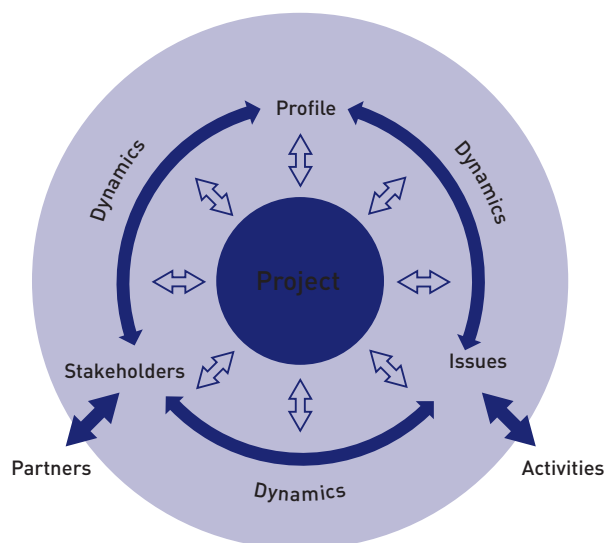
### 4.1 Conflict risk and impact assessment

The absence of violence in a project area is no guarantee for the future. Few major greenfield projects are developed in areas of actual violent conflict, precisely because of the risks entailed. More commonly, violence at the local level will follow the start of operations; or violence at the national level will soon turn to draw the project in. As major investments inevitably alter local contexts, even in relatively peaceful environments tensions may increase, leading to violence.

Project financiers should include conflict risk and impact assessment (CRIA) as part of their standard due diligence procedures. By assessing the two-way dynamics between a project and the context in which it is developed, project financiers will be in a better position to understand the nature of conflict risk that may affect a project, with far greater sophistication than is currently standard practice. Conflict risk analysis from this perspective will also enable financiers to identify particular weaknesses and strengths in a project's design and management strategy, which in turn will allow for more informed risk mitigation strategy dialogue with a project sponsor.

Enhanced due diligence that emphasises CRIA is a relatively new concept. One set of tools has been developed by International Alert and is currently being tested by leading oil, gas and mining companies – in Colombia, Nigeria and elsewhere. This methodology proposes a three-tier process of CRIA: initial screening, macro-level (M-CRIA), and project-level (P-CRIA).<sup>24</sup>

Figure 1: Conflict-risk analysis mitigation strategy



The CRIA process will identify conflict issues and promote understanding of the two-way interaction between these and the project, as well as appropriate mitigation strategies. The methodology is designed to accompany the entire life-cycle of a project, which means it should be constantly updated to reflect the changing dynamic in the external context and as the project develops. At its core, the Alert tool involves participatory analysis to draw on the perspectives of those living in affected areas, so that the analysis of the context is enriched. Alert's methodology seeks to overcome some of the shortfalls in approach and implementation of standard ESIA methodologies, and integrates a more thorough understanding of the nature of violent conflict.

The key principles guiding the approach are:

- Participatory analysis
- Enhanced communication
- Strong local relationships
- Shared decision-making

Shared decision-making processes themselves enhance transparency and act as a conflict-risk mitigation strategy, as trust will be built, fostering legitimacy and relieving tensions.

While project financiers may find the in-depth and dynamic CRIA approach not suited in every situation, aspects can be built into existing due diligence procedures in order to give a fuller and richer picture of the risk context. Lenders and insurers should conduct an initial conflict risk screening process at an early stage that can help identify key conflict risk issues facing a particular project. Sample screening questions can focus on identifying any potential correlates of conflict that exist at the local, national or regional levels.

An important aspect of enhanced due diligence by lenders would include consideration of the project sponsor's track record in addressing and managing conflict risk. This would require exploring the sponsor's past performance on social and environmental issues, particularly if the sponsor has operated in a conflict zone, and how it has dealt with security and human rights issues. A financial institution may also enquire into the project sponsors' policies on corruption, business ethics, environmental issues, and project security.<sup>25</sup>

## 4.2 'No-go' criteria

In some countries, the probability of conflict affecting a particular project may be so high that from the conflict-sensitive perspective it would be unwise for an investment to proceed. If properly conducted, the enhanced due diligence screening should alert project financiers and insurers to this possibility. Where a project is located in an area where egregious human rights abuses are widespread, or have been committed in the recent past, financiers should think very carefully and seriously before proceeding with the investment. This is because experience shows that a large-scale investment occurring in a context where such abuses are being committed is unlikely to escape involvement in the local power struggle around which abuses are occurring, whether through security forces, payment to armed groups, or use of company infrastructure and hardware for political ends on the part of conflict actors.

Proximity to egregious human rights abuses has associated legal risks that should inform no-go criteria. International humanitarian law applies to all actors, and international criminal law requires companies to comply. Non-compliance can lead not only to adverse publicity and potentially costly civil litigation, but also in some cases criminal prosecution against company executives. Indeed, a number of national jurisdictions permit criminal or civil prosecutions of business entities on certain grave breaches of international law.

### Box 5: Legal risk to companies in conflict-prone states

In conflict-prone states, the line between the state and a private investing company can become blurred. Project sponsors often end up, or are expected to, deliver services or create infrastructure that traditionally the government is meant to build or provide. The state and companies under its control are often partners of the sponsor. And companies may enter into contractual or other business relationships with state security forces.

This exposes companies operating in conflict zones to the risk of being implicated in acts state bodies commit in the conflict. In several recent instances, companies have provided practical assistance to state security forces which have then committed human rights abuses or violated international humanitarian law.<sup>26</sup> While many of the cases have involved the project's sponsors, in some cases, the financiers have also been implicated.<sup>27</sup> Some companies have provided money or resources and others have built infrastructure which the combating parties have used to commit abuses.<sup>28</sup> The relationship between the company and the state, or an armed group, cannot be considered as neutral and strictly contractual or commercial.

Even if the company has not directly committed an illegal act, and even if it has not intended for such an act to be committed, if it can be established that the company has aided, abetted, assisted, facilitated, contributed, encouraged, or provided support to such acts, then the company's officials run the risk of prosecution under international criminal law and the company may be accused of being complicit in human rights abuses if such abuses follow.<sup>29</sup> And even if the state does not prosecute the company, individual litigants can, and have, sued companies for violating their rights, particularly under tort laws such as the Alien Tort Claims Act in the US. While no company has lost a case so far, there have been 36 such cases filed against companies. These cases have adversely affected companies by generating negative publicity, imposing financial and legal costs, and making demands on management time.

As noted earlier, the chain linking a project to banks in non-recourse financed projects (such as many cases of project finance) is often direct, raising the risks significantly for the financial institution to be held accountable for the conduct of the project sponsor, if that conduct has broken the law.

International law on complicity is still evolving. Being aware of abuses taking place and doing nothing about it can also raise legal complications for a company, particularly if the abuse is a grave war crime.<sup>30</sup> Financial institutions which have extended finance to project sponsors with insufficient due diligence, or inadequate analysis of the conflict context, may be at risk. They are often at least one step removed from the risk of direct exposure, and most of the relevant cases deal with project sponsors, such as oil or mining companies. But in some cases, banks and other lending institutions have faced associated campaigns targeting them and there is nothing in the jurisprudence that would prevent a particularly egregious case coming to court. Developing no-go criteria that draw on these emerging legal norms is a key element of a conflict-sensitive approach.

### 4.3 Improved conflict risk management by project sponsors

If conflict risks and potential impacts are comprehensively assessed by financiers during due diligence, the logical next step is to identify and implement conflict risk mitigation measures appropriate for the sponsor, or to encourage them to do so. One option is for lenders to work with sponsors to ensure projects are developed and operated in a conflict-sensitive manner. This may lead to the incorporation of warranties and covenants in loan agreements such as requiring that the project sponsor has conducted a project-level risk assessment, and that the sponsor will comply with conflict-sensitive business practices (for instance, by demonstrating adherence to the Voluntary Principles on Human Rights and Security and/or by using conflict assessment tools such as those discussed above or equivalent). However, covenants and warranties are meaningful only if the lenders can monitor and assess compliance.

Lenders have leverage during the financing phase; political risk insurers have leverage while negotiating terms and while paying out claims. It is in the interest of insurers to work with sponsors to increase awareness of the two-way relationship between the project and the conflict context. In order to improve compliance, insurers could include carve-out clauses in contracts, specifying circumstances under which the provider will not pay out a claim after the outbreak of violent conflict, where the sponsor may have been responsible for escalating tensions or failing to adopt conflict risk management strategies. This would encourage sponsors to take steps to avoid conflict risk rather than potentially exacerbating conflict, and to contribute to a more stable operating environment based on an integrated analysis and mitigation framework such as that described above.

### 4.4 Policy coherence

Multilateral and regional development banks are in many cases active in conflict prevention, peacebuilding and post-conflict reconstruction. New analytical tools for designing development projects are also gaining currency, which encourages planners to address root causes of conflict. Increasingly private sector investment is being linked to development – yet policy coherence between the goals of investment promotion and conflict prevention remain ill-defined.<sup>31</sup>

The World Bank Group has come under particular scrutiny for the role IFC and MIGA have played in the support of extractive industry and other projects linked with social disruption, increased vulnerabilities, social hostility and conflict. The Extractive Industries Review (EIR) commissioned by the World Bank in 2003 recommended that the Groups' institutions mainstream human rights and support project sponsors to adopt human rights policies.<sup>32</sup> The EIR also recommended an end to bank support for extractive industry investments in countries prone to or affected by violent conflict, precisely because the developmental benefits of such investments in such conditions are so unclear. While the bank's management did not accept this recommendation, the need to tighten policy coherence across all areas of bank activity has been

highlighted by the process. Adopting conflict-sensitive lending practices could be a step in this direction.<sup>33</sup>

Export credit agencies (ECAs) also have similar responsibilities, since they are government institutions which are, as part of their overseas development assistance, often committed to peacebuilding.<sup>34</sup> Governments need to ensure that the national policy on investment promotion and trade policy are in line with the stated development and foreign policy goals of the government. At present however these arms of government tend to sit far from one another culturally and functionally, resulting in agencies such as ECAs having little linkage with wider international policy goals. The fact that some foreign ministries have begun to share country analyses with ECAs as an input to risk analysis is a small but important step in the right direction, on which adopting conflict-sensitive lending practices could build.<sup>35</sup>

## 4.5 Strengthened regulatory environment

There is no internationally agreed overarching, legal or voluntary instrument on how to conduct business in unstable states in a way that minimises conflict risk. That being so, there are several initiatives underway to close the gap in international frameworks for addressing corporate operations in conflict zones. In relation to the activities of extractive industry actors, instances include the Voluntary Principles on Security and Human Rights, and the Extractive Industry Transparency Initiative. More broadly, the work of the Special Representative to the UN Secretary General on Business and Human Rights over the next two years will focus on conflict and weak governance zones and could lead to useful further guidance and norm-setting. MDBs, ECAs and banks alike could do more to ensure that they actively promote meaningful adherence to these standards by clients, as well as existing standards such as the OECD Guidelines for Multinational Enterprises, including through monitoring implementation as part of the financial relationship.<sup>36</sup> Banks are aware of their increasing responsibilities and the Equator Principles have emerged as an important international benchmark, now adopted by 40 financial institutions, to promote higher standards in lending, bearing in mind social and environmental risks.<sup>37</sup> The principles have been revised recently to underscore best practices. In April 2006 the IFC released its policy on social and environmental sustainability, comprising eight performance standards which include key concerns on conflict and the extractive sector.<sup>38</sup>

Taken together with the increase in legal cases filed against companies discussed above, these policy developments indicate a gradual move on the part of governments, financial institutions, and civil society to create a level playing field so that there are clear benchmarks in place to guide investment decisions in conflict-prone regions. Taking a clear lead in implementing and advancing relevant standards will place project financiers in good stead for managing conflict risk in the longer term.

## Annex 1 – Limitations in current risk assessment and management practice

Financial institutions have developed advanced risk management processes to determine the risk/reward trade-off for a range of commercial and non-commercial risks. In addressing conflict, banks, ECAs and MDBs use a variety of existing techniques. For qualitative assessment of conflict risks, the preferred model is a combination of environmental and social impact assessments (ESIA), country-level risk indices and political risk analysis. While these assessments draw attention to some aspects of conflict, they fall far short of the systematic two-way conflict risk and impact assessment (CRIA) processes required.

### 1. Environmental and Social Impact Assessments (ESIAs)

Host governments and commercial and multilateral financial institutions increasingly require Environmental Impact Assessments (EIAs) before the project can go ahead. Lenders also require Social Impact Assessments (SIAs) in many cases to identify potential social risks and opportunities.

As the United Nations Environment Programme (UNEP) has observed, it is the intention of the EIA to maximise the positive impact of the project, but in reality, its practical implication is limited to preventing or minimising adverse effects.<sup>39</sup> EIA methodologies are well developed, particularly in comparison with nascent SIA techniques, but they are widely criticised. Common concerns include:

- Flawed stakeholder engagement process due to unequal power, expertise and resources
- Inadequate consideration of cumulative effects and social and health impacts and risks
- Failure to consider indirect effects on systems and communities outside of project ‘space frame’<sup>40</sup>

SIAs combine scoping studies, evaluation of significant issues, and baseline data generation, after which they attempt to predict the impact, and recommend mitigation strategies. The approaches are neither uniform, nor developed empirically. As with EIAs, SIAs’ effectiveness depends on whether the assessment is mandatory and whether the top management is committed. While SIAs’ results could guide resettlement and compensation, they are unlikely to have a wider influence in deciding whether the project should go ahead in the first place.

EIAs and SIAs depend on simple models of ‘cause and effect’ and ‘impact and mitigation’ which, experience has shown, are frequently inadequate to deal with the complexities of project-induced social change, particularly in conflict-prone areas. Understanding conflict requires meaningful stakeholder consultation and mapping, which are often absent. As ESIAs are public documents, they are less likely to contain conflict-risk related data (such as the human rights records of state security forces) that may put sponsors at risk of political recriminations.

### 2. Country risk ratings

Country risk ratings, such as those provided by Fitch, the Economist Intelligence Unit<sup>41</sup>, the Business Environment Risk Intelligence (Beri), Institutional Investor, or Moody’s Investor Services, are what banks rely on to examine economic, political, financial and social factors, but at a fairly broad level. Risk ratings are useful to gauge levels of market risk, but they are not specific about the nature of political risks particular investment or projects may face.<sup>42</sup>



## 2.1 Political risk analysis

Project sponsors in emerging markets frequently commission political risk analysis to pin-point likely threats to develop risk management strategies. These risks tend to include cronyism, organised crime and fraud, unfair competition, corruption, safety of capital employed, and poor legal standards. One major problem with traditional quantitative political risk methodologies is over-reliance on retrospective data which may not account for new dimensions. Social relationships are complex and cannot necessarily be modelled in the same way as more technical considerations.<sup>43</sup> Despite advances made by some specialist political risk consultancies, including in ability to highlight conflict risk issues facing a particular project, the approach has limitations:

- PRA reports tend not to be linked to project cash flows, and are viewed as a separate activity and not integrated in the wider risk assessment process
- The results of PRA are not linked with the prevention/mitigation strategies in the SIA
- Conflict-prone environments can change rapidly, while PRAs are static, conducted at a particular moment, and may not build in continual monitoring and revision throughout the project cycle
- PRA is used to *determine risk*, and not to *reduce risk*
- Stakeholder perceptions of risk may differ significantly from those gleaned from official sources and yet, in their desire to be ‘objective’, PRAs do not pay adequate attention to perceptions which cannot be proven

## 2.2 Political Risk Insurance (PRI)

Sponsors and lenders will frequently transfer political risk to insurers. This is often a pre-requisite for lending and the provision of credit guarantees. Political risk insurance traditionally provides cover for expropriation, currency inconvertibility, repatriation problems, and political violence (including physical damage due to politically motivated strikes, riots, civil commotion, terrorism, sabotage, war, and/or civil war). Additional coverage is also available for net profit lost, and compensates for defaults caused by political violence.<sup>44</sup>

However:

- The extent of PRI coverage is limited. PRI premiums are high, coverage capacity in the insurance market is limited, and there are restrictive terms and conditions<sup>45</sup>
- Those who offer PRI do not offer a comprehensive coverage. As seen earlier, conflict often cannot be foreseen
- PRI rarely reaches beyond the replacement value of assets to encompass cash flows<sup>46</sup>
- PRI often does not cover risks at local levels
- PRI creates a moral hazard by providing an incentive for sponsors to invest where they would not otherwise invest. In certain situations, that can accelerate conflict, if not exacerbate it. For this reason, PRI provider Multilateral Investment Guarantee Agency (MIGA) which is part of the World Bank Group has been criticised for failing to consider the interconnections between different components of political risk and assessing whether a client’s business activities will aggravate these risks<sup>47</sup>
- NGOs criticise PRI because it benefits companies which suffer losses due to conflict, but not communities

## 3. Covenants and warranties

A lender may attempt mitigating the non-commercial risks by requiring covenants and warranties so that the sponsor has an environmental management plan and community support mechanisms in place. Since covenants and warranties are confidential and deal-specific, it is difficult to draw

conclusions about their effectiveness regarding management of conflict risk. In any case, as noted earlier, compliance with best practices, while necessary, may not be sufficient to ensure that conflict risk is mitigated. Such covenants are meaningful if the compliance is monitored throughout the life-cycle of the project, but that is often not the case. And lenders lack the capacity to monitor progress themselves. The Environmental and Social Review Procedures followed by MIGA require the institution's clients to provide warranties and assurances that environmental and social issues will be managed effectively. However, as pointed out by the CAO's 2002 report *Insuring Responsible Investments*, MIGA does not systematically assess client capacity to adhere to such warranties.<sup>48</sup>

## Annex 2 – Financial services and conflict

Different financial services can interact with conflict in different ways. While this paper has focused on project finance, attention to the following is also required:

### 1. Facilitating the enrichment of corrupt and repressive regimes

- **Capital flight and money laundering:** Corrupt dictators have been able to transfer their wealth offshore only because some financial institutions or private banks facilitated the process. In 2005 US-based Riggs bank was fined US\$41 million for its failure to scrutinise suspicious transactions by former dictator Augusto Pinochet of Chile and President Obiang of Equatorial Guinea.<sup>49</sup> Such grand-scale corruption is often a correlate with human rights abuses and violent conflict.
- **Financial advice:** Banks offer financial advice to sovereign governments, but sometimes this advice is employed for dubious ends. In 1997 a Jardine Fleming banker was sacked for providing financial advisory services to the Papua New Guinea government after it was revealed that the government had sought assistance to source and finance mercenaries in an attempt to suppress a separatist uprising and stop protests against the Bougainville copper mine, operated by Rio Tinto.<sup>50</sup>
- **Sovereign loans:** Financiers provide loans to sovereign governments that may engage in human rights abuses or act aggressively in the conflict context. The best known case involves banks active in apartheid South Africa. The UK-based Barclays Bank reportedly made loans worth US\$725.4 million to the apartheid regime at a time when making such loans was legal.<sup>51</sup>
- **Sovereign bonds:** Repressive governments offer bonds to raise capital. At a time when the government of Guatemala was accused of human rights abuses and political repression, Morgan Stanley led a sovereign bond offering by the government in November 2001. Citigroup served as the bookrunner for Guatemala's US\$330 million 30-year sovereign bond issue in 2004.<sup>52</sup>
- **Financing state-owned enterprises:** In countries where revenues from natural resource extraction provide financial support to a state which is accused of repression or engaged in civil war, state-owned companies can play a key link between the financial sector and violent conflict. For example, in 1996 the Angolan state-owned oil company, Sonangol, borrowed US\$310 million from a sixteen-member international bank syndicate led by UBS. The next year UBS arranged another US\$400 million syndicated bank loan for the company. In 1997 and 1998 the Swiss company Glencore, which traded in Angolan oil, arranged a series of oil-backed loans worth US\$900m from institutions like Banque Paribas. The NGO Global Witness claims that 'much of the money from these [Glencore-arranged] loans was used to purchase weapons'.<sup>53</sup>

### 2. Providing financial facilities for the trade in weapons

- **Trade facilities:** Merchant banks provide trade finance that enables governments to import weapons, communications equipment, and other products which offer logistical support for a war. On the other side of the transaction, financiers may also support the manufacture of these items. For instance, AXA, Dexia, Fortis, ING and KBC have been linked to the financing of cluster bombs, landmines, nuclear weapons and depleted uranium weapons.<sup>54</sup>
- **Export credits and support of arms sales:** A significant proportion of European ECAs support the defence industry. While officials claim that export controls ensure that weapons are only sold to recognised sovereign governments and in line with international regulation, experience has shown that this is not always the case.<sup>55</sup>

### 3. Trading in 'conflict commodities'

- **Natural resources:** Timber, cobalt, tin, diamonds, gold and oil may generate hard currency for tyrannical regimes, civil war or violent conflict, as has been the case in countries such as Liberia and Angola. Links between international financial markets and conflict commodities are well documented, including some cases where the commodities themselves are used as a form of payment. For instance, ING, UBS and HSBC have all extended loans or revolving cash facilities to the Angolan government that were repaid in crude oil cargoes, rather than cash.<sup>56</sup> During the Sierra Leone crisis in 1999-2000, international human rights campaigners targeted ING Bank, ABN Amro Bank, and the diamond-finance banks in Antwerp, Belgium, to highlight the link between the trade in rough diamonds from parts of Africa with conflict.

## Endnotes

1. Organisations including Amnesty International, Global Witness, Oxfam, and Human Rights Watch have campaigns focusing on links between natural resource exploitation and violent conflict, as do numerous NGOs in countries affected by these issues.
2. There is a growing literature exploring this relationship. See Nelson, J. (2000) *The Business of Peace: the Private Sector as a Partner in Conflict Prevention and Resolution* (London, UK: International Alert, International Business Leaders' Forum, Council on Economic Priorities); Ballentine, K. and V. Haufler (2005) *Enabling Economies of Peace: Public Policy for Conflict-Sensitive Business* (New York: UN Global Compact); Collaborative for Development Action, Inc. *Do No Harm/Local Capacities for Peace Project*. [www.cdainc.com/dnh/](http://www.cdainc.com/dnh/); International Alert (2005) *Conflict-Sensitive Business Practice: Guidance for Extractive Industries* (London, UK: International Alert).
3. For instance, community representatives from Thailand and Malaysia have, together with international NGOs, campaigned against Barclays Bank's financial backing of the Trans Thai-Malaysia gas pipeline project. The project has been criticised for its security arrangements; it is associated with the continued use of state violence, with reports of over 500 police personnel guarding a proposed gas separation plant site.
4. Developed following UN sanctions against trade in rough diamonds sourced from Sierra Leone, Liberia and Angola, where revenue was financing rebel forces. The Kimberley Process is a tri-sector initiative which aims to break the link between conflict and trade in diamonds by requiring exporters of rough diamonds to establish a certification mechanism. The sectors involved are all nations engaged in the diamond trade, the industry, and interested NGOs. Details can be found at [www.kimberleyprocess.com](http://www.kimberleyprocess.com)
5. An initiative promoted by the UK Government, this includes governments where natural resources are found and governments where companies are located, as well as companies and civil society groups, to promote best practices to ensure that payments made by the industry to the governments are disclosed publicly. Details can be found at [www.dfid.gov.uk/News/files/extractiveindustries.asp](http://www.dfid.gov.uk/News/files/extractiveindustries.asp), and at [eitransparency.org](http://eitransparency.org)
6. A tri-sector approach promoted initially by the US and UK governments, the process includes 16 companies, four governments, and seven CSOs, and seeks to ensure that legitimate security needs of companies do not lead to human rights violations, and that the relations between companies and security forces are based on prevailing international human rights standards. Details can be found at [www.voluntaryprinciples.org](http://www.voluntaryprinciples.org)
7. A set of benchmarks agreed by leading banks to manage social and environmental impact of projects to which they lend. Details can be found at <http://www.equator-principles.com/>
8. A voluntary initiative promoted by UN Secretary-General Kofi Annan to promote responsible practices by companies, to uphold human rights, labour and environment, and to combat corruption. Details can be found at [www.unglobalcompact.org](http://www.unglobalcompact.org)
9. Smith, D. (2004) 'Trends and Causes in Armed Conflict' in Austin et. al. (eds) *Transforming Ethno-Political Conflict: The Berghof Handbook* (Berlin, Germany: Berghof Center for Constructive Conflict Management).
10. United Nations Development Programme (UNDP) (2005) *International Development at the Crossroads: Aid, Trade and Security in an Unequal World* (New York, US: UNDP).
11. Smith (2004) *op. cit.*
12. UNDP (2005) *op. cit.*
13. Asiedu, E. (2005). 'Foreign Direct Investment in Africa: The Role of Natural Resources, Market Size, Government Policy, Institutions and Political Instability' *World Institute for Economic Research (WIDER) Research Paper No. 2005/24*. UNDP (2005) *op. cit.*
14. Lynn Karl, T. (1997) *The Paradox of Plenty: Oil Booms and Petro-States* (Berkeley, US: University of California Press); Ross, M L (1999 'The Political Economy of the Resource Curse' *World Politics* 51: 325-61; International Alert (2005) *op. cit.*; Ross, M.L. (2003) 'The Natural Resource Curse: How Wealth Can Make You Poor' in Bannon, I. and P. Collier P (eds) *Natural Resources and Violent Conflict* (Washington DC, US: World Bank Group); Switzer, J. (2001) *Armed Conflict and Natural Resources: The Case of the Minerals Sector* (London, UK: IIED).
15. For example, Barclays Bank's advisory role in the Omkareshwar Dam project in India has been criticised by Friends of the Earth as the project fails to meet IFC standards in relation to indigenous people, resettlement and compensation – problems that are linked to incidences of violent conflict elsewhere (FoE (2005) briefing: Barclays and the Omkareshwar Dam). Similarly, the role of the World Bank and Asian Development Bank along with commercial banks including BNP Paribas, Societe General, Standard Chartered, ANZ, ING and others in the Nam Thuen 2 hydroelectric dam project in Laos has been criticised for flawed stakeholder engagement processes and a failure to address detrimental effects on the environment, human rights and livelihoods (Bank Information Centre (BIC) (2005) *World Bank, ADB approves Nam Theun 2 Dam project in Laos*). ECA-backed dams have been criticised for aggravating ethnic tensions in Sri Lanka and Senegal (Hildyard, N. in Ballentine, K. and H. Nitzchke (eds.) (2005) *Profiting from Peace: Managing the Resource Dimensions of Civil War* (Boulder, Colorado: Lynne Rienner)). Numerous advocacy campaigns and official complaints have been made by civil society groups in relation to ECA, IFC and EBRD involvement in projects such as the Baku-Tiblisi-Ceyhan (BTC) pipeline which runs through a region beset by a number of violent and 'frozen' conflicts in the South Caucasus.
16. The US Judiciary Act of 1789 established the federal judiciary. It included the Alien Tort Statute, now defined as the Alien Tort Claims Act, or 28 USC § 1350. The law states that the US district courts 'shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States'. Human rights lawyers have used the 'law of nations' provision to argue that US courts can hear cases against any entity to adjudicate claims of grave violations of human rights. Two prominent cases involving banks (neither of which has succeeded) have dealt with apartheid-era violations. While these have not been project-finance related cases, the charges are fairly broad. The cases have not succeeded, but that does not minimise the

- risk of lawsuits in future. See *Ntzebesa, et. al. v. Citigroup, Inc., et. al.*, 02 Civ 4712 (S.D.N.Y. 2002) and *Khulumani, et. al. v. Barclays National Bank, et. al.* Case No. 02-CV5952 (S.D.N.Y. 2002).
17. Hainz, C. and S. Kleimeier (2004) *Political Risk in Syndicated Lending: Theory and Empirical Evidence Regarding the Use of Project Finance* (Bank for International Settlements Quarterly [www.bis.org](http://www.bis.org)).
  18. In particular, project financed public-private partnerships (PPPs) are increasingly the vehicle of choice of developing country governments, particularly for large infrastructure projects. Esty Benjamin, C. (2004) *Modern Project Finance* (New York, US: John Wiley and Sons).
  19. Hildyard, N. in Ballentine, K. and H. Nitzschke (2005) *op. cit.* Worldwide Fund for Nature (WWF) (2003) *BTC Applications to IFC and EBRD for Finance: WWF Comment*. [www.wwf.org](http://www.wwf.org)
  20. Amnesty International Report (2005) *The State of the World's Human Rights* AI Index 10/001/2005. Guatemala can be found at <http://web.amnesty.org/report2005/gtm-summary-eng>
  21. International Finance Corporation (November 2004) *Montana Exploradora: Marlin Gold Project* (Washington DC, US: IFC).
  22. Compliance Advisor Ombudsman (CAO) (2005) *Media Advisory: Assessment of the Complaint on the Marlin Project in Guatemala*, 8 September 2005. [www.ifc.org/cao](http://www.ifc.org/cao)
  23. CAO *op. cit.*
  24. See International Alert (2005) *Conflict-Sensitive Business Practice: Guidance for Extractive Industries* (London, UK: International Alert).
  25. Henisz Witold, J. and B.A. Zelner (2004) 'Political Risk Management: A Strategic Perspective' in Theodore Moran (ed.) *International Political Risk Management: The Brave New World* (Washington DC, US: World Bank Group).
  26. *Wiwa v. Royal Dutch Petroleum Co., et. al.*, Case No.96 CIV 8386 (KMW) (S.D.N.Y. 2002); *Bowoto, et. al. v. Chevron, et. al.* Case No. C99-2506 (N.D. Cal. 2000); *The Presbyterian Church of Sudan, et. al. v. Talisman Energy, Inc., Case No. 01CV9882* (S.D.N.Y. 2001); *Sinaltrainal, et. al. v. Coca-Cola Co., et. al.*, Case No: 01-03208 (S.D. Fla. 2001); *Estate of Rodriguez, et. al. v. Drummond Company, Inc., et. al.* Case No. CV-02-0665-W (N.D. Ala. 2002), *Sarei et. al. v. Rio Tinto; et. al.* Case No. CV 00-11695 MMM 221 F. Supp.2d 1116 (C.D. Cal. 2002).
  27. The World Bank, for example, is a target of accusations by many civil society groups, which say its support for certain projects in conflict zones raises the risk of its complicity in abuses that follow. See <http://www.brettonwoodsproject.org/art.shtml?x=351540>. Banks are increasingly aware of their vulnerability, see Watchman, P. 'Banks, Business and Human Rights'. Available at [http://www.equator-principles.com/documents/IB\\_02.2006\\_Paul%20Watchman.pdf](http://www.equator-principles.com/documents/IB_02.2006_Paul%20Watchman.pdf).
  28. In the post-war Nuremberg trials, several German bankers were tried for financing the war effort of the Nazi-era German government. Some bankers were convicted. A detailed discussion of banks' liabilities in the context of human rights abuses can be found in Ramasastry, A. 'Banks and Human Rights: Should Swiss Banks be Liable for Lending to South Africa's Apartheid Government?' Available at <http://writ.news.findlaw.com/ramasastry/20020703.html>. Two specific cases under ATCA related to apartheid are *Khulumani, et. al. v. Barclays National Bank, et. al.* Case No. 02-CV5952 (S.D.N.Y. 2002) and *Digwamaje, et al v Bank of America et al* (02-CV-6218 (SDNY 2002).
  29. See, for example *Tadic*. <http://www.un.org/icty/tadic/trialc2/judgement/index.htm>
  30. For further information see International Alert, 'Understanding Corporate Complicity in Zones of Conflict' forthcoming; and the Business and International Crimes project at the FAFO Institute for Applied International Studies, available at <http://www.fafo.no/liabilities/index.htm>.
  31. Killick, N. (2006) 'Local Business and the Economic Dimensions of Peacebuilding' in Banfield, J., Gündüz, C., Killick, N. (eds.) *Local Business, Local Peace: the Peacebuilding Potential of the Domestic Private Sector* (London, UK: International Alert).
  32. The World Bank set up a panel of experts for a review of its operations in the extractive sector in 2000. After three years, the Extractive Industry Review published a report with several critical recommendations to the World Bank group. The report is no longer on the internet in its original form or from its publisher. Responses from the World Bank are available, at: <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTOGMC/0,,contentMDK:20605112~menuPK:336936~pagePK:148956~piPK:216618~theSitePK:336930,00.html>. A summary of its recommendations can be found at <http://www.eldis.org/static/DOC14381.htm>.
  33. Adopting a conflict-sensitive approach to project finance would also be in line with internal Bank policy on conflict: Operation Policy 2.30 on Development Cooperation and Conflict offers guidance to Bank activity in conflict-affected countries, recognising the need to promote and protect human security and to understand and work to minimise the causes of conflict.
  34. Department for International Development (DFID) (2006) *Eliminating World Poverty: Making Governance Work for the Poor: A White Paper on International Development* (London, UK: DFID); Norwegian Ministry for Foreign Affairs (2004) *Norwegian Peacebuilding Policies: Lessons Learnt and Challenges Ahead* Evaluation Report 2/2004 (Oslo, Norway: Royal Norwegian Ministry of foreign Affairs); Swedish International Development Agency (SIDA) (2003) *Reflections on Development Cooperation and Violent Conflict* (Stockholm, Sweden: SIDA); Canadian International Development Agency (CIDA) (2004) *Sustainable Development Strategy 2004-06* (Ottawa, Canada: CIDA).
  35. MacDonald, S (2005) *Foreign Direct Investment: Following the Global Cycle* (Ottawa: EDC). [www.edc.ca](http://www.edc.ca)
  36. See OECD, Directorate for Financial and Enterprise Affairs [http://www.oecd.org/department/0,2688,en\\_2649\\_34889\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/department/0,2688,en_2649_34889_1_1_1_1_1,00.html). The OECD Investment Committee is currently developing a Risk Management Tool for Investors in Weak Governance Zones drawing on existing OECD instruments including the OECD Guidelines for Multinational Enterprises.
  37. Recognising that project financiers may encounter social and environmental issues that are both complex and challenging, particularly with respect to projects in the emerging markets, the Equator Principles Financial

Institutions (EPFIs) have adopted the Principles to ensure that the projects they finance are developed in a socially-responsible manner and reflect 'sound environmental management practices'. The institutions aim to avoid negative impacts on project-affected ecosystems and communities 'where possible', and if these impacts are unavoidable, the institutions will aim to 'reduce, mitigate and/or compensate for' those impacts. However, conflict is not articulated as a special area of concern.

38. These are social and environmental assessment and management systems; labour and working conditions; pollution prevention and abatement; community health, safety and security; land acquisition and involuntary resettlement; biodiversity conservation and sustainable natural resource management; indigenous people; and cultural heritage. Further details available at [http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/pol\\_SocEnvSustainability2006/\\$FILE/SustainabilityPolicy.pdf](http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/pol_SocEnvSustainability2006/$FILE/SustainabilityPolicy.pdf)
39. United Nations Environment Programme (UNEP) (2002) *Environmental Impact Assessment Training Resource Manual*, 2nd Edition. [www.unep.ch/etu/publications/EIAMan\\_2edition\\_toc.htm](http://www.unep.ch/etu/publications/EIAMan_2edition_toc.htm)
40. Goldwyn, R. and J. Switzer (2004) 'Assessments, Communities and Peace: A Critique of Extractive Sector Assessment Tools from a Conflict-Sensitive Perspective' *Oil, Gas and Energy Law Intelligence*, 2(4) ([www.gasandoil.com/ogel/](http://www.gasandoil.com/ogel/)); International Association for Impact Assessment/Institute of Environmental Assessment. 1998. *Principles of Environmental Impact Assessment Best Practice*. [www.iaia.org](http://www.iaia.org)
41. The EIU's Country Risk Service (CRS) provides ratings for seven categories of risk, including political risk. The political risk category is divided into two components: political stability (which examines whether the political scene is free of internal or external threats to security); and political effectiveness (which assesses the quality of governance).
42. Linder, A and C. Santiso (2002) 'Assessing the Predictive Power of Country Risk Ratings and Governance Indicators' *SAIS Working Papers* WP/02/02 (Washington DC: Paul H. Nitze School of Advanced International Studies of Johns Hopkins University). For instance, the International Country Risk Guide (ICRG) database of the Political Risks Service (PRS) Group's political risk model includes numeric indicators of government stability, external and internal conflicts, corruption, socio-economic conditions, ethnic tensions, and the influence of the military on politics. While these may be a useful broad indicator for looking at the potential for conflict in a specific country, they will not provide the specific qualitative information necessary to understand the 'two-way' dynamics between macro-level social, economic and political conditions and a particular project. Nor will country-level risk indicators necessarily reflect the level of conflict risk at the project level.
43. Goldwyn and Switzer (2004) *op. cit.*
44. Wagner, D. (2000) 'Defining Political Risk' in *International Risk Management* April 2000. [www.irmi.com](http://www.irmi.com)
45. Swiss Re (1999) *Project Finance: The Added Value of Reinsurance*. [www.swissre.com](http://www.swissre.com)
46. Henisz and Zelner, in Moran (2004) *op. cit.*
47. Compliance Advisor Ombudsman (CAO) (2002) *Insuring Responsible Investments? A Review of the Application of MIGA's Environmental and Social Review Procedures*.
48. MIGA (2002) *op. cit.*
49. O'Hara, T. (2005) 'Riggs Bank Agrees to Guilty Plea and Fine: Civil, Criminal Penalties would total \$41 Million' *Washington Post*, 28 February 2005.
50. Ridding, J. (1997) 'HK Banker Fired over Mercenaries: Jardine Fleming Acts on PNG' *Financial Times*, 15 May 1997.
51. See Jubilee South Africa press release, <http://www.nu.ac.za/ccs/default.asp?3,69,3,702>. Viewed 12 August 2005.
52. *Latin Finance* (2001) 'Sovereign Bond Blowout' December 2004.
53. Global Witness (2000) *A Crude Awakening: The Role of Oil and Banking Industries in Angola's Civil War and the Plunder of State Assets*. [www.globalwitness.org](http://www.globalwitness.org)
54. Netwerk Vlaanderen (2004) *Cluster Bombs, Landmines, Nuclear Weapons and Depleted Uranium Weapons: A Report on the Financial Links between Banks and the Producers of Controversial Weapon Systems*. [www.netwerk-vlaanderen.be](http://www.netwerk-vlaanderen.be)
55. The current EU Code of Conduct on the export of military technology and equipment is only politically, not legally, binding. However, the Code is currently under review and it is expected that a revised Code will be adopted as legislation by mid-2006, stipulating that States must deny an export licence for military technology or equipment which would provoke or prolong armed conflicts or aggravate existing tensions or conflicts in the country of final destination. Ingram, P. and I. Davis (2001) *The Subsidy Trap: British Governmental Financial Support for Arms Exports and the Defence Industry* (Oxford Research Group/Saferworld); Mephram, D. and P. Eavis (2002) *The Missing Link in Labour's Foreign Policy: The Case for Tighter Controls over UK Arms Exports* (London: Institute for Public Policy Research/Saferworld).
56. Global Witness (2005) 'Case Study 2: Cash Corruption and Commodities' in *Corporate Responsibility, A Big Deal? Corporate Responsibility and the Financial Sector in Europe* (compiled by the New Economics Foundation). Also, Global Witness (2000) *op. cit.*

## References

African Development Bank (2005) *Overview of Post-Conflict Recovery and Reconstruction: Experience and Lessons Learnt* (Tunis, Tunisia: African Development Bank).

Africa Peace Forum, Consortium of Humanitarian Agencies, FEWER, International Alert and Saferworld (2004) *Conflict Sensitive Approaches to Development, Humanitarian Assistance and Peacebuilding – a Resource Pack* (London, UK: Africa Peace Forum, Consortium of Humanitarian Agencies, FEWER, International Alert and Saferworld).

Asiedu, E. (2005) 'Foreign Direct Investment in Africa: The Role of Natural Resources, Market Size, Government Policy, Institutions and Political Instability' *World Institute for Economic Research* (WIDER), Research Paper No. 2005/24.

Amnesty International (2005) *Contracting out of Human Rights: The Chad-Cameroon pipeline project*. Available at [www.amnesty.org](http://www.amnesty.org)

Amnesty International (2005) *Guatemala – Report 2005*. [www.amnesty.org](http://www.amnesty.org)

Ballentine, K. and V. Haufler (2005) *Enabling Economies of Peace: Public Policy for Conflict-Sensitive Business* (New York, US: UN Global Compact).

Ballentine, K. and H. Nitzchke (eds) (2005) *Profiting from Peace: Managing the Resource Dimensions of Civil War* (Boulder, US: Lynne Rienner).

Ballentine, K. and J. Sherman (eds.) (2003) *The Political Economy of Armed Conflict: Beyond Greed and Grievance* (Boulder, US: Lynne Rienner).

Bank Information Centre (BIC) (2005) 'Caña Brava Dam Protest: More than 300 Take over IDB's Brazil Office'. Available at [www.bicusa.org](http://www.bicusa.org)

BIC (2005) 'World Bank, ADB Approve Nam Theun 2 Dam Project in Laos'. Available at [www.bicusa.org](http://www.bicusa.org)

BankTrack (2004) *Standards at Stake: Exploring Common Ground between Equator Banks and Civil Society on IFC's Proposed Performance Standards*. Available at [www.banktrack.org](http://www.banktrack.org)

Barron, P. et al (2004) 'Understanding Local Level Conflict Pathways in Developing Countries: Theory, Evidence and Implications from Indonesia' *Social Development Papers: Conflict Prevention and Reconstruction*, Paper No. 19/December 2004.

Berlin, A. (2004) 'Managing Political Risk in the Oil and Gas industries' *Transnational Dispute Management* 1(1).

Bowden, A. et al (2001) *Triple Bottom Line Risk Management: Enhancing Profit, Environmental Performance and Community Benefits* (New York, US: Wiley & Sons).

Compliance Advisor Ombudsman (CAO) (2005) 'Media Advisory: Assessment of the Complaint on the Marlin Project in Guatemala' 8 September 2005. Available at [www.ifc.org/cao](http://www.ifc.org/cao)

CAO (2005) 'Assessment of a Complaint Submitted to CAO in Relation to the Marlin Mining Project in Guatemala' 7 September 2005. Available at [www.ifc.org/cao](http://www.ifc.org/cao)



CAO (2003) *Extracting Sustainable Advantage? A Review of How Sustainability Issues have been Dealt with in Recent IFC & MIGA Extractive Industries Projects*. Available at [www.ifc.org/cao](http://www.ifc.org/cao)

De Zeeuw, D. et al (2002) *Advisory Review of the Environmental and Social Impact Assessment Reports for the Baku-Tbilisi-Ceyhan Oil Pipeline and the South Caucasus Gas Pipeline in Georgia* (Dutch Commission for Environmental Impact Assessment). Available at [www.eia.nl/eia/](http://www.eia.nl/eia/)

ECA Watch (2005) *Strengthening the OECD Action Statement on Combating Bribery in Officially Supported Export Credits – A Historic Opportunity*. Available at [www.eca-watch.org](http://www.eca-watch.org)

Elgar, E. (2002) *Politics and International Investment: Measuring Risks and Protecting Profits* (Cheltenham, UK: Edward Elgar Publishing).

Environmental Defense (2000) *Export Credit Agencies in Sub-Saharan Africa: Indebtedness for Extractive Industries, Corruption and Conflict*. Available at [www.edf.org](http://www.edf.org)

Everett, R. et al (2003) *Impact of the World Bank Group's Social and Environmental Policies on Extractive Companies and Financial Institutions* (Washington D.C., US: Associates for Global Change). Available at [www.agchange.com/](http://www.agchange.com/)

F&C Asset Management and KMPG (2004) *Banking on Human Rights: Confronting Human Rights in the Financial Sector*. Available at [www.fand.com](http://www.fand.com)

Friends of the Earth (FoE) (2005) 'NGOs warn of "Environmental Money Laundering," Media Advisory' 21 July 2005. Available at [www.foe.org](http://www.foe.org)

FoE (2005) 'Case Study 7: Financing Unsustainable Development: the Trans Thai-Malaysia Gas Pipeline' in *Corporate Responsibility, A Big Deal? Corporate Responsibility and the Financial Sector in Europe* (compiled by the New Economics Foundation).

FoE (2005) *Briefing: Barclays and the Omkareshwar Dam*. Available at [www.foe.org](http://www.foe.org)

Forster, M., P. Watchman and C. July (2005) *The Equator Principles – Towards Sustainable Banking?* Part 1 (London, UK: Freshfields Bruckhaus Deringer). Available at [www.freshfields.com](http://www.freshfields.com)

Gary, I. and N. Reisch (2005) *Chad's Oil: Miracle or Mirage? Following the Money in Africa's Newest Petrol State* (Washington, D.C., US: Catholic Relief Services/Bank Information Centre). Available at [www.catholicrelief.org](http://www.catholicrelief.org); [www.bicusa.org](http://www.bicusa.org)

Global Witness (2005) 'Case Study 2: Cash Corruption and Commodities' in *Corporate Responsibility, A Big Deal? Corporate Responsibility and the Financial Sector in Europe* (compiled by the New Economics Foundation).

Global Witness (2000) *A Crude Awakening: The Role of Oil and Banking Industries in Angola's Civil War and the Plunder of State Assets*. Available at [www.globalwitness.org](http://www.globalwitness.org)

Goldwyn, R. and J. Switzer (2004) 'Assessments, Communities and Peace: A Critique of Extractive Sector Assessment Tools from a Conflict-Sensitive Perspective' *Oil, Gas and Energy Law Intelligence*, 2(4). Available at [www.gasandoil.com/ogel/](http://www.gasandoil.com/ogel/)

- Government Accountability Office (GAO) (2005) *Efforts to Secure Colombia's Caño Limón-Coveñas Oil Pipeline Have Reduced Attacks, but Challenges Remain* (Washington D.C., US: GAO Report to Congressional Requesters). Available at [www.gao.gov](http://www.gao.gov)
- Halifax Initiative (2004) *Risk, Responsibility and Human Rights: Assessing the Human Rights Impacts of Trade and Project Finance*. Available at [www.halifaxinitiative.org](http://www.halifaxinitiative.org)
- Harmon, J. et al (2005) *Diverging Paths: What Future for Export Credit Agencies in Development Finance?* Available at [www.wri.org](http://www.wri.org)
- Hainz, C. and S. Kleimeier (2004) *Political Risk in Syndicated Lending: Theory and Empirical Evidence Regarding the Use of Project Finance* Bank for International Settlements Quarterly. Available at [www.bis.org](http://www.bis.org)
- Hawley, S. (2003) *Underwriting Bribery: Export Credit Agencies and Corruption* (London, UK: Corner House). Available at [www.cornerhouse.org](http://www.cornerhouse.org)
- Hussels, M. and J. Switzer et. Al. (2004) *Investing in Stability – Conflict Risk, Markets and the Bottom-Line* (Geneva, Switzerland: United Nations Environment Programme). Available at [www.unep-fi.org](http://www.unep-fi.org)
- Ingram, P. and I. Davis (2001) *The Subsidy Trap: British Governmental Financial Support for Arms Exports and the Defence Industry* (London, UK: Oxford Research Group/Saferworld).
- International Alert (2005) *Conflict-Sensitive Business Practice: Guidance for Extractive Industries* (London, UK: International Alert). Available at [www.international-alert.org](http://www.international-alert.org)
- International Finance Corporation (IFC) (2005) *International Finance Corporation's Sustainability Policy and Performance Standards* Public Release Draft, 22 September 2005. Available at [www.ifc.org](http://www.ifc.org)
- IFC (2004) *Montana Exploradora: Marlin Gold Project*. Available at [www.ifc.org](http://www.ifc.org)
- International Peace Academy/Fafo AIS (2004) *Business and International Crimes: Assessing the Liability of Business Entities for Grave Violations of International Law*. Available at [www.fafo.no/liabilities](http://www.fafo.no/liabilities)
- Lawrence, S. (2003) *The World Bank in the Democratic Republic of Congo* (Washington, D.C., US: Environmental Defense). Available at [ww.edf.org](http://ww.edf.org)
- Lind, J. and K. Sturman (eds) (2003) *Scarcity and Surfeit: The Ecology of Africa's Conflicts* (Pretoria, South Africa: Institute of Security Studies).
- Linder, A. and C. Santiso (2002) 'Assessing the Predictive Power of Country Risk Ratings and Governance Indicators' *SAIS Working Papers* WP/02/02.
- Lynn Karl, T. (1997) *The Paradox of Plenty: Oil Booms and Petro-States* (Berkeley, US: University of California Press).
- MacDonald, S. (2005) *Foreign Direct Investment: Following the Global Cycle* (Ottawa, Canada: EDC). Available at [www.edc.ca](http://www.edc.ca)

Mephram, D. and P. Eavis (2002) *The Missing Link in Labour's Foreign Policy: The Case for Tighter Controls over UK Arms Exports* (London, UK: Institute for Public Policy Research/Saferworld).

Moody, R. (2005). *The Risks We Run* (Utrecht, Netherlands: International Books).

Moran, T. H. (ed) (2001) *International Political Risk Management: Exploring New Frontiers* (Washington D.C., US: World Bank).

Moran, T. H. (ed) (2004) *International Political Risk Management: The Brave New World* (Washington D.C., US: World Bank).

Netwerk Vlaanderen (2004) *Cluster Bombs, Landmines, Nuclear Weapons and Depleted Uranium Weapons: A Report on the Financial Links between Banks and the Producers of Controversial Weapon Systems*. Available at [www.netwerk-vlaanderen.be](http://www.netwerk-vlaanderen.be)

O'Hara, T. (2005) 'Riggs Bank Agrees to Guilty Plea and Fine: Civil, Criminal Penalties would Total \$41 Million' *Washington Post*, 28 February 2005.

Petts, J. (ed) (1999) *Handbook of Environmental Impact Assessment* (London, UK: Blackwell Science).

Ridding, J. (1997) 'HK Banker fired over Mercenaries: Jardine Fleming Acts on PNG' *Financial Times*, 15 May 1997.

Rights and Accountability in Development (RAID) (2005) *Response to Anvil Mining's 'Report on the Visit by NGOs to the Dikulushi Mine, DRC'* (Oxford, UK: RAID).

Ross, M. L. (1999) 'The Political Economy of the Resource Curse' *World Politics* 51: 325-61.

Smith, D. (2004). 'Trends and Causes in Armed Conflict' in Austin et. Al. (eds) *Transforming Ethnopolitical Conflict: The Berghof Handbook* (Berlin, Germany: Berghof Center for Constructive Conflict Management).

Standard & Poor's (2001) *Project Finance Summary Debt Rating Criteria*. Available at [www.standardandpoors.com](http://www.standardandpoors.com)

Swiss Re (1999) *Project Finance: The Added Value of Reinsurance*. Available at [www.swissre.com](http://www.swissre.com)

Switzer, J. (2002). *Armed Conflict and Natural Resources: The Case of the Minerals Sector* (London, UK: IIED). Available at [www.iied.org/mmsd/](http://www.iied.org/mmsd/)

United Nations Development Programme (UNDP) (2005). *International Development at the Crossroads: Aid, Trade and Security in an Unequal World* (New York, US: UNDP).

United Nations Environment Programme (UNEP) (2002). *Environmental Impact Assessment Training Resource Manual*, 2nd Edition (Geneva, Switzerland: UNEP). Available at [www.unep.ch/etu/publications/EIAMan\\_2edition\\_toc.htm](http://www.unep.ch/etu/publications/EIAMan_2edition_toc.htm)

UN Global Compact (2004) *Who Cares Wins: Connecting Financial Markets to a Changing World* (New York, US: UN Global Compact). Available at [www.unglobalcompact.org](http://www.unglobalcompact.org)

United Nations (2005) *In Larger Freedom: Toward Development, Security and Human Rights for All*. Report of the Secretary General of the UN for decision by Heads of State and Government, September. Available at <http://www.un.org/largerfreedom/>

Vanclay, F. (2002) 'Conceptualising Social Impacts' *Environmental Impact Assessment Review*, 22.

Vinter, G. D. (1995) *Project Finance* (London, UK: Sweet & Maxwell).

Wagner, D. (2004) 'Project Financiers' and Insurers' Roles in Promoting Social Responsibility in the Developing World' *International Risk Management* January 2004. Available at [www.irmi.com](http://www.irmi.com)

Watchman, P. (2005) *The World Bank is Not Enough: Equator Principles Survey 2005* (London, UK: Freshfields Bruckhaus Deringer). Available at [www.freshfields.com](http://www.freshfields.com)

Ward, S. and C. Chapman (2003) 'Transforming Project Risk Management into Project Uncertainty Management' *International Journal of Project Management*, 21: 97 – 105.

World Bank (2004) *Striking a Better Balance – the World Bank Group and Extractive Industries: The Final Report of the Extractive Industries Review* (Washington, D.C., US: World Bank).

Zehner, D. (2003) 'An Assessment of Two Economic Rationales for Export Credit Agencies' *Chazen Web Journal of International Business* Spring: 1 – 11.



**International Alert.**

346 Clapham Road, London SW9 9AP, United Kingdom

Tel +44 (0)20 7627 6800, Fax +44 (0)20 7627 6900, Email [general@international-alert.org](mailto:general@international-alert.org)

[www.international-alert.org](http://www.international-alert.org)

ISBN: 1-898702-78-0