

# How to Balance FDI and Environmental Protection Under the Belt and Road Initiative

Guo Shiyu <sup>1, 2</sup>

<sup>1</sup> South China Agricultural University, GuangZhou, GuangDong 510000, China

<sup>2</sup>Corresponding author. Email: shiyuguo54@gmail.com

## ABSTRACT

Since the launch of the Belt and Road Initiative in 2013, the debate over how to balance foreign direct investment and environmental protection has been enduring for a long time. This article examines the environmental problems from the perspective of the host state and foreign investors. Host state relaxes domestic environment law while the economy-orient investor lack external constraints, making the local environment worse. It concludes that the inclusion of environmental protection clauses in international investment treaties may be the best solution, although a more rigorous law may also play a role (if it is ignored, it may leave the host country at a competitive disadvantage). After analyzing 2577 international investment treaties, we find that adding the environmental provisions into international investment agreements can guarantee the legal right of the host state and force investors to undertake its social responsibility. The article calls on the host state to encourage investment without relaxing domestic law and add more environmental provisions in international investment agreements, especially emphasizing corporate social responsibility.

**Keywords:** Belt and Road Initiative, Foreign direct investment, Environmental protection

## 1. INTRODUCTION

In 2013, the president of the People's Republic of China, Xi Jinping, announced an economic strategy called "Belt and Road Initiative (BRI)", which focuses on infrastructure development and investments. This ambitious global strategy works as the Chinese government imaged and by the end of October 2019, China has signed a total of 200 cooperation documents on the belt and road initiative with 138 countries and 30 international organizations [1].

See the figure 1, the construction of the belt and road initiative indeed make contributions in the increasing of the foreign direct investment (FDI) along the BRI countries and regions, especially the East Asia Pacific.

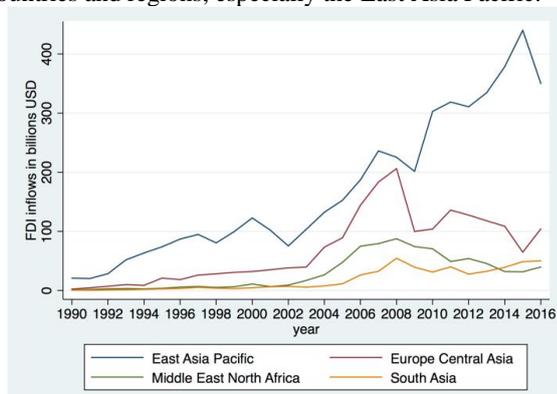


Figure 1 FDI Trends in BRI Economies [2]

Foreign direct investment stimulates local economic growth, which can create new jobs and increase the income of employees, thus re-stimulate the local economic, form a virtuous circle of economy. The strategy of the Belt and Road Initiative also brings advanced technology (like the high-speed railway project) to the host state's community and improve the level of local infrastructure construction.

Despite these achievements, economic growth under the BRI may conflict with the environmental sustainability goals [3], since the establishment and development of infrastructure in environmentally sensitive areas contribute to some environmental issues like biodiversity loss and environmental degradation. There are already some cases involving investment and environmental disputes, including *Commerce Group v. El Salvador* [4], *Industria Nacional de Alimentos V. Peru* [5], etc. This also shows that the environmental protection issue in investment is worth exploring.

This article explores the different approaches to balance foreign direct investment and environmental sustainability. Part II focuses on environmental problems in the construction of the Belt and Road Initiative, from the perspective of the host state and investors, analyzing the problems and their causes. Part III illustrates reasonable solutions to the potential environmental issues, including establishing a stringent legal system and adding environmental protection provisions to the international investment treaty. Part IV concludes by calling for lawmakers to achieve its investment objectives without relaxing domestic environmental law and investors strictly abide by the corporate social responsibility in the investment treaty.

## 2. THE ENVIRONMENTAL ISSUES UNDER BRI

BRI area includes many important environmental areas, if it is improperly developed, it can generate a wide range of negative environmental consequences. According to a report published by World Wildlife Fund (WWF), BRI corridors overlap with the range of 265 threatened species including 39 critically endangered species and 81 endangered species [6]. Environmentally important areas and Protected areas under the same serious condition among the BRI area.

Now, from the perspective of the host state and foreign investors to find the actual environmental issues and their causes.

### 2.1. From the Host state's perspective

First, foreign investors are more likely to invest in environmentally-sensitive sectors like energy, which might cause some unavoidable environmental issues.

Take China as an example of the home state of the foreign investor. From figure 2, we can see that between 2008 and 2018, China's foreign investment was mainly concentrated on energy, and energy investment accounted for almost half of the total investment. From 2004 through 2018, energy investment remained the largest share of all foreign investment, even if its investment ratio fell.

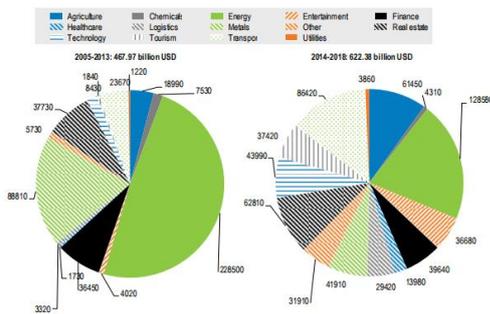


Figure 2 Chinese investment by sector in the global economy, cumulative notional amount expressed in USD million, 2005-2013 versus 2014-2018 [7]

Natural resources like coal, natural gas, and petroleum can generate significant amounts of energy by burning, which plays an important role in industrial production. However, the use of these energy raises serious environmental concerns. Coals contain a high level of carbon, which is a primary contributor to global warming. Petroleum burning accelerates the climate change and the toxicity of it cause air pollution, acid raid and some illnesses in human. Extracting natural gas cause environmental hazards such as fracturing the rocks which might cause mini-earthquakes.

Besides, the government may attract investment by relaxing domestic law which makes the environment worse. Most of the countries participating in BRI are developing countries, which desire to attract foreign

investment to develop their economies. In general, developing countries have no advanced technology, no high skilled labor, low level of transport and infrastructure, all they can attract investment are opening up their natural resources projects and relaxing domestic law.

As the concept "race to the bottom" [8] shows, despite the aspiration to protect the environment of the host state, attract or retain economic activity still the first objective for the government. If they put environmental protection as much important as economic development, they will be at a competitive disadvantage because other states have not done so.

Therefore, for the host country, they need foreign investment to bring funds to drive the domestic economy, provide more employment opportunities for the country, and improve local infrastructure level. While foreign investment brings in capital, because of its investment sensitivity and action relaxing domestic law by the host state, it will inevitably consume local natural resources, occupy cultivated land and make animals and plants lose their living space.

### 2.2. From investors' perspectives

First of all, the purpose of foreign direct investors investing is to make a profit. Foreign direct investment is an investment made by a firm or individual in one country into business interests located in another country, which means investors will not sacrifice investment interests to protect the local environment.

Also, investors' lack of external constraints on investment behavior in the host country makes local environmental problems even more severe. In the host state, as we said before, they are more likely to relax their domestic environment law to attract foreign direct investment. The low standard environment policy means investors only have to bear a slight responsibility for their actions that undermine the local environment. In the international stage, when a dispute arises between the investor and the host state, the investor may file a lawsuit with an international arbitration institution such as the ICSID arbitral tribunal, but the host state can not initiate a lawsuit by itself and can only file a counterclaim against the investor's lawsuit.

Last but not least, there are few provisions on environmental protection in international investment agreements(IIAS). We analyzed 2,577 international investment agreements [9] and found that there were only 143 agreements(5.54%) involving environmental provisions in preamble, 317 agreements(12.30%) involving environmental provisions in other clauses(except for preamble), 241 agreements (9.35%) involving environmental provisions in exception. International investment agreements were created at the time people do not have such strong environmental awareness, thus IIAS pay more attention to protect investors [10] and provisions governing host country obligations predominate in international investment treaties [11].

In a word, environmental degradation is the result of multiple actions. The economic orientation of investors

makes them do not care about local environmental protection; The loss of the external constraints in investment, especially the relaxed domestic environment law makes foreign investors undertake less responsibility. The more emphasis on protecting investors rather than sustainable development in international investment agreements contribute to more challenge for the host state to protect the environment.

**3. SOLVING THE PROBLEMS**

So much for the existing environmental issues in the host states and reasons contribute to that, we recognize how serious environmental challenges the BRI area may face if it develops inappropriately. It is better to take into account the reasonable solutions to prevent foreign investment from damaging the environment or limit such adverse environmental impacts, rather than remedies such as when the environment is destroyed.

**3.1. Stringent legal system**

The host country should develop a stringent legal system. There is no doubt that the establishment of stringent legal system, especially the formulation of strict domestic environmental laws, will limit the pollution behavior of foreign investment, thus achieving the purpose of environmental protection.

However, as we mentioned before, the stricter environmental law may deter FDI. The Pollution Haven Hypothesis (PHH) [12] posits that polluting capital will look for the cheapest resources and labor, often in countries with lenient environmental regulation. Keller and Levinson (1999), Becker and Henderson (2000), and many other papers in favor of the PHH. Kolstad and Xing (2001) concluded that “The laxity of environmental regulations in a host country is a significant determinant of FDI from the US for heavily polluting industries and is insignificant for less polluting industries [13].”

But, a small number of papers have a different opinion, which concluded that the stricter environmental regulation will not deter FDI. Robert J. R. Elliott and Ying Zhou presented “a simple theoretical framework to demonstrate that greater stringency in environmental standards can lead to a strategic increase in capital inflows which we refer to as environmental regulation induced FDI [14].” Dijkstra and others pointed out that “a firm may want to relocate to a country with stricter environmental regulation when the move raises it’s rival’s cost by sufficiently more than its own [15].”

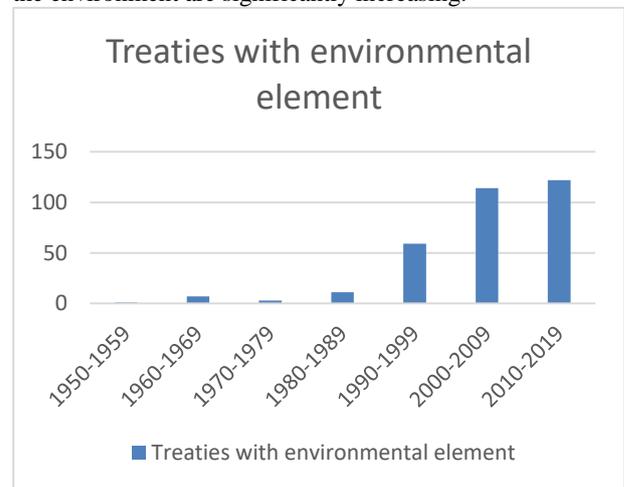
Although there is no final conclusion on the PHH, setting higher environmental standards in the host country does has a positive effect on protecting the environment.

**3.2. Environmental protection in agreements**

Provisions on environmental protection should be added to international investment agreements. Determining that environmental protection and investment are equally important, the IIAS should provide civil liability of foreign investors who violate local environmental laws.

Adding environmental protection to the international investment agreements could provide an additional and powerful guarantee for the host country and its citizens to prevent the adverse effects of foreign investors from dangerous economic activities. This combination will ensure adequate protection for victims of environmental damage by, on the other hand, providing them with prompt and appropriate compensation, and on the other hand, returning the affected environment to its original state.

Nowadays, adding environmental protection provisions into investment agreements is a trend. From the figure 3, from 1950 to 2020, we can see the agreements involving the environment are significantly increasing.



**Figure 3** treaties with environmental element [16]

After analyzing the 281 agreements of the all 317 agreements involving environment in other clauses (except for preamble), we make the figure 4. There are 23 provisions mentioning the corporate social responsibility [17], 76 provisions showing that non-discriminatory regulatory actions to achieve legitimate public welfare objectives do not constitute expropriation [18], 122 provisions showing that the Agreement shall in no way limit the right of Contracting Party to take any measures necessary [19] and 96 provisions putting forward it is inappropriate to encourage investment by relaxing domestic environmental law [20].

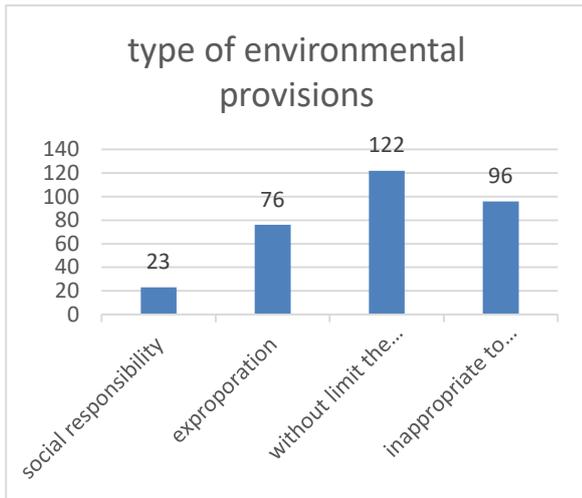


Figure 4 Type of provisions [21]

We also found that environmental provisions pay more attention to the state’s rights rather than emphasize corporate social responsibility. There are 23 agreements involving social responsibility, accounting 8.19% of all agreements involving the environment and all of the rest are about the state’s rights like the exception of expropriation.

International investment agreements could specify that the investors should be responsible for environmental damage caused by their investment activities in the host state. International investment agreements could also impose special restrictions on specific investors, such as provisions for prevention or restoration measures in investment agreements with investors who exploit nonrenewable resources like petroleum. Therefore, the investors will take effect to avoid the danger of environmental damage caused by their investment activities. If the damage has occurred, the investors would be required to take all necessary measures to reduce, control or manage the damage and restore the environment to its original state.

In a word, the inclusion of environmental protection clauses in international investment agreements imposes penalties on investors’ violation of local environmental laws and can effectively achieve the objective of environmental protection. It would be much better to balance the state’s rights and corporate social responsibility by adding more provisions focusing on social responsibility.

#### 4. CONCLUSION

The Belt and Road Initiative has been controversial since its introduction. We have to admit that the Belt and Road Initiative has enormous economic benefits and has played an indispensable role in the development of countries along the Belt and Road.

However, environmental protection issues in the Belt and Road region are also worthy of attention. Its exploitation and utilization of natural resources will cause a lot of

environmental problems. From the perspective of the host state and investors, it will find conflicts between investment and environmental sustainability.

How to solve the problems in the construction of the Belt and Road Initiative, this paper proposes two solutions. By formulating a stringent legal system, it can not only attract foreign investment but also achieve sustainable development of the environment. In addition, the incorporation of environmental protection provisions into international investment agreements enables host countries to protect the environment in accordance with the provisions of the treaty, and investors will also maintain the environment based on corporate social responsibility.

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[8] The race to the bottom is a socio-economic phrase to describe government deregulation of the business environment, or reduction in tax rates, in order to attract or retain economic activity in their jurisdictions.

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[17] "Each Contracting Party should encourage enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate internationally recognized standards of corporate social responsibility in their practices and internal policies, such as statements of principle that have been endorsed or are supported by the Contracting Parties. These principles address issues such as labour, the environment, human rights, community relations and anti-corruption." Article 17 (Corporate Social Responsibility) of the Benin-Canada BIT. See also, e.g. Burkina Faso- Canada BIT.

[18] "Non-discriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, and the environment, do not constitute expropriation." Annex 2 (Expropriation and Compensation)

of ASEAN-Hong kong, China SAR investment agreement. See also, e.g. ASEAN-India Investment agreement

[19] "The provisions of this Agreement shall in no way limit the right of either Contracting Party to take any measures (including the destruction of plants and animals, confiscation of property or the imposition of restrictions on stock movement) necessary for the protection of natural and physical resources or human health, provided such measures are not applied in a manner which would constitute a means of arbitrary or unjustified discrimination." Article 5 ( Exceptions) of the Argentina-New Zealand BIT. See also, e.g. Botswana-Ghana BIT.

[20] "The Contracting Parties recognise that it is inappropriate to encourage investment by relaxing domestic environmental law. Accordingly, each Contracting Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws as an encouragement for the establishment, maintenance or expansion in its territory of an investment." Article 5 of Bahrain-BLEU(Belgium-Luxembourg Economic Union) BIT. See also, e.g. Barbados-BLEU BIT.

[21] Investment policy hub. DOI: <https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping>