

Trade, investment and conflict

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Civil Society Dialogue Network

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Introduction

In April 2012 the Council of the European Union's statement on the partial suspension of sanctions against Myanmar started by welcoming the "overall transparent and credible conduct" of the by-elections that led to opposition leader Aung San Suu Kyi's entering parliament, as well as the government's "efforts to conclude ceasefires with armed groups in the ethnic regions". It then announced the EU's intention to engage in dialogue and cooperation with Myanmar authorities. The following paragraph elaborates on the potential role of the private sector in this process:

The EU recognises the vital contribution the private sector has to make to the development of Myanmar/Burma and would welcome European companies exploring trade and investment opportunities. This should be done by promoting the practice of the highest standards of integrity and corporate social responsibility. These are laid out in the OECD Guidelines for Multinational Enterprises, UN guiding principles on business and human rights and the EU's own CSR strategy 2011-2014. The EU will work with the authorities, the private sector and the people of Myanmar/Burma to create the best possible regulatory environment.¹

The Council's statement therefore touches on several of the key themes of this paper in that it affirms the potential "vital contribution" of European trade and investment in a conflict-affected country while at the same time stating that the EU could itself play a role in working with a combination of stakeholders – "the authorities, the private sector and the people of Myanmar/Burma". However, it does not elaborate on what precisely that role might entail.

This briefing paper explores the possibilities in greater detail. It has three core arguments:

- The first relates to the interrelationship between politics, economics and private sector development. Peace processes are inherently and inescapably political. However, they will not succeed without equitable economic development. State resources on their own are not sufficient to achieve this.
- The private sector is therefore essential, but not all private sector development is equally constructive. On the contrary, commercial activities can – more often through carelessness than design – contribute to social divisions and therefore to conflict. The challenge is to encourage responsible business conduct while deterring rogue behaviour. For this to happen, we need state institutions that are capable of delivering good governance.
- The third argument is to do with local ownership and international connectedness. Peacebuilding will not succeed in Myanmar or anywhere else without the active support of a broad range of local stakeholders. However, this will not happen in isolation. International actors – both companies and intergovernmental institutions such as the EU – can play a vital supporting role.

There is no 'typical' conflict-affected country but Myanmar exemplifies many of the most important issues. This briefing paper therefore stays with current and potential future developments in Myanmar as a leitmotif while at the same time citing other illustrative examples, including Côte d'Ivoire, Madagascar, Sri Lanka and Georgia/Abkhazia. It starts with an overview of the role of the private sector in peacebuilding, and then focuses first on trade

¹ Council of the European Union. 2012. *Council conclusions on Burma/Myanmar*. 3159th Foreign Affairs Council Meeting, Luxembourg, 23 April 2012.
www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/129703.pdf

and then on investment. The paper concludes with a set of recommendations for EU institutions, companies and civil society, arguing that all three sectors have essential complementary roles.

1. War economies and conflict sensitivities

In a recent review of “The private sector and the challenges of peacebuilding”, Mats Berdal and Nader Mousavizadeh (2010: 37) observed that:

While there has been some acknowledgement of the ability of economic instruments to provide incentives for peace, the prevailing interpretation among both scholars and development actors and donors, at least with regard to the foreign private sector, has been one of suspicion and disapproval.

Their observation all too often holds true, but we need to get over it. Blanket approval and blanket disapproval are equally inappropriate. The starting point must be a more nuanced view of the private sector in its multiple manifestations in both good times and bad.²

War economies

No economy now operates in isolation, either in war or in peace. Some kind of trading continues even during wartime, often across battle lines.³ Enhanced global communications mean that the interconnections between apparently distant war conflict regions and the rest of the world are more diverse and more complex than they have ever been. The challenge for peacebuilders is to ensure that these interconnections have a positive impact, bringing people together and sowing the seeds of cooperation, rather than dividing them.

This task is far from straightforward, especially in cases where existing conflict-based economic and political structures are deeply entrenched. In Myanmar the history of conflict between the ethnic Burman-dominated central government and ethnic minority armed groups dates back to within a few weeks of independence in 1948. The hazards of travel in remote areas meant that there was a particular premium on high-value, low volume goods. These included opium in parts of north-east of the country, notably in Shan State, as well as jade and precious gems in Kachin State. Along the south-eastern borders ethnic Karen and Mon rebel groups have historically benefited from ‘taxes’ imposed on goods smuggled from Thailand.

Similar patterns – again including opium smuggling - have applied in the very different terrain of Afghanistan. In Sierra Leone, Angola and the Democratic Republic of Congo (DRC) ‘conflict diamonds’ provided a vital source of revenue for rebel arms and regional warlords in the 1990s and early 2000s. The war-torn areas of eastern DRC have notoriously been a source of Coltan, a mineral used in the production of tantalum capacitors for mobile phones and other electronic devices.⁴

² Studies that offer a more nuanced view of the economics of conflict and the role the private sector include – among others - Ballentine & Sherman (2003), Banfield Gündüz & Killick (2006), Lister & Pain (2004), Pugh & Cooper (2004), UNDP (2008).

³ There were many cases of ‘trading with the enemy’ during the Bosnian war in the early 1990s. One example comes from Kiseljak, a Croat-majority town north-west of Sarajevo. The town was under the control of hardline Croat nationalists who developed a lucrative economic role as middlemen between the Serbs besieging Sarajevo and Muslim black marketeers. Much of the trade was in essential foodstuffs. In other cases black marketeers are said to have exchanged fuel and even weapons across the various frontlines. See Little & Silber (1997: 295).

⁴ On the links between warlords, conflict regions and international markets see in particular Reno (1999 and 2011).

At the very local level, small and micro businesses survive as best they can, adopting a variety of coping mechanisms simply to keep afloat.⁵ The activities of small local businesses rarely capture the headlines but they play an especially important role as providers of livelihoods during periods of both war and reconstruction. At a minimum they require the acquiescence of political and military leaders in order to survive. They may also belong to politically-connected patronage networks. For smaller as well as larger enterprises, it is hard to remain neutral.

Post-conflict opportunities

Cease-fires bring new opportunities, but do not automatically alter the basic patterns of war economies. The commercial domination of individual warlords typically continues well after ceasefires. In some cases they may seek to develop existing trade networks, as with the opium routes of Afghanistan. In other cases, they may try to diversify into new ventures, for example urban property or hotels, a pattern that is readily apparent in contemporary Myanmar. 'Warlords' are of course far from being the only domestic commercial actors, but they are often a particularly powerful constituent, and it may be hard for other businesses to avoid engaging with their commercial patronage networks in one way and another.

At the same time, ceasefires bring opportunities for international companies operating either on their own or in some sort of local partnership. Typically, ceasefires or political turning points as in contemporary Myanmar prompt much excited chatter about 'first mover advantage'. The immediate excitement has to be tempered by a more sober analysis of the potential prospects. Different sectors naturally have different considerations when evaluating potential opportunities. For example:

- Telecommunications companies have been among the earliest to invest after – or even before – conflicts end. This is in part because of their business model. Mobile start-ups require relatively low investments, typically in the low hundreds of thousands of dollars, and they start marking a return as soon as the first subscriber makes a call. In many African countries the fact that there had been no earlier investment because of conflict meant that there was a 'pent-up demand' among would-be subscribers. Successful early movers in the mobile phone industry include the Netherlands-based Celtel in post-war Sierra Leone, and the South African companies MTN in Rwanda and Vodacom in the Democratic Republic of Congo (DRC). Contemporary Myanmar offers similar opportunities.
- Companies in the oil, gas and mining sectors have a very different business model in that they require initial investments of hundreds of millions – or billions – of dollars over many years before they come into production. Major Western companies may be quick to sign exploration contracts once conflicts end, but slow to make more substantial investments unless they can be confident that the host country has truly turned away from conflict.
- Retail bankers are trained to be risk-averse. International banks will not set up operations in a post-conflict country unless there is a well-crafted banking code. Even then, they will be selective in accepting customers, all the more so because of increasingly tight anti-money laundering regulations. This is particularly true in Myanmar's case because US is still in the process of lifting financial sanctions.

Avoiding harm

In her now-classic book *Do no harm*, Mary B. Anderson (1999) pointed out that development agencies are rarely regarded as neutral in polarised conflict environments. To the extent that their activities were seen as assisting one community rather than another rival group, they

⁵ On the theme of 'coping', see especially the introduction to Banfield, Gündüz & Killick (2006).

might actively contribute to conflict. In an alternative and more positive scenario, they might serve as 'connectors', drawing communities together and thus contributing to peace, for example by helping develop a common resource to mutual benefit.

Similar principles apply to the activities of private sector companies.⁶ Mobile phones generally have a positive development impact, for example by allowing for the poor to access finance through mobile banking services (Honohan & Beck, 2007). In the most literal sense, they serve as 'connectors'. In other cases, private sector development might turn out to be more problematic. Hypothetical but realistic examples of how companies might contribute to conflict include:

- An oil company is setting up a drilling operation in a region that has long been affected by a low-level insurgency. The host government considers oil supplies to be a strategic asset, and on its own initiative decides to create a *cordon sanitaire* around the installation. The army forcibly removes villagers to a new settlement site.
- An international company is constructing a power station on land that was acquired through a compulsory purchase order. Local villagers fear that the project will pollute vital water supplies and organise a demonstration against it. The government deploys paramilitary police to protect the plant. Fearing that the demonstration will turn violent, they open fire on the protesters. Several people are killed, and the police are accused of committing a human rights abuse by resorting to excessive force.

This is the sort of episode that contributes to the "suspicion and disapproval" to which Berdal & Mousavizadeh refer but there are of course many other aspects to foreign investment. Governments need revenue. Citizens need jobs. Foreign investment brings technical expertise as well as financial resources that can transform economies for the better.

The challenges are therefore how to encourage constructive investment that has positive impacts, and – particularly in the case of countries recovering from conflict – how to do so sooner rather than later.

2. Governance, policy and problem-solving

The central issue is governance, or the lack of it. The World Bank's *World Development Report 2011 on Conflict, Security and Development* takes as its central message that "strengthening legitimate institutions and governance to provide citizens security, justice, and jobs is crucial to break cycles of violence" (p.2). Failures of governance are of course among the prime causes of conflict. Equally, the establishment or re-establishment of equitable state institutions is an essential requirement for sustainable peace-building.

In the absence of effective governance there is a greater risk of corruption, deliberate or unwitting complicity with human rights abuses and conflict insensitivity on the part of private sector actors.

Defining the problem

Business, human rights and the governance gap

In his 2008 UN Human Rights Council report *Protect, Respect Remedy*, Professor John Ruggie highlighted the "governance gaps created by globalization - between the scope and impact of economic forces and actors, and the capacity of societies to manage their adverse

⁶ Anderson and her colleagues have explored this theme through the Corporate Engagement Project of the Collaborative for Development Action (CDA). For further details, see www.cdainc.com

consequences” (2008). The fundamental challenge is therefore “how to narrow and ultimately bridge the gaps in relation to human rights” and, as Ruggie goes on to explain, this challenge is particularly acute in conflict-affected societies. Both the 2008 report and the 2011 *UN Guiding Principles on Business and Human Rights* outline the State’s duty to protect citizens’ human rights, as well as business’ responsibility to respect human rights, and the need for both parties to provide remedies when needed.

Private sector development

Good or bad governance has a direct impact not only on human rights but also on the commercial prospects for both domestic and international trade and investment. If the private sector is to flourish – and to make a positive rather than a negative impact - it needs an “enabling environment”. World Bank (2004:8) research has showed that small and informal firms often suffer more than medium and large companies from a poorly developed investment climate. This includes the existence of state institutions that guarantee access to justice and the security of property rights.

Weak governance does not mean that there is no private sector activity, but it is more likely to be of the ‘war economy’ variety. Domestic companies have little option but to engage with whatever power-brokers and rudimentary institutions are already in place. As noted above, this may mean association with political and communal patronage networks, as well as various forms of tribute and pay-offs to political leaders who may have a greater vested interest in the continuance of low-level political conflict, if not outright violence, rather than peacebuilding.

In a highly competitive global environment, international companies have a wider range of choices. If poor governance standards mean that their investments are insecure, they will hesitate to make major commercial investments. Again, this does not mean that there will be no trade or investment at all. However, the companies that attach greater importance to corporate responsibility are more likely to stay away. The ones that do engage in the first instance are more likely to take a pragmatic – not to say ruthless – approach to managing risk. Again, this is likely to include less-than-transparent relationships with local powerbrokers who almost inevitably are associated with one side of the political divide rather than another. By contributing to their ‘war chests’, literally or metaphorically, they reinforce their power bases. They cannot claim to be impartial.

Corruption

A similar argument applies to the complex phenomenon of corruption. This relates directly to conflict because, as noted above, governance failures are often among the main reasons why civil wars break out in the first place. Similarly, high levels of corruption undermine the legitimacy of post-conflict political orders, as in contemporary Afghanistan, thus increasing the risks of renewed outbreaks of fighting.

Historically, many business people have tended to take a pragmatic view of bribery, arguing that they need to deal with the world as it is, rather than the world as it should be. However, to draw an analogy with Mary Anderson’s *Do No Harm* analysis, bribe-paying companies cannot simply present themselves as neutral participants in a social order that they did not create. By paying bribes, they reinforce bad practice, often depriving the state of much-needed revenue (as in customs bribery) and reinforcing the power bases of dishonest politicians and corrupt officials.

Finding solutions

Governance reforms take time. The *World Development Report 2011* issues the necessary reminder that:

Creating the legitimate institutions that can prevent repeated violence is, in plain language, slow. It takes a generation (p.10).

Realistically, this means that in conflict-affected areas private sector actors – however well-intentioned – will have to continue to cope with imperfect governance for years to come. To echo Ruggie’s phrase above, we may in the short term need to be content with “narrowing” rather than “bridging” the governance gap, but we should not assume that the gap is either inevitable or perpetual. The question for both EU policy makers and private sector actors is where to start the bridging process.

Governance reform

The governance reforms needed to create an enabling environment for the private sector should begin as soon as there is a political opening, for example after a ceasefire. EU technical assistance can make a vitally important contribution by assisting with the development of accountable state institutions sooner rather than later.

This sounds obvious but there are many reasons why it is difficult. In the immediate aftermath of war humanitarian relief and physical reconstruction are obvious priorities. The ceasefire may have ended outright warfare, but political hostilities remain. The political manoeuvring needed to maintain peace leaves little time or energy to think about governance reforms or private sector development. But an early start is essential all the same.

A recent UNDP report (2010) on *Fighting Corruption in Post-Conflict and Recovery Situations* highlights the lessons learnt in Afghanistan, the Democratic Republic of Congo, Iraq, Sierra Leone and Timor Leste. It points out that corruption remains pervasive in all five countries and calls for stronger commitment on the part of states and development agencies to institute reforms promoting transparency and accountability as early as possible. In relation to Sierra Leone, the same report (p.128) noted that would-be government reformers had had “little or no engagement with the private sector, which regarded corruption to be such a serious impediment that many businesses were moving out of Sierra Leone into neighbouring countries”.

The private sector does not itself have a mandate to institute governance reforms but through industry associations may be able to advise on what measures are and are not likely to be effective in relation to the management of the economy. To the extent that the EU is involved in technical assistance in support of governance reforms, it should use its influence to encourage appropriate consultation with responsible business leaders.

Active EU endorsement of corporate responsibility and human rights standards

Similarly, the EU can make an important contribution through its active endorsement of corporate responsibility standards and strategies, including human rights. Current initiatives include the *Renewed EU strategy 2011-14 for Corporate Social Responsibility* as well as proposals on how to implement the *UN Guiding Principles* at the EU level. This endorsement should include a focus on the particular challenges of business operations in conflict-affected areas, and this of course will be the main focus of the EPLO’s Civil Society Dialogue Meeting on 29 October.

The *UN Guiding Principles* put particular emphasis on human rights due diligence. Clause 18 states that:

In order to identify, prevent, mitigate and account for how they address their adverse human rights impacts, business enterprises should carry out human rights due diligence. The process should include assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed.

In conflict-affected areas due diligence will need to include an assessment of how a company's activities could either alleviate or, in the worst case, contribute to conflict (see below). Among other measures, the EU should emphasise the need for companies to conduct such assessments.

Hard law, now and in the future

John Ruggie took a considered decision not to press for a global treaty forcing companies to follow binding rules on human rights (on this point see, for example, Ruggie 2008). This approach has been criticised by many NGOs who argued that he thereby missed an opportunity to introduce 'hard law' measures to combat corporate complicity in human rights abuses, at least for now. Our own view is that the *UN Guiding Principles* are a well-designed exercise in the 'art of the possible'. Their 'soft law' approach does not preclude the possibility of future measures to strengthen the international legal regime in relation to business and human rights.

Be that as it may, hard laws against corruption already exist. All the OECD member states – and therefore all the EU countries – now have extra-territorial anti-corruption laws in accordance with the 1997 OECD Anti-bribery Convention. These laws make it possible to prosecute companies and individuals who bribe foreign officials. Meanwhile, the European Anti-Fraud Office (OLAF) of the European Commission spearheads the fight against corruption within EU institutions, including in the international development arena.

One reason why it has so far proved easier to draft anti-corruption legislation is that the scope of anti-bribery legislation is much narrower than the human rights agenda. The OECD Anti-bribery Convention applies to the bribery of foreign officials for commercial benefit. Tight definitions make it easier to enforce the law.

Supporting companies in difficulty

While seeking to deter bad practice, the EU and other governmental institutions should also look for ways of supporting well-run companies who find themselves in difficulty because of a refusal to pay bribes in regions where corruption is commonplace. The main focus of international anti-corruption initiatives has been on bribes to secure contracts. In these cases, companies in principle have a choice: they can 'walk away'. However, bribery demands often take the form of extortion, for example a solicitation for a payment to release a colleague from prison on trumped up charges, or a demand to overlook spurious environmental offences which would result in the closure of an important installation.

The International Chamber of Commerce (2012) and three partner organisations have developed a set of scenarios outlining how companies can resist such demands on their own resources. Depending on the circumstances, it may be helpful if they can also draw on diplomatic assistance. According to information released under the UK Freedom of Information Act, six British companies operating in unspecified countries in the Gulf States and the Former Soviet Union have complained to their embassies about corruption since the UK Bribery Act was passed into law in 2010 (Binham 2012). In four of these cases, UK diplomats made representations to their local counterparts. EU diplomatic missions may wish to consider whether they might be able to make similar representations if needed.

Myanmar as an example

Myanmar exemplifies many of these arguments. Until recently most EU-based companies eschewed business with the country either because of sanctions (see the next section) or because of the reputational risks of being associated with a country with a poor human rights record. In addition, they were concerned – or should have been concerned – at the fact that, in a country lacking an independent judicial system, they had no effective recourse in the event of a dispute with the government.

The current political reform process marks a genuine, positive change but by no means demonstrates that Myanmar's problems are over. The country lacks capacity in almost every area but, most of all, in human capital. Companies considering investment in the country need to take care when selecting local partners lest they have past history of association with the drugs trade or political oppression. As Kyaw Hin Hliang and Dominic Nardy (2012) point out, the justice sector is in urgent need of reform, and human rights concerns are particularly acute in the conflict-affected border areas which are rich in natural resources of particular interest to international companies.

The EU will perform an important service if it can follow through the Council's proposal to assist with the development of "the best possible regulatory environment". Meanwhile, as will be discussed below, companies need to be scrupulously careful when conducting their own risk assessment.

3. Trade

Opening up mutual access between the EU and Myanmar for flows of trade and investment is a welcome move, and signals the better integration of this long-isolated country into the international arena. The 'symbolism' of opening up and encouraging trade with external countries is powerful in itself, but it is important to remember that international trade is an inherently self-interested activity. The central tenet of all trade theories since the seminal work of Adam Smith (2008 [1776]) is that two parties derive mutual benefit from a mutually self-interested activity of exchanging that which each has a competitive advantage to produce – by virtue of climate, resources or other non-natural endowments – for something which the other cannot produce at the same or lower cost.

This self-interest is in contrast to the emergence in foreign policy of the concept that states and supra-national institutions such as the EU have a responsibility to foster sustainable development and good governance in countries outside their own region, and where necessary to act to prevent conflict. The EU's external policies indeed have the explicit aims of supporting stability; promoting human rights and democracy; spreading prosperity; and supporting the enforcement of the rule of law and good governance (see European External Action Service website: www.eeas.europa.eu).

Existing framework

Even before the Lisbon Treaty brought the EU's commercial policy under a more comprehensive single framework (covering trade in goods, services and foreign direct investment), there was a balance struck between the regional bloc's self-interest in pursuing trade, and its interest in fostering peace and stability in other parts of the world. The carrot-and-stick approach consists of granting preferential access to what is one of the single biggest markets for many developing countries, and the threat of constraints (sanctions) should conditions be breached, and in theory should provide a clear set of incentives for those wishing to benefit from international trade. The EU's regulations setting out the eligibility criteria for countries to become beneficiaries under the Generalised System of Preferences (GSP), and its two special arrangements, the GSP+ and 'Everything But Arms' (EBA),⁷ refer to governance standards which must be met. The GSP, in place since the 1970s, is undergoing a review (see below); nonetheless, it is instructive to assess how it has functioned up to this point, and examine a number of cases that fell under the existing provisions.

⁷ Currently the GSP benefits a total of 176 countries and territories, while the GSP+ has 14 beneficiaries and the EBA covering 48 least developed countries (LDCs).

Generalised System of Preferences

The GSP lays out in its preamble that the regulation aims to be consistent with development policy including the promotion of good governance and sustainable development.⁸ Those wishing to access the GSP+, a special incentive scheme to foster sustainability of development and good governance in beneficiary countries, must meet additional standards:

The special incentive arrangement for sustainable development and good governance is based on the integral concept of sustainable development, as recognised by international conventions and instruments such as the 1986 UN Declaration on the Right to Development, the 1992 Rio Declaration on Environment and Development, the 1998 ILO Declaration on Fundamental Principles and Rights at Work, the 2000 UN Millennium Declaration, and the 2002 Johannesburg Declaration on Sustainable Development.⁹

The stated aim is to grant additional tariff preferences to those countries that are poorly integrated into global trade, but who have ratified and are effectively implementing their responsibilities under the “core international conventions on human and labour rights, environmental practice and good governance.”¹⁰ This is verified upon application of a country by the European Commission, who “should monitor the effective implementation of the international conventions ... [and] assess the relationship between the additional tariff preferences and the promotion of sustainable development.”¹¹ This clearly places a duty on the Commission to monitor whether the trading partners who benefit from preferential access to the European market are in fact living up to the standards set by relevant international conventions.

The EBA, which is designed for least developed countries (LDCs), ensures exemption from all duties and quotas of imports, with the exception of armaments. Meanwhile, the Economic Partnership Agreements with African, Caribbean and Pacific (ACP) countries are anchored in the Cotonou Agreement, which includes good governance as an essential element, and states that violations of governance standards can be expected to lead to the suspension of development cooperation.

The reasons for temporary removal from the GSP or either of the other schemes include “serious and systematic violations of the principles laid down in certain international conventions concerning core human rights and labour rights or related to the environment or good governance”.¹² It was on this basis that Myanmar was originally excluded from the GSP, for violating core labour rights relating to the prohibition on the practice of any form of forced labour.

Carrot-and-stick

The carrot of preferential access to the EU market for those who meet the standards of governance specified in the GSP and the special arrangements is balanced by the ‘stick’ of not only the removal of those preferences and economic impacts this would entail, but also the use of ‘restrictive measures’ or sanctions. EU policy on sanctions is guided by the objectives of safeguarding the values set out in the UN Charter, preserving the EU’s security, strengthening international peace and security, promoting international cooperation, and

⁸ Council Regulation (EC) No 732/2008: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:211:0001:0039:EN:PDF>.

⁹ Council Regulation (EC) No 732/2008: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:211:0001:0039:EN:PDF>; paragraph 7.

¹⁰ Ibid, paragraph 8.

¹¹ Ibid, paragraph 9.

¹² Ibid, paragraph 22.

consolidating the rule of law and democracy.¹³ Measures include arms embargoes, economic and financial sanctions and restrictions on admission (visa and travel bans). The latter two are targeted as closely as possible to particular individuals, but the EU is understandably cautious in when it chooses to apply financial or economic sanctions given the WTO framework but notes that “Suspension clauses in existing agreements...may have to be invoked, or such agreements may have to be terminated, before sanctions can be applied.”

The following three cases examine the use of carrot and stick in relation to different conflicts and provide examples to consider how these measures can be combined with sensitivity to the nature of the conflict.

Côte d'Ivoire

Withdrawal of preferences or use of sanctions are unsurprisingly more effective where the EU or its Member States represent a country's largest trading partner, and the parties in conflict will have their means to continue fighting squeezed as a result of any restrictions. Myanmar did not meet these criteria.

By contrast, a good example of effectiveness was the swift and targeted sanctions on Côte d'Ivoire introduced by the Council in response to the 2010 post-election crisis. These contributed to isolating the Gbagbo regime and, combined with intense diplomatic pressure as well as international coalition-building in support of a transition, proved effective in helping to resolve the crisis. The Muslim north/Christian south divide that spans the West African coast is complicated in Côte d'Ivoire with the north's increasing economic importance through control of the all-important cocoa sector. Southerners, the group to which Gbagbo belonged, have traditionally dominated politics since independence. The concept of 'Ivoirité' (a policy that denied land and voting rights to groups identified as 'non-indigenous') was a major issue in the September 2002 rebellion by the northern-based Forces Nouvelles, and was also a factor in the disputed 2010 elections with Gbagbo's side portraying his northern challenger Ouattara as a foreigner.¹⁴ The targeted sanctions against those controlling the export of coffee and cocoa were important in cutting off financial flows to Gbagbo's administration and cutting short the conflict.¹⁵ Although these have been removed and the sector is again a mainstay of government revenues, the shifting political economy in the country is likely to continue to stir tensions along ethno-religious lines.

Madagascar

By contrast, the 'stick' of withdrawing preferences in Madagascar's case has proven less effective. The EU denounced the coup in March 2009 and immediately suspended development cooperation of \$783 million including general budget support to the government.¹⁶ Since then, the EU has continued to provide development assistance for humanitarian needs, channelled through local and international NGOs rather than through the interim authorities, the HAT.¹⁷ There has been limited progress in SADC-brokered mediation

¹³ See EEAS website: http://eeas.europa.eu/cfsp/sanctions/index_en.htm

¹⁴ The principle of *Ivoirité* states that only those whose parents are both Ivorian-born are eligible to stand as candidates in presidential elections. Ouattara's father was born in neighbouring Burkina Faso.

¹⁵ Council Regulation (EU) No 330/2011 of 6 April 2011; available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:093:0010:0015:EN:PDF>

¹⁶ Council of the EU press release Luxembourg 7 June 2010
http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/114973.pdf

¹⁷ Haute Administration de la Transition.

talks and, while the international community hopes that it will be possible to hold elections in 2013, preferential access under the EBA remains suspended.¹⁸

The US followed the EU's example in January 2010, removing Madagascar from the African Growth and Opportunity Act (AGOA) on the basis of the "undemocratic transfer of power and the inability to establish a return to democracy".¹⁹ AGOA had been instrumental in creating jobs in the Malagasy textile industry which in the last year of access had generated between 6% and 8% of GDP. The removal of this access has left the industry much weaker and thousands of workers were made redundant, leading to increased competition in other parts of the economy.²⁰ It also deprived the government of much-needed revenue. Despite the economic squeeze (which saw the country top Forbes' list of the World's Worst Economies in 2011) the restrictive measures appear not to have made significant progress in getting the opposing parties to agree on a resolution.

The EU has maintained imports from Madagascar, and European companies continue to operate there, and restrictive measures were not employed. The lesson of the Malagasy case is that incentives matter: where intransigent regimes have credible alternatives for continued funding that are politically acceptable to their power base, they will pursue the political incentive rather than the broader economic incentive. Given that the HAT has other trading partners, in Europe but also in Asia, with which it can continue to engage, as well as existing 'cash cow' projects in the extractive sector, the budgetary gaps left by trade restrictions are not enough to force all factions to negotiate in earnest. Nonetheless, the faltering economy, significant rises in crime and unemployment, and a deterioration in governance standards (state capacity is being eroded under growing corruption and factionalism), mean that a return to violence in the country cannot be ruled out. Currently, the worrying trends are on human rights impacts, with human trafficking a particular concern (U.S. State Department, 2011).

Sri Lanka²¹

This is another example of where a carrot-and-stick approach has been used to limited effect: the country was earmarked in 2008 for graduation to the GSP+ but its application has been held up after the Commission initiated a year-long investigation into Sri Lanka's eligibility on the basis of its implementation of national legislation incorporating a range of human rights conventions.²² Sri Lanka is in fact the only country to have seen its application under the GSP+ withheld; El Salvador also saw its application put on hold while the Commission investigated the incorporation of ILO Convention No. 87 on the Freedom of Association and Protection of the Right to Organise, however this was found to be satisfactory allowing for the country to benefit from the special incentive arrangement.²³

During the course of the Commission's investigation on Sri Lanka, the armed conflict in the north-east of the country reached a crescendo and a humanitarian crisis ensued with hundreds of thousands displaced. A subsequent UN Panel of Experts report released in 2011

¹⁸ *Madagascar: European Union to resume its development aid and target health and education of the most vulnerable people.* European Commission press release, Brussels, 10 May 2012. Available at http://ec.europa.eu/commission_2010-2014/piebalgs/headlines/news/2012/08/20120808_en.htm

¹⁹ US State Department press release, December 2009

²⁰ IRIN news report, February 2010. Available at:

<http://www.irinnews.org/Report/88224/MADAGASCAR-Textile-industry-unravels>

²¹ [http://europa.eu/rapid/press-release MEMO-08-777_en.htm?locale=en](http://europa.eu/rapid/press-release_MEMO-08-777_en.htm?locale=en)

²² Namely, the International Covenant on Civil and Political Rights, the Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment and the Convention on the Rights of the Child.

²³ *Termination of the GSP+ investigation on El Salvador.* European Commission press release, Brussels, 22 October 2009. Available at <http://trade.ec.europa.eu/doclib/press/index.cfm?id=471&serie=278&langId=en>

detailed allegations of violations of human rights and of international humanitarian law, including by government armed forces in their prosecution of the campaign. Following the Commission's investigation, the Council of the EU decided in February 2010 to temporarily withdraw additional preferences under GSP+, but Sri Lanka retained its access under GSP.²⁴ The EU's status as Sri Lanka's main export market (€2.2 billion of exports in 2009) for its textiles as well as other goods appears to confer enhanced leverage to encourage peacebuilding, although this is counteracted by the approach of non-European investors and trading partners who do not attach the same conditions of complying with international conventions.

In seeking to draw lessons from the experience with Sri Lanka's removal, it is worth reflecting on the pool of information which the Commission draws upon both in its investigations and when making decisions. Greater breadth, such as expanding on the provision of core information by the United Nations and ILO, may help to nuance the EU's position. A possible expansion here would also mirror the expansion of the set of international conventions which is included in Annex VIII of the proposed new regulation for GSP.²⁵

Although the transmission mechanism in these cases is an economic one, where economically-disadvantaged or advantaged groups coincide with political or identity groups, there will be consequences for conflict dynamics: youth unemployment, for example, is a growing concern not only in conflict-affected states but also in some European ones given associations with social unrest and increased criminality. Where trade measures either substantially increase or decrease unemployment levels in the medium term, the chances for peacebuilding are enhanced or reduced accordingly.

Sustainability impact assessments

The trade Sustainability Impact Assessments (SIA) that are carried out early in the process of negotiating a trade agreement, with a view to inform the Commission's policy-setting in the negotiations, represent an opening to explore how conflict-sensitivity can be integrated into trade policy. The *Handbook for Trade Sustainability Impact Assessment* (2006) summarises quite nicely the potentials and pitfalls in opening up trade from a development perspective:

Trade liberalisation can... create opportunities for economic growth and for social development, for instance, through boosting employment for women in the tourism sector... Yet trade liberalisation can also lead to negative environmental or social impacts, particularly *if the domestic regulatory framework is not properly geared up to it*. The challenge is to maximise the positive side and to minimise the negative. (p.6; emphasis added).

This is an important acknowledgement that there are gains and losses to trade, and regulation – especially inadequate regulation – is a key determinant of how those gains and losses balance each other. The core group of indicators used in trade SIAs to measure social, environmental and economic impacts is focused on quantitative measures, of water and air quality, poverty and income distribution, average real incomes etc. but does make provision at present for overlaying qualitative assessments of more complex issues such as conflict dynamics in the country, and triggers that could be flicked on or off as a result of the changes that will arise through trade liberalisation. These triggers are, admittedly, further down the causal chain than more easily-captured statistical measures such as median incomes.

²⁴ *EU temporarily withdraws GSP+ trade benefits from Sri Lanka*. Press release, Brussels 15 February 2010. Available at <http://trade.ec.europa.eu/doclib/press/index.cfm?id=515>

²⁵ European Commission, 10th May 2011, *Proposal for a Regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences*. Brussels.

SIAs are conducted by independent consultants and are intended to analyse the issues covered by a trade negotiation from a sustainability perspective, informing negotiators of possible consequences. Importantly, the SIAs can also provide guidance to policymakers and negotiators on 'flanking' measures that would improve sustainability outcomes, which extend to capacity building and international regulation. They typically entail rounds of consultation with stakeholders (public and private) in both the EU and the third country, and are carried out mainly by economic consultants with inputs from civil society. However, the social impact assessments which would be the natural 'home' for conflict indicators to sit in this framework tend to receive far less attention than the economic side of the equation. Furthermore, it is not immediately clear to what extent proposals made in SIAs are consistent across countries where there may be similar concerns, or how proposals have formed a basis for action during the course of a trade negotiation.

It is interesting to note that the *Methodology Handbook* emphasises the importance of identifying risks from trade policy, with flanking measures intended to mitigate some of these risks; however, a brief survey of SIA reports²⁶ indicates that even where risks are flagged up in an assessment, the flanking measures proposed are not necessarily directly linked to those risks, as means of mitigation. This points to some limitations in application of the methodology, or perhaps room to tighten the guidance on application.

While individual free trade agreements (FTAs) concluded by the European Union with its trading partners have in recent years been more explicit in taking into account development needs of the partner in question, through the inclusion of a chapter on sustainable development. However, the EU's position on this has made clear that sustainability issues were subordinate to economic issues in the negotiation of any individual FTA (Lukas & Steinkellner, 2010), which is something that may be reconsidered for future agreements.

Proposed framework

According to the European Commission's press release, the current review of the GSP seeks firstly to concentrate preferences on those countries most in need, and away from middle-income countries. It also aims to simplify the EU's system of preferences such that countries with equivalent access through another free trade arrangement are no longer considered under the GSP. The third element is to reinforce the respect for "core human and labour rights, environmental standards and good governance".²⁷ Article 9 of the proposed regulation²⁸ refers to a far more comprehensive list of international conventions with which GSP+ applicants must comply. Additionally, the onus will shift to the GSP+ applicant countries to prove compliance, as opposed to the EU Commission launching an investigation where it has concerns.

These are welcome moves to encourage governments to raise their own standards. However, the specification of the burden of proof is not yet clear and it remains questionable how effectively all of these conventions can be implemented, and proven to be implemented, in countries with weak governance. While the burden of proof for EBA countries will be

²⁶ Trade SIA in support of a Deep and Comprehensive Free Trade Agreement (DCFTA) between the EU and respectively Georgia and Moldova 2012; Trade Sustainability Impact Assessment (SIA) of the EU - Libya Free Trade Agreement 2009; Trade Sustainability Impact Assessment for the FTA between the EU and the Republic of India 2009. Available at: <http://ec.europa.eu/trade/analysis/sustainability-impact-assessments/assessments/>

²⁷ *Focusing on needs: the EU reshapes its import scheme for developing countries*. DG Trade press release, Brussels, 10 May 2011. Available at http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147894.pdf

²⁸ European Commission, 10th May 2011, *Proposal for a Regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences*. Brussels.

unchanged, the regulation raises a higher bar in terms of the standards that LDCs are required to meet in order to maintain preferential access.

Importantly, the review seeks to increase transparency and predictability in the implementation of GSP. This is important from a conflict perspective because delays or uncertainty in export access are often felt most keenly by smaller operators: these producers typically do not have the necessary levels of working capital or access to alternative finance to sustain a long period without selling their goods, and are thus more vulnerable to fluctuations in international trade. The EU's foresight of introducing a 'rollover' regulation in this regard is to be commended, as the absence of such a provision on US trade preferences had significant impacts on vulnerable communities in the countries affected in by the failure of Congress to agree on renewing its own GSP for developing countries before adjourning in December 2010; the programme expired temporarily and was only renewed ten months later, for a period to run until mid-2013.

The gradual rehabilitation of Myanmar may prove a test case for the EU's promotion of conflict-sensitive trade, under the proposed new framework for GSP. Another potentially instructive example is that of Georgia, which has been stuck in a so-called 'frozen' conflict since the end of the Soviet era with secessionist entities, Abkhazia and South Ossetia.

Georgia

Since December last year, negotiations have been underway with Georgia on a Deep and Comprehensive Free Trade Area (DCFTA), one of the first of its kind and coming under the EU's Eastern Neighbourhood Policy.²⁹ Reaching a practical agreement is complicated by the Russian sanctions on trade with Georgia; Russia has however maintained trade relations with both breakaway regions. Despite the apparent and immediate difficulties in this regard, interestingly an economic feasibility study (commissioned by the European Commission) that preceded the opening of negotiations between the EU and Georgia made little reference to a conflict situation: the focus is rather on the 'uncertain' status of both territories and the practical limitations this places for the conclusion of a FTA.³⁰ Nonetheless, it raises some key issues around the ability of these regions to benefit from any DCFTA. While the study notes that "Georgian sovereignty over Abkhazia does, of course, mean that any FTA signed by Georgia would cover Abkhazia [and South Ossetia] as well" (p.110), it recognises the practical hurdles involved. In theory the Georgian government issues certificates of origin for the whole of the country, but in practice it considers all goods originating in both territories as smuggled and therefore does not issue the certificates that would be necessary for such goods to access the EU market. This is also an issue with regard to services, as the prospects for tourism to develop in these regions will be constrained by travellers being unable to move freely between the territories; this has already been highlighted as a potential issue for the 2014 Winter Olympics, set to be held across the border in Sochi, Russia. Indeed, the study confirms that "Since Abkhazia is legally part of Georgia, it would be covered by such an FTA. That means that any measures taken by the Georgian government to limit trade between Abkhazia and the EU (e.g. export of Abkhazian citrus fruits to the EU by Russian companies operating in Abkhazia) would be in contravention of the agreement" (p.114).

Negotiations have proceeded over the course of the past two years, though the internal and regional issues persist. In terms of practical measures EU policymakers can take to overcome

²⁹ *EU launches trade negotiations with Georgia and Moldova*. European Commission press release 5th December 2011. Available at: http://europa.eu/rapid/press-release_IP-11-1504_en.htm?locale=en. Negotiations are also ongoing with Moldova, and intended to start up with Armenia on similar arrangements.

³⁰ Maliszewska, M. (ed.) 2008. *Economic Feasibility, General Economic Impact and Implications of a Free Trade Agreement between the European Union and Georgia*. Warsaw: Centre for Social and Economic Research

these hurdles, it is worthwhile considering the findings of the SIA, conducted on behalf of the Commission.³¹ The report makes a number of recommendations in relation to ‘flanking’ measures which the Commission can consider to enhance the sustainability impacts, but has little to say on the impacts on conflict dynamics with south Ossetia and Abkhazia, noting only that:

The movement of local population in and out of those areas is restricted and the potential DCFTA effects may differ significantly in these regions compared to the rest of Georgia. (p.69)

The report does note that discrimination against minority groups who receive lesser protection of their rights is “an area of concern” but leaves this to the realm of “broader negotiations” namely an Association Agreement (see latest EEAS press release³²). This leaves space, then, to link the two as suggested earlier.

Proposed controls on the international arms trade

Turning to a different aspect of international business, the international arms trade obviously has the potential for a direct impact on conflict. This is particularly true of the trade in small arms which has helped facilitate – if not fuel – a series of small wars in Africa.

The UN Conference on the Arms Trade Treaty (ATT), which took place in New York from 3 to 27 July 2012, resulted in the formulation of a draft treaty. In the final days of the conference it became clear that the treaty would not be adopted by consensus because of last-minute reservations by the US. Despite this setback, it is likely that an ATT will eventually emerge in one form or another. The EU has already developed a Common Position on arms controls (see Bromley 2012). Once the ATT has been agreed, there will be an obvious question how the EU can support and reinforce it.

Risk assessment will be an important part of the discussion. Article 4 of the current draft ATT refers to ‘National Assessment’, and begins by stating that:

In considering whether to authorize an export of conventional arms within the scope of this Treaty, each State Party shall assess whether the proposed export would contribute to or undermine peace and security.

It goes on to state that:

Each State Party, when considering a proposed export of conventional arms under the scope of this Treaty, shall consider taking feasible measures, including joint actions with other States involved in the transfer, to avoid the arms:

- a. being diverted to the illicit market or for unauthorized end use;
- b. being used to commit or facilitate gender-based violence or violence against children;
- c. being used for transnational organized crime;
- d. becoming subject to corrupt practices; or
- e. adversely impacting the development of the importing State.

³¹ *Trade Sustainability Impact Assessment in support of negotiations of a DCFTA between the EU and Georgia and the Republic of Moldova - Final report, Draft version*, Rotterdam 20 August 2012. http://trade.ec.europa.eu/doclib/docs/2012/september/tradoc_149898.pdf

³² *Statement by Commissioner Štefan Füle to the media in Tbilisi*. Memo, 18th October 2012. Available at http://europa.eu/rapid/press-release_MEMO-12-792_en.htm?locale=en

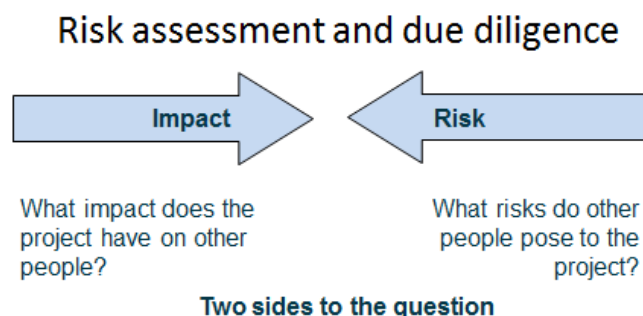
As with similar international initiatives, agreement on the principles is only the first step: implementation presents greater challenge, and the EU together with EU-based businesses will play an important part in ensuring that a future ATT is effective.

4. Investment

Investment in conflict-affected or post-conflict regions areas may be in the public interest. However, as with international trade, policy-makers need to start with the recognition that no investment will take place unless there is a plausible business case. Furthermore, companies vary in their appetites for risk according to their size, country of origin and – as much as any other factor – their commercial sector. As noted above, mobile phone companies are often among the first to enter conflict-affected areas. By contrast risk-averse retail bankers will be much slower. Host governments – assisted by international agencies – can speed up the process by accelerating whatever governance reforms may be necessary, but it will take time for post-conflict foreign investment to pick up momentum.

Risks and impacts

New entrants will weigh the commercial opportunities against the potential risks. Classic company risk assessments review the potential impact on the company from political, security, legal and reputational risks. The human rights and conflict-risk assessments required by the *UN Guiding Principles* look at the other side of the coin: what impact will the company have on other people?



Companies in any case need to address both aspects of risk: if they are responsible for adverse impacts on host communities there will sooner or later be a political and security backlash. The EU can play a constructive reinforcing role by underlining the need for conflict risk analysis in its CSR policy recommendations and – as will be discussed below - when making lending decisions through the European Investment Bank (EIB).

Lending decisions and conflict contexts

The EIB derives its mandate from the policies set by the European Union institutions and provides long-term lending predominantly to projects within European Member States, with about ten percent of its lending going to projects outside the EU, reaching €7 billion in 2011 (*Activity Report, 2011*). This portion of activities is split between the neighbourhood states of the Mediterranean rim, Eastern neighbours and Russia; as well as partner countries in Central Asia, ACP, Asia and Latin America. The focus is on local private sector development, social and economic infrastructure, and climate change mitigation and adaptation projects. These activities essentially support the implementation of the EU's development and cooperation policies. As such, the EIB follows external lines drawn by the EU: a notable recent example was the suspension of all lending and technical assistance to projects in Syria as of November last year, when the Council imposed EU sanctions on the country (EIB, 2011). This suggests a *reactive* approach to the broader political and conflict context around the EIB's activities; what we seek to explore here is the extent to which the EIB may also be *proactive* in setting lending criteria that are sensitive to the political and conflict context around its sponsorship of

individual projects. We also provide a brief update on a review of the EIB's framework and elements that may be considered as part of that process.

Social performance standards

The EIB has its own Environmental and Social Principles and Standards (ESPS) issued in 2009 that set out the following position on public investment in relation to conflict:

...the EIB does not finance projects that give rise to conflicts or intensify existing conflicts. Additionally, the Bank takes into account that a number of countries where it operates face difficult post-conflict recovery and reconstruction efforts. When financing projects in such fragile states, the Bank is guided by the EU approach.³³

The 'EU approach' referred to is the Council's conclusions on situations of fragility³⁴ which date from 2007 and are focused on development cooperation rather than (public or private) investment. As reported in a recent study commissioned by the DG Enterprise and Industry, the EIB "has been criticised for supporting projects that allegedly did not comply with these standards" (Augenstein, 2010: p.42).

The IFC Performance Standards (PS) are the closest comparator in terms of guiding lending by public sector institutions into fragile or conflict-affected states. These provide a framework for defining the roles and responsibilities of borrowers for managing projects, and are accompanied by a set of Guidance Notes for borrowers in how to meet the standards. There are eight areas covered³⁵ and the guidance provided is prescriptive in terms of the provisions to be met for investment to proceed, compared to the ESPS. For example, PS4 covering Community, Health, Safety and Security states that:

In conflict and post-conflict areas, the level of risks and impacts described in this Performance Standard may be greater. The risks that a project could exacerbate an already sensitive local situation and stress scarce local resources should not be overlooked as it may lead to further conflict. (p.10)

The guidance in relation to this PS expects that clients "should understand not only the risks posed to...operations and personnel but also whether its operations could create or exacerbate conflict."

Reporting

At a corporate level, the EIB reports its corporate social responsibility according to the Global Reporting Initiative (GRI), which provides a common standard for sustainability reporting for private companies and other organisations. The GRI encompasses performance indicators on human rights, labour standards, environmental, anti-corruption, and other issues relating to corporate citizenship. The EIB reports performance under economic and environmental indicators as well as decent work practices within the Bank, but does not yet report on some human rights indicators. This owes largely to a lack of data collection of data across projects,

³³ Paragraph 47.

³⁴ *Council Conclusions on a EU response to situations of fragility*, 2831st External Relations Council meeting, Brussels, 19-20 November 2007

³⁵ PS1: Assessment and Management of Environmental and Social Risks and Impacts; PS2: Labor and Working Conditions; PS3: Resource Efficiency and Pollution Prevention; PS4: Community Health, Safety, and Security; PS5: Land Acquisition and Involuntary Resettlement; PS6: Biodiversity Conservation and Sustainable Management of Living Natural Resources; PS7: Indigenous Peoples; PS8: Cultural Heritage. *Performance Standards on Environmental and Social Sustainability*. IFC, 2012. Available at http://www1.ifc.org/wps/wcm/connect/115482804a0255db96fbfd1a5d13d27/PS_English_2012_Full-Document.pdf?MOD=AJPERES

or in some cases there is no data. For example, in relation to indicator HR1 on investment agreements that include human rights clauses or that have undergone human rights screening, the EIB “does not screen or appraise a project explicitly from a human rights perspective”.³⁶

However, the EIB’s social due diligence procedures are based on a set of Social Assessment Guidance (SAG) notes, whose underpinning principles “are derived from a rights-based approach”. These guidance notes, contained in the *Environmental and Social Practices Handbook* (2010), cover the following areas: involuntary resettlement; rights and interests of vulnerable groups; labour standards; community and occupational health and safety; and consultation and participation. Whereas the guidance notes for the IFC Performance Standards are aimed at ‘clients’, these provide checklists for use by the project teams (who are responsible for project appraisal and monitoring) to assess projects being considered for financing at the pre-appraisal stage. This is early enough in the process to identify areas of concern or potential gaps and, where possible, work with the future borrower to fill these.

Some of the information collected through this process is relevant to assessing how a project may influence an existing conflict dynamic in a region or country; for example, whether or not vulnerable groups such as minorities are affected by resettlement. Most questions relate to impacts within the immediate vicinity of the project or to those directly impacted such as employees and local populations. Understanding impacts at this local level is certainly important for a conflict perspective, but much as was discussed in relation to private sector investment above, it is also important to contextualise the broader political and security environment in which a large and often high-profile investment by an EU institution takes place, such as the extent to which this is seen to confer legitimacy on the party benefiting from such an investment. It is also not entirely clear to what extent the screening of local-level impacts is factored into decisions on whether to lend or refuse certain projects on the basis of risks identified at this screening stage, and less so on the significance of the broader political or conflict context.

The lack of clarity may relate to the process and organisational structure behind project appraisal, such as having the screening conducted by project teams. One area that could therefore benefit from focused attention is how the EIB captures and actively learns from lessons from previous projects that may have adopted conflict-sensitive approaches, or had issues with regard to conflict dynamics.

Inguri power complex

The Inguri dam and power complex provides an instructive example of the conflict context around public sector investment, and the risks and opportunities for peacebuilding. On the Georgian side of the Inguri River lies the dam, while the power plants and other infrastructure needed to generate electricity are situated on the Abkhazian side of the disputed border. During the Soviet era, it was one of the largest hydropower facilities supplying up to 1.3 million kilowatt/hours of electricity across the southern Caucasus.³⁷ The facility did not initially attract much attention after the outbreak of armed conflict between the Georgian and Abkhaz sides, but once fighting had died down in 1993 the hydropower complex and economic potential it represented did enter into political calculations on both sides. As the complex is the sole source of electricity in Abkhazia, it is crucial to the maintenance of de facto independence. Meanwhile, it provides a large share of Georgia’s energy needs and is vital to economic recovery in the country. Both sides realise that cooperation is essential, but fundamental

³⁶ See EIB website: <http://www.eib.org/about/cr/gri/1-3-performance-indicators/4-2-human-rights/4-2-1-investment-and-procurement-practices/HR1.htm?39>

³⁷ *Reflections on Water: New Approaches to Transboundary Conflicts and Cooperation*, Blatter, J. and H. Ingram, MIT Press (2001)

disagreements persist about ownership.³⁸ While this has not prevented the continued operation of the complex – only once during the conflict did the “lights go out” – it has restricted maintenance and upgrading so that today the actual capacity today is far below potential.

The unresolved question of ownership fed into much intrigue around the decision of Georgia’s Ministry of Energy to sign a memorandum on joint operation of the station with a Russian company, which was later objected to by Abkhaz authorities. The memorandum was supposedly signed in December 2008, four months after the conclusion of the short but intense August war over South Ossetia. The EIB in 2011 provided a €20 million loan to Georgia, along with a further €20 million from the EBRD, to complete the rehabilitation of generator units at the complex.³⁹ Meanwhile negotiations with the Russian company were suspended in mid-2010, with observers drawing inferences between this suspension and the subsequent provision of funding from the EBRD and under the European Neighbourhood Policy framework.⁴⁰ Although this funding was partially intended to better incentivise both sides to cooperate, it appears to have had little impact on the conflict dynamic. While it may do little to advance peacebuilding, by removing (intentionally or unintentionally) the need for investment from a third party that was not acceptable to the Abkhaz side, it arguably did help to preserve an acceptable status quo.

Review of framework

As discussed above, the existing framework for project screening is essentially focused on assessing compliance with labour standards and management of resettlement, without targeted or explicit consideration of conflict issues. However, a review of this framework is currently underway, with a view to accommodating the Charter of Fundamental Rights of the European Union as well as the Ruggie Principles. Consultations are ongoing with a range of stakeholders, and the likely outcome is to have more explicit attention to human rights in the EIB’s standards and processes. The following are some of the areas that the review will touch upon:

- Redefining risk and identifying whose risk to be evaluated (e.g. EIB as an institution, client, local community);
- Integrating conflict-specific analysis;
- Prioritisation of mitigation measures;
- Linkages of impacts;
- Stakeholder engagement in operations.

As part of its review process, the EIB may wish consider some measures for improving verification and evaluation of clients’ stakeholder engagement to ensure at the ground level projects are appropriately managed with regard to conflict dynamics. Another aspect that may be considered is strengthening knowledge- and information-sharing with external sources of expertise, for example the thematic units within the EEAS dealing with conflict and fragility issues.

³⁸ Basaria, V., ‘The Inguri hydropower station: why this model of trans-Inguri economic cooperation remains the only one’ in *Regulating trans-Inguri economic relations: Views from two banks*, International Alert July 2011

³⁹ Part of the loan is also to finance rehabilitation work at the Vardnili hydropower cascade. EIB Press release 7 January 2011; <http://www.eib.org/projects/press/2011/2011-001-georgia-eib-supports-rehabilitation-of-enguri-and-varnili-hydropower-plant-cascade.htm>

⁴⁰ Op cit.

Investment incentives

The World Bank's 2005 *World Development Report* discusses the value of selective government interventions that might assist particular classes of investors. It argues that such interventions hold a natural allure, but should be approached with care: there are many traps, and few sure-fire strategies. The same overall argument applies to incentives to attract foreign investors to post-conflict countries: governments and multilateral agencies should have a variety of tools at their disposal, but they should use them selectively. External incentives are unlikely to turn a bad business case into a good one but – as in the Bosnia case study below – they might speed up a process that is already under way.

EU-funded political risk insurance for foreign investors in Bosnia

In 1997 the European Union (EU) joined with the World Bank's Multilateral Investment Guarantee Agency (MIGA) to set up the European Union Investment Guarantee Trust Fund to provide political risk insurance for international investors in Bosnia.⁴¹ The EU provided capital of EUR10 million to set up the Fund, and MIGA administered it. For three years there were no takers, partly because Bosnia's governance problems served as a deterrent, and there were in any case few viable business opportunities. The first guarantee was issued in 2000 for Coca Cola's factory in Sarajevo, and this was followed in the early 2000s by subsequent guarantees for – among others – four Austrian banks. Coca Cola had identified a small but attractive local market, and the entry of the banks was facilitated by financial reforms, including the abolition of the socialist-style Payment Bureaux.

The timing of these Bosnian guarantees was significant. By the early 2000s Bosnia was already reaching a turning point in its fortunes, and investors had identified potential economic opportunities. The extra assurance provided by PRI helped give investors the confidence to go ahead, but they would not even have considered Bosnia if the other ingredients – governance reforms and commercial opportunities – had not already been in place.

5. Conclusions

Our overall argument in this paper is for a holistic approach to private sector development in conflict-affected areas, tempered by a sense of realism.

In this case being 'holistic' requires an appreciation of the different but complementary roles played by international institutions, national governments companies and civil society organisations. Realism implies an acknowledgement that none of these actors have perfect or instant solutions. However, this is not an argument for passivity or complacency. If peacebuilding takes time, it is all the more urgent to start now. There are three key themes:

- First, this paper has underlined the central importance of efficient and equitable governance if responsible companies are to flourish. The EU can contribute by offering both diplomatic support and technical assistance for appropriate reforms and – as discussed above – by offering appropriate trading incentives to countries that meet high standards. Companies at a minimum should uphold their own governance standards, including an avoidance of corruption which might otherwise serve to corrode government institutions. Civil society can work as an independent voice testing and – where necessary – challenging both governments and companies.
- The second theme concerns risks and impacts. We should of course all do our best to minimise risks and adverse impacts, while at the same time recognising that some level of political, security and commercial risk is inevitable in conflict-affected areas. An important part of what we should be doing is encouraging responsible risk-taking by

⁴¹ For a review of the fund's impact on foreign investment trends, see Bray (2004).

good companies in difficult areas. Governments and civil society organisations have a legitimate role to play in challenging companies on - for example – the need to conduct conflict and human rights risk assessments. Equally they need to appreciate the significance of commercial risks. If companies fail to achieve sufficient return on their investments, they may not survive.

- Thirdly, while it is important to acknowledge the economic drivers of conflict, peace processes are bound to be political. Trade incentives and private sector development may serve to reinforce or undermine a process that is already taking place: they cannot on their own turn war into peace.

All this reinforces rather than contradicts the need for both EU policy-makers and EU-based companies to play their parts. No economy now operates in isolation. Even distant conflicts can have local repercussions within Europe. If trade and private sector development can make even a minor contribution to peace, we should seize every opportunity to promote them.

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