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INTERNATIONAL FINANCE CORPORATION: AN INVESTOR FACING TROUBLE IN CONTEMPORARY TIMES

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I. ABSTRACT

The International Finance Corporation (IFC), through loans and direct investments provide financing of private enterprise investment to the low-income/developing countries with the primary objective of improving the development, the economy and provision of jobs in these countries. The IFC is affiliated with the World Bank Group (WBG), it acts as the private sector investor of the World Bank Group and also provides advisory services to develop the private sector of the countries which might be lacking the necessary resources and infrastructure or liquidity to secure financing otherwise.¹

The basis for IFC's strategy is threefold: (i) It recognises the private sector's role in the developing countries as a driver of their economic growth, and as a creator of multiple job opportunities; (ii) The IFC offers the private sector of the developing countries a combination of Advisory Service (AS), Investment Services (IS) and the IFC Asset Management Company (AMC), its role as part of the WBG, and combination of both development and financial goals through its global knowledge; and (iii) Providing the opportunity to the WBG to act as a transformational with support of a collaborative approach which leverages, complements and supports the activities in the private sector.²

The IFC's failure to address the abuses caused by its investment projects and their failure to remediate the situation is not new and has been in practice since multiple decades. The failure of the IFC to disclose its investments, to provide compensations, to conduct proper due diligence

¹ International Finance Corporation (IFC): Definition and Example, available at: <https://www.investopedia.com/terms/i/international-finance-corporation.asp> (last visited on October 18, 2023).

² International Finance Corporation (IFC), available at: <https://www.enterprise-development.org/agency-strategies-and-coordination/international-finance-corporation-ifc/> (last visited on October 18, 2023).

*etc. are just the tip of the iceberg.*³ “An External Review⁴ of the World Bank Group’s private funding institutions found that social and environmental abuses caused by their development projects went largely unaddressed, leaving victims without remedies. The review focused on the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA), and their accountability office, the Compliance Advisor Ombudsman (CAO). It found that only 13 percent⁵ of compliance investigations resulted in a satisfactory response from the IFC”.

The author intends to exhaustively highlight the abuses financed by the so called ‘torch bearer’ of the financial institutions of the world along with the issues faced by it in its diligence and governance practices. The paper exhaustively deals with the issues faced by IFC in case of their ESG financing and policies, its failures and provides suggestions for improving with its dealing in the developing countries and to dilute the boisterous situation.

Key words: International Finance Corporation, World Bank Group, Accountability, Due Diligence, Abuse, Failure, Developing Countries, Ombudsman

II. LIST OF ACRONYMS

IFC – International Finance Corporation

WBG – World Bank Group

MIGA – Multilateral Investment Guarantee Agency

CAO – Compliance Advisor Ombudsman

AMC – Asset Management Company

AS – Advisory Services

FDI – Foreign Direct Investment

FY – Financial Year

FI – Financial Intermediary

ESG – Environmental, Social and Governance Practice

³ World Bank Group Failing at Remedies for Project Abuses: Independent Review Recommends Funding to Address Harms, available at: <https://www.hrw.org/news/2020/08/24/world-bank-group-failing-remedies-project-abuses> (last visited on October 18, 2023).

⁴ External Review of IFC/ MIGA Environmental & Social (E&S) Accountability, including CAO’s Role and Effectiveness, available at: <https://www.worldbank.org/en/about/leadership/brief/external-review-of-ifc-miga-es-accountability> (last visited on October 18, 2023).

⁵ *Ibid.*

LIC – Low-Income Countries

LMIC – Low-Mid-Income Countries

III. RESEARCH QUESTION

The Research Question for this paper is hereunder:

How does the IFC face the issues related to ESG financing in Low-income/developing countries?

IV. RESEARCH HYPOTHESIS

The author attempts to check the veracity of the following hypothesis:

The IFC has failed to mitigate the abuse/losses caused to the local communities and the **environment** and has failed to provide compensation for the same. The IFC has also regularly been unsuccessful in disclosure of the reports of investment and the due diligence conducted by it before providing the financing.

V. RESEARCH METHODOLOGY

This paper is a result of the Doctrinal/Non-Empirical Research Study performed by the author. The author has resorted to the pre-existing literature which includes blogs, articles, research papers, websites etc.

VI. RESEARCH OBJECTIVES

To analyse:

1. Bad investments which caused major harm to the local communities and the **environment**.
2. The Sustainable, Social and Economic issues of financing faced by the IFC.

INTRODUCTION

The International Finance Corporation (IFC) is the World Bank Group's affiliate that promotes economic growth in developing countries through the private sector. To this end, the Corporation invests in private firms, mobilizes complementary financing, and advises on important aspects of private sector development, such as corporate restructuring, capital markets, privatization and Foreign Direct Investment (FDI). The IFC was set up in 1956 but did not become very active in project finance until the 1960s. An entrepreneur or a company, wanting to start a new venture or supplement an existing one, can acquire financing from the IFC by directly approaching them with

the business proposal. The proposal is then reviewed by the IFC, and it may request a detailed feasibility study or report on the venture and may decide on investing accordingly if the entrepreneur/company meets its investment criteria.

IFC has, especially over the past few decades, grown into a substantial source of development assistance. “In financial year 1970, for example, it financed some 40 projects. In FY 1989, IFC made 90 investments, committing \$1.3 billion of its own resources and mobilizing an additional \$8.4 billion from other investors. Over the years, IFC has evolved from a purely project investment body to a diversified group that offers a range of advisory and management services as well. Project investments, nevertheless, remain IFC’s dominant activity. At the end of FY 1989, IFC held investments in 468 firms in 79 countries, a significant increase over the 288 firms in the investment portfolio in 1980. In addition to its project investments, IFC seeks to promote development through its Capital Markets Department, established in 1971”.⁶ IFC has protections in place to ensure its investments “do no harm” and ensure “that the costs of economic development do not fall disproportionately on those who are poor and vulnerable.”⁷ However, “IFC has struggled to ensure its financial intermediary (FI) clients, who now make up around 62% of IFC’s total lending portfolio (as opposed to direct project finance) apply its environmental and social standards”.⁸ The International Finance Corporation, the private-sector arm of the World Bank, has spearheaded this change. “It invested \$50 billion in financial intermediaries such as commercial banks, private equity funds and hedge funds between 2010 and 2015 alone. That’s more than three times what the rest of the World Bank Group invested in education. Other development banks, such as the African Development Bank and the European Investment Bank, have followed suit”.⁹

The IFC, since the 1990s has been involved in financing heavily in the development projects in the developing countries averaging about a billion dollars investment per year and the number has only increased substantially since then. The IFC since its inception has been funding through the lending model under which it would provide investment to the third-party intermediaries which

⁶ Guy Pfeffermann and Gary Bond, “IFC and Development”, in *Finance and Development volume 26 issue 004 December 1989* (International Monetary Fund, 1989).

⁷ IFC Sustainability Policy (2006) and Performance Standards.

⁸ Outsourcing Development: Campaigning for transparency and accountability in financial intermediary lending, available at: <https://www.inclusivedevelopment.net/campaign/campaign-to-reform-development-lending-through-financial-intermediaries/> (last visited October 18, 2023).

⁹ *Ibid.*

would then invest in projects in the developing countries. All these things sound nice but the reality is often disappointing which is the case here. The IFC has been consistently negligible in its accountability and reporting standards and has continually failed in its principles of improving the economic situation in the developing countries but instead has resulted in the abuse of the local communities. In the past, the IFC has fought against those who were affected because of the failed abidance to its internal policies and reporting standards.

Reports have shown that the IFC has slowly shifted its focus from low-income countries to mid-high-income countries. It doesn't perform the proper due diligence which ultimately results in failure of the projects. Despite its principal objective, the IFC acts like an investment bank with a profit-centric approach towards investment and funds the projects even in high-risk countries which shows total breakdown of its risk management system.

1. Analysis of bad investments which caused major harm to the local communities and the environment.

INDIA –

Fishermen from Gujarat, and the International Finance Corporation (IFC) of the World Bank have been at odds since 2011. The Tata Mundra power station was built in 2007 thanks to a \$450 million financing from the IFC.

IFC is being held responsible for funding a project that will damage the livelihood of the fishermen of Mundra in the Kutch district through the lawsuit they have filed. Unsurprisingly, IFC has asserted that there is no case because it is exempt from any legal action in any court. This is true even if IFC's own accountability system berated the organization for its involvement in the project.

The Compliance Advisor Ombudsman (CAO) in 2013 found that IFC had not made sure the project satisfied the relevant environmental and social criteria required for IFC projects. It concluded that the IFC failed to take the necessary actions to safeguard nearby people and the environment despite anticipating the kind of harm the project may create and identifying the problems that would most likely cause that harm.

The IFC disregarded the CAO's conclusion. Later in 2015, the CAO once more published a report

and reaffirmed that the IFC had not yet made any significant efforts to resolve found shortcomings. It further noted that IFC had failed to make amends for the damages already done. The International Finance Corporation was not prepared to address the repeated concerns voiced. Thus, the community turned to the court.

IFC and other World Bank group organizations can now be sued in US courts, according to a decision by the US Supreme Court. For the Gujarati farmers and fishermen who were one of the petitioners in the lawsuit, this is a significant victory.

For the IFC, the department of the World Bank Group that lends to the private sector, the Court's ruling signals a turning point. For many years, the IFC has conducted business as if it were "above the law,"¹⁰ pursuing rash loan initiatives that occasionally resulted in major human rights violations in the local communities they impacted before abandoning the people to fend for themselves.

GUATEMALA –

The International Finance Corporation, the private sector arm of the World Bank, released its 2018 investigation into its role in the contentious Santa Cruz Barillas hydroelectric dam project. This accountability mechanism is known as the Compliance Advisor Ombudsman (CAO) and this CAO released the above-mentioned investigation.

Corporación Interamericana para el Financiamiento de Infraestructura (CIFI), a Latin American financial intermediary, received \$20 million in loans from the IFC and \$9.9 million in equity investments in 2008. CIFI used this money to finance a second business, Hidro Santa Cruz (HSC), which built the hydroelectric project.

Following a complaint made by the locals in 2015, the CAO's compliance inquiry report found the IFC to be irresponsible in failing to protect the Santa Cruz Barillas indigenous community. The investigation showed that the IFC had a responsibility to prevent harms associated with the project, including the unlawful detention of opponents of the project, the murder of local activist Andrés Pedro Miguel, and the use of force against a number of other community members.

¹⁰ *Budha Ismail Jam, et al. v. International Finance Corporation, Civil Action No. 15-612 (JDB).*

In its answer, the IFC acknowledged that the community had suffered negative effects and acknowledged certain oversights in its monitoring and due diligence. While disputing that the effects are directly related to the building of the dam, it did not promise to take corrective steps to rectify the harm.

Local organizations and members of civil society were outraged by the IFC's response. Civil society organizations issued a letter to Phillippe Le Houérou, the chief executive of the IFC, requesting that he change the IFC's stance.

Phillippe Le Houerou, the IFC's chief executive officer, urged the organization to be more receptive to the recommendations of its ombudsman and more proactive in resolving issues brought up by communities in 2019.

Until IFC shows that it is responding to its noncompliance findings, CAO will continue to monitor this issue.¹¹

2. Analysis of the Sustainable and Social issues of financing faced by the IFC.

The International Finance Corporation (IFC) has played a pivotal role in promoting sustainability and solving social problems in the field of global finance. IFC's mission is to promote private sector investment in developing countries, and its mission has faced multifaceted challenges. Sustainable, Social and Economic responsibility have become central to its operations, reflecting on the growing awareness of the need for environmental and social aspects in economic development. Sustainability is a fundamental principle of IFC's work. By promoting investments that prioritise environmental, social and governance (ESG) practices, the institution aims to promote sustainability in emerging markets. One of the most important aspects of IFC's sustainability efforts has been its commitment to climate action. It has been at the forefront of financing projects supporting renewable energy, energy efficiency and sustainable infrastructure, and has made a significant contribution to climate change mitigation. However, IFC is not immune to challenges in this arena. Balancing economic growth in developing countries with the need to reduce carbon emissions remains a difficult task. The IFC must ensure that its investments are consistent with the goals of the Paris Agreement¹² and contribute to a more sustainable future.

¹¹ Compliance Advisor Ombudsman, "Guatemala: Real LRIF-01/Coban" (August, 2019).

¹² The Paris Agreement, 2015, art. 2.

Along with sustainability efforts, IFC has grappled with multifaceted social issues. The organization is very aware of the need to promote social inclusion and fair development in the countries where it operates. In this regard, a visible challenge is the exclusion and adverse social effects caused by large projects. Although the IFC tried to implement strong safeguards and standards, it was criticized for its handling of these situations, especially where local communities experienced negative consequences. This highlights the need to accurately assess the potential social risks of investment projects and to communicate with affected communities. IFC's commitment to sustainability and social issues has evolved over the years. It recognized the need to integrate sustainability into financial decision-making and made significant efforts to introduce ESG considerations. In addition, the operational principles of impact management were adopted, the purpose of which is to establish standards in the field of impact investments. In short, it can be said that the International Finance Corporation has two challenges in striving for sustainable development and solving social problems. Although it has made significant progress in promoting green investment and initiatives to increase social inclusion, it is not without its challenges. Striking a balance between economic development and sustainability remains difficult, and ensuring social equity requires constant diligence and adaptability. As the global community increasingly understands the links between economic development, sustainability and social responsibility, IFC's role in addressing these challenges is more critical than ever. It must continue to learn from past experiences, develop its approach and work with stakeholders to promote a more sustainable and socially inclusive future in developing countries.

SUGGESTIONS AND CONCLUSION

Based on the analysis and study on the contemporary issues that are creating trouble in the financial decision making of the IFC leading to disastrous situations in the world, the below mentioned suggestions are submitted:

1. Conducting bona fide in-house assessments before blindly banking on the reports/studies provided by the prospective clients. This would result in a credible and dependable analysis without any bias towards pushing the investment to go through. Thus, this would increase the probability of a reasonable bet for a good investment in the LICs.
2. There should be a mechanism for compensation and remedy in case an investment ends up being a bad investment and causes harm to the environment and torment to the local community. This is imperative keeping in mind the principal objective of IFC which was to support the developing countries and not to tell them down.

3. There has to be a strict liability law in place for utmost implementation in order to give effect to the suggestions of the CAO, i.e., there have to be stricter checks and balances on the implementation of the recommendations of the CAO and in case the IFC is non-compliant to the recommendations, then there have to be penalties in place to penalise the International Organisation.
4. The investment focus of IFC needs to shift back to the LICs and keeping in mind the financial constraints faced by the LICs at the moment, the WBG should look into providing requisite funding in order for IFC to satisfy its objective. This would result in steering away of IFC from profit making like some investment bank and would uphold its principal objective, i.e., economic development in the developing/poor countries. The interference of the WBG is paramount because striking the balance between economic development and sustainability is a complex concern.
5. The IFC in our opinion needs to revamp its approach and desperately needs to collaborate with stakeholders in order to foster a more sustainable and socially inclusive future in the progressive world.

In conclusion, the IFC has made substantial effort in cultivating environmental responsible investments as evident by its ESG policy, however, it was not successful every time in making good investments. But this can drastically change if the IFC makes changes in its due diligence policy and reporting standards.

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