

Inverting the Paradox: Empowering Natural Resource Management in the Foreign Investment Regime in Sri Lanka

CS Gunasekera

Faculty of Law, General Sir John Kotelawala Defence University, Ratmalana, Sri Lanka
sisimali92@gmail.com

Abstract Foreign investments, often serve as major catalysts in economic development. For a developing country like Sri Lanka rich with natural resources, such resources can be used as key means of attracting huge inflows of foreign investments. However, unplanned and unsustainable natural resource exploitation at foreign investor hands would give rise to a range of environmental, economic and social issues thereby creating drastic impacts on sustainable national development. The objective of this research is to evaluate the comprehensiveness of the existing Sri Lankan foreign investment regime in facilitating optimal use of natural resources and put forward recommendations for further development of law in this field in the light of relevant international standards. Research will be qualitative based on books with critical analysis, journal articles, conventions, statutes, hanzard reports, case laws and data collected from legal experts, policy making authorities and civil society victims. Multi-lateral investment and trade instruments such as GATT and GATS encourage sustainable and optimal use of natural resources in the context of international investments. Given the geophysical characteristics of Sri Lanka this paper analyses how optimal use of natural resources would fuel national development. Although the Sri Lankan foreign investment regime provides substantive safeguards to mitigate environmental pollution caused by foreign investment projects, it has failed to address optimal use of natural resources by foreign investors. This research proposes a mechanism to integrate natural resource management into the legal regime governing foreign investments in Sri Lanka. Accordingly, the study examines how international environmental law principles i.e. inter-generational and intra-generational equity, public trust doctrine and precautionary principle can be incorporated into domestic legal framework in terms of policy decisions and judicial activism. Further, ensuring foreign investor compliance into these standards and monitoring such compliance is required. Hence, proposed mechanism proves that if effectively managed, optimal use of natural resources by foreign investors would boost Sri Lankan national development. In absence of much legal authority in this regard, this research can be used as a guideline for multi disciplinary professionals like policy makers, lawyers, judges, investment consultants and

engineers to enhance professionalism in the respective professions.

Keywords Natural Resource Management, Foreign Investments, Sustainable Development

I. INTRODUCTION

Sri Lanka is a developing nation rich with natural resources. However, owing to the lack of adequate capital, technology and knowledge, most often, the use of natural resources in its development process has been minimal. In this context, foreign investments can be recognized as one of the most viable solutions available for the exploitation of natural resources in the country's strive for economic development.

Foreign investments can be classified as Foreign Direct Investments (FDI) and Portfolio Investments. (Sornarajah, 2010) For the purpose of this paper, the sole consideration will be placed on FDI. Portfolio investments being concerned with the investment in financial assets, it is difficult to identify a considerable impact of this type of investment on the natural resources of the host state.

However, it should be noted that not all investments pave the way for sustainable development especially where the domestic regulatory mechanisms are ineffective and inadequate. (IISD, 2014) Accordingly, the poorly calibrated exploitation of natural resource at the hands of foreign investors would give rise to a number of environmental, economic and social issues. Consequently, natural resources would become a curse to the country rather than being a blessing. Therefore, promoting the right type of investment plays a vital role in the sustainable development of a country.

In this backdrop, the main argument put forward by this paper is if properly harnessed, the exploitation of natural resources by foreign investors would lead to sustainable development. For this purpose, this paper proposes a mechanism to integrate the natural resource management into the legal regime governing foreign investments in Sri Lanka. Accordingly, this paper first examines the role played by foreign investments in the

economic development of a developing state, secondly how the unsustainable exploitation of natural resources by foreign investors impede sustainable development, thirdly, the repercussions of unmanaged exploitation of natural resources in the Sri Lankan context, and fourthly the importance of integrating natural resource management in foreign investment regime. Fifthly this paper analyses how the natural resource management has been integrated into the foreign investment regime in the international sphere followed by the existing domestic regime. Ultimately, a mechanism to integrate natural resource management into the domestic foreign investment regime will be proposed.

II. THE ROLE PLAYED BY FOREIGN INVESTMENTS IN THE ECONOMY OF DEVELOPING COUNTRIES

Sornarajah (2010) defines foreign investments as the “transfer of tangible or intangible assets from one country to another for the purpose of their use in that country to generate wealth under the total or partial control of the owner of the assets.” The classical economic theory asserts foreign investments as being wholly beneficial to the host state. Since foreign investments facilitate the flow of foreign capital, the domestic capital available in the host state can be used for other purposes in the public interest. The technology which is not available in the host state is also introduced thereby triggering its diffusion in the host state.

Further, such foreign investments open a wide range of new employment opportunities for the host state employees. Once such individuals are employed by Multi-national Enterprises (MNEs) they will be able to upgrade their skills acquainted with advanced technology, management etc. Subsequently, when such labour moves to other companies including domestic firms or become entrepreneurs so learned skills can be transferred to the host economy. And also it can be observed that the infrastructure facilities in the host state improved to accommodate huge inflows of foreign investments would be of much beneficial to the host state economy as a whole. (Sornarajah, 2010) Hence foreign investments are often being perceived as beneficial to the sustainable development of developing states. For Singapore though devoid of natural resources reached the height of its development through foreign investments. In contrast

Broadly speaking, many regional and multi-lateral investment instruments are rooted on the tenet that foreign investments contribute to the development process of the host state. For example the Multilateral Investment Guarantee Agreement promotes insurance of

foreign investment against political risks on the basis that it would set aside barriers to international investment and strengthen the development process. (Shihata, 1988). Further, the World Bank's Guidelines on the Treatment of Foreign Direct Investment issued in 1992 is also based on the classical theory.

Moreover, it is evident that arbitral tribunals have also given recognition to this proposition. For example in *Amco v Indonesia* (1984) 23 ILM 351 the arbitral tribunal was on the opinion that “to protect investments is to protect the general interests of development and developing countries.”

III. DOES THE UNSUSTAINABLE EXPLOITATION OF NATURAL RESOURCES BY FOREIGN INVESTORS IMPEDE SUSTAINABLE DEVELOPMENT?

Natural resources could be either renewable or non-renewable. A wide range of resources including forestry, water, fauna and flora and marine resources fall within the scope of renewable resources whereas minerals can be classified as non-renewable resources.

However, most of the resource rich countries are developing countries. Given the lack of adequate capital, technology and knowledge, most often, they do not have any means to make use of their natural resources in the country's development process. Hence, resource rich developing countries often resort to foreign investments for the purpose of exploiting their natural resources. For example developed countries like Canada, and developing countries like Chile and Mexico have successfully made use of inward FDI in mining industry to reach economic development.

However, the realization that foreign investments promote economic development has led the so called developing countries to attract foreign investments as much as possible. Hence the host states often tend to liberalize their regulatory regimes so as to create an investor favourable climate. Accordingly, environmental standards are often lowered. (Viñuales, 2011) This may either result in environmental pollution or excessive natural resource exploitation. It is this second repercussion that will be analysed right throughout this paper.

The excessive exploitation of natural resources can have adverse impacts on the host economy as a whole. The finite character of non-renewable resources has the perils of leaving the producers in a vulnerable state once

when the stocks are completely depleted. Further, the 'boom and bust cycle' caused by the price fluctuations in the international market of main commodities exported by resource rich countries often drastically affects on their economies. In addition, when a country starts mass scale exporting of suddenly discovered natural resources then such nations are more vulnerable to the 'Dutch disease'. (Ravago, Roumasset, Burnett, 2008).

Further, the over exploitation of resources by foreign investors would deprive the domestic entrepreneurs from using the same resources and they would be left unemployed. It would adversely affect the poverty rate of the host country. Such over exploitation resulting in the depletion of natural resources would also amount to adverse climatic changes and affect bio diversity, cultural heritage sites, extremely sensitive environments etc. Ironically, the natural resources would impede the development process of the host state.

Many of the African countries provide home for large endowments of natural resources such as natural gas, oil, gold and diamond etc. Natural resources thus act as the key factor for attracting huge inflows of foreign investments. But most of these countries are still struggling with no considerable economic development. According to the United Nation's Human Development Index (Human Development Report 2005) Which summarizes information on income, health, and education across countries worldwide, most of the oil producing African countries such as Equatorial Guinea, Gabon, The Republic of Congo, Yemen, Nigeria, Angola and Chad are among the lowest ranked countries. Hence it is understandable that investment in natural resources does not per se contribute for the development process of the host state. Paradoxically it would rather be an impediment on the development process.

IV. REPERCUSSIONS OF UNMANAGED EXPLOITATION OF NATURAL RESOURCES IN SRI LANKA

In the Sri Lankan context unplanned and poorly calibrated natural resource exploitation at the hands of foreign investors has given rise to a wide range of environmental, economic and social issues thereby creating drastic impacts on the sustainable national development. For the purpose of this essay two such instances will be analysed.

In *Bulankulama v The Secretary, Ministry of Industrial Development* (also known as the Eppawala case) [2000] 3

Sri L. R. 43 the government entered into a joint venture agreement with a foreign company Freeport MacMoran Resources Partners of United States to mine the phosphate deposits in Eppawala area. According to scientific evidence the phosphate deposits in Eppawala region amounted to 25 million metric tons. As laid down in the agreement the mining was to be carried out at a proposed rate of 1.2 metric tons for the first 12 years and thereafter at 900,000 metric tons per year. Accordingly the whole phosphate deposit would be completely depleted within a period of thirty years and thereafter Sri Lanka will have to import phosphate for its needs.

In addition the petitioners contended that owing to the exploration and exploitation of the phosphate deposit around 2,600 families or 12,000 persons, including themselves, are likely to be permanently displaced from their homes and lands. According to scientific evidence environmental pollution and severe health issues are likely to be caused due to the large scale mining activities and the construction of factory for the production of phosphoric acid and sulphuric acid in Trincomalee.

Eppawala phosphate deposit is located in an area of extreme historical importance and of archaeological value in the proximity of monuments close to the Cultural Triangle sites with the Sri Mahabodhi and Ruwanweli Saya. Under the proposed large scale mining activities Jaya Ganga or Yoda Ela irrigation systems would also be adversely affected. These cultural monuments and ancient irrigation works are non renewable cultural heritage which reflect the ancient civilizations and therefore should be preserved for the benefit of future generations. However, the court giving due consideration to all these issues ultimately rejected the proposed project.

The clearance of the Somawathiye National Park by the US based Dole Food Company for the purpose of cultivating bananas is another instance for the unplanned and unsustainable exploitation of natural resources by foreign investors. Somawathiye National Park provides home for varying species of fauna and flora and also it is of vital importance as a national heritage site. Hence the so called clearing would endanger the lives and habitats of wild animals that live in this area. Further adverse environmental issues were likely to result from such clearances. In terms of S. 3 and S. 6 of the Fauna and Flora Protection Ordinance No 1 of 1970 clearing of such national parks is highly prohibited. However, the company has taken over more than 10,000 acres and around 900 hectares were cleared. The environmental lawyer Mr Jagath Gunawardena noted

that such a national park cannot not be cleared even after conducting an Environmental Impact Assessment (EIA). However, owing to the strong objections raised by the environmentalists ultimately the project was abandoned.

V. THE IMPORTANCE OF INTEGRATING NATURAL RESOURCE MANAGEMENT IN THE FOREIGN INVESTMENT REGIME

The discussion so far put forward by this paper establishes what matters most is not the quantity but the quality of foreign investments. Foreign investments can have both positive and negative economic, social and environmental impacts. What is more important is promoting the right type of investment. This could be achieved by means of a stable regulatory regime.

Hence, it is obvious that if properly managed the optimal use of natural resources by foreign investors would boost the national development in Sri Lanka. Instead, Natural resources are often regarded as a curse merely because most resource-rich countries do not have a proper strategy for the sustainable exploitation of natural resources. For example it can be observed that some resource rich countries have become successful in achieving long-term economic development whereas some other countries still struggling with no considerable development achieved. For example when comparing oil rich countries which are favourable destinations for foreign investments one can notice that around thirty years ago both Indonesia and Nigeria had comparable per capita incomes. But today Indonesia's per capita income is four times that of Nigeria. (Ross, 2003)

In this backdrop, an undeniable obligation is vested with the host state to devise a code of conduct for MNEs to follow in exploiting the host state natural resources. (Mabey and Mcnalley, 1999) Integration of natural resource management into the foreign investment regime in Sri Lanka, therefore, is of vital importance to facilitate the sustainable exploitation of natural resources by foreign investors.

VI. INTERNATIONAL INSTRUMENTS

This paper in this section analyses how the optimal use of natural resources by foreign investors has been given recognition in the international context. On one hand, this notion has found expression in several international instruments and on the other hand many states seem to have incorporated the standards laid down in the so

called international instruments into their domestic regimes.

Talking about international instruments, the OECD Guidelines for Multinational Enterprises (2000) can be regarded as the one of the world's prominent corporate voluntary code of conduct. The Environment chapter of the Guidelines lays down some key guidelines to be followed by MNEs to manage the sustainable use of natural resources. Accordingly, the companies are required to establish a system of environmental management which includes collection and evaluation of timely information regarding environment, establishing and monitoring measurable objectives targeting improved environmental performance. The Guidelines also require the companies to conduct Environmental Impact Assessment (EIA), adopt environment friendly technology which enhances the company's environmental performance and maintain contingency plans for preventing, mitigating and controlling environmental damage caused from their operations.

The UN Global Compact (2000) is another voluntary initiative, established to guide the private sectors for the accomplishment of Millennium Development Goals adopted by the United Nations General Assembly (UNGA) in 2000. It lays down ten cardinal principles in the areas which are possibly being affected by the business activities that is to say human rights, labour, environment and anti-corruption. In respect of environment this initiative requires the businesses to adopt a precautionary approach to meet environmental challenges, undertake to promote environmental responsibility, and develop and diffuse environmentally friendly technologies. Furthermore, the UN Principles of Responsible Investment lays down principles for investors pertaining to the exploitation of natural resources.

It should also be noted that 'non lowering standards' clauses are incorporated into regional trade and investment instruments for the purpose of averting the host state from lowering their environmental standards as a means of attracting foreign investors. For example Article 1114(2) of North American Free Trade Agreement (NAFTA) which is a non-binding approach to a "non-lowering of standards" on environmental protection recognizes that it is "inappropriate to encourage investment by relaxing domestic health, safety or environmental measures."

In addition, it can be observed that many environmental law principles uphold notion of natural resource management. Accordingly, the concept of sustainable development as defined in the Brundtland report (World

Commission on Environment and Development, 1992) provides that it is the “development which meets the needs of the present without compromising the ability of future generations to meet their own needs”. The intergenerational and intra-generational equity as recognized in Principle 3 of the Rio Declaration on the Environment and Development 1992 provides that “The right to development must be fulfilled so as to equitably meet developmental and environmental needs of present and future generations” Similarly Principle 2, 3 and 4 of the Stockholm Declaration(1972) emphasizes on the management and conservation of natural resources and natural eco systems for the benefit of present and future generations. Principle 5 provides for the management of non-renewable resources to prevent its future depletion. Hence, these principles thereby impose an obligation to effectively manage natural resources for the benefit of present and future generations.

The precautionary principle as embodied in the principle 15 of the Rio Declaration imposes an obligation to foresee and assess environmental risks, to warn the potential victims of such risks and take measures to mitigate such risks. Most often this precautionary principle is put into action in terms of the Environmental Impact Assessment. According to the principle 17 of the Rio Declaration “Environmental impact assessment, as a national instrument, shall be undertaken for proposed activities that are likely to have a significant adverse impact on the environment and are subject to a decision of a competent national authority.”

Further, in terms of the principle 11 of the Rio Declaration the state parties are required to enact legislations and environmental standards which promote the regulation of the optimal use of natural resources. Likewise, Principle 13 of the Stockholm Declaration requires the state parties to integrate resource management into development planning with a view to preserve and improve the environment. These environmental law principles are of vital importance because many host states seem to have incorporated them into their foreign investment regimes to enhance the natural resource management.

For example, in Russia the Constitution itself in Art 42 endorses the sustainable use of environment and its resources. Foreign investors seeking entrance to Russia are required to adhere into domestic environmental regulations. Accordingly, the Law ‘On Environmental Protection’ (2002), Russia’s main environmental legislation, in a separate chapter lays down general

requirements for various economic activities including the selection of location, construction and operation of various types of facilities, and general features of the legal regimes pertaining to specially protected areas. Furthermore, foreign investors are required to obtain environmental permits and also to adhere into the concept of the State Environmental Expertise (SEE) and EIA. Environmental fines are incurred for the non compliance with Russian environmental laws. In addition the Law on the Protection of Marine Biological Resources the new Law on Subsoil Resources are currently in the process of negotiation before the Russian Parliament.

Similarly, Canada has taken a number of steps to ensure the sustainable use of natural resources by foreign investors in the mining industry. The Mineral and Metal Policy of the Government of Canada (NRCan, 1996) is in compliance with sustainable development goals. The Canadian Environmental Protection Act is the main legislation which regulates the sustainable use of natural resources at the federal level. The foreign investors are also required to act in compliance with the Environmental Code of Practice for Metal Mines(2009). Environmental Impact Assessment (EIA) is mandatory for most of the large scale projects in Canada. Moreover, in cases where the indigenous communities own mines and mineral rights investors must gain title or lease by paying royalties to the community or entering into a Impact Benefit Agreement(IBA) with the community.

VII. SRI LANKAN LEGAL REGIME

The foreign investment regime in Sri Lanka has provided for numerous substantive protections to mitigate environmental pollution caused by such operations. However, it can be observed that it has not become that successful in promoting the optimal use of natural resources by foreign investors.

The Natural Resource management and conservation is provided in terms of S.17 of Environmental Environment Act No 47 of 1980 (as amended). Accordingly, it is mandatory for the Central Environment Authority to recommend to the Minister ‘the basic policy on the management and conservation of the country’s natural resources in order to obtain the optimum benefits there from and to preserve the same for future generations and the general measures through which such policy may be carried out effectively’

The precautionary principle has been incorporated in to the domestic system in terms of the Environmental Impact Assessment(EIA) as laid down in the part 1VC of the Environmental Environment Act No 47 of 1980 (as amended).Accordingly, an obligation is imposed to conduct an EIA prior to the commencement of the project and identify the potential environmental impacts that can be caused due to such project. Hence the mitigatory measures can be incorporated in to the planning process prior the commencement of the project thereby reducing the possible environmental impacts. The EIA can thus be used to identify the most feasible area for the proposed project. The Board of Investments requires these mechanisms to be adhered into by the foreign investors seeking entrance to Sri Lanka.

The Strategic Environmental Assessment (SEA), though not legislatively incorporated, is currently conducted in different districts of Sri Lanka.Accordingly, a whole district is subjected to the environmental impact assessment and ultimately the particular industries that should be located in different areas of the district is determined giving due consideration to its natural resource concentration. Consequently, the industries can be located in areas which are apt for such industries and rich with natural resources which are useful for such industries. Such SEA has been carried out in Northern Province, Hambanthota and Trincomalee.

In addition it can be observed that the judiciary has also given expression to the environmental law principles dealing with natural resource management. The concept of sustainable development was upheld in the Eppawala case. Similarly, the precautionary principle has also found expression in the said case.

The principle on intergenerational and intra- generational equity upholds the rights of future generations while recognizing the rights of the present generation to exploit natural resources. Justice Amarasinghe in Eppawala case referring to the intergenerational and intra-generational equity in the context of the sustainable use of phosphate deposits in Sri Lanka was on the opinion that

“International standard setting instruments have clearly recognized the principle of inter-generational equity. It has been stated that humankind bears a solemn responsibility to protect and improve the environment for present and future generations. (Principle 1, Stockholm Declaration) . The natural resources of the earth including the air, water, land flora and fauna must be safeguarded for the benefit of present and future

generations. (Principle 2, Stockholm Declaration). The non-renewable resources of the earth must be employed in such a way as to guard against their future exhaustion and to ensure that benefits from such employment are shared by all humankind (Principle 5, Stockholm Declaration) The right to development must be fulfilled so as to equitably meet developmental and environmental needs of present and future generations. (Principle 3, Rio De Janeiro Declaration). The inter-generational principle in my view, should be regarded as axiomatic in the decision making process in relation to matters concerning the natural resources and the environment of Sri Lanka in general, and particularly in the case before us. It is not something new to us, although memories may need to be jogged”

VIII. INTEGRATION OF NATURAL RESOURCE MANAGEMENT INTO THE FOREIGN INVESTMENT REGIME.

Given the inadequacy of measures to safeguard the optimal use of natural resources by foreign investors it is of vital importance to devise a mechanism to integrate the natural resource management into the foreign investment regime.

It is therefore recommended to carry out a survey and prepare a list classifying renewable and non-renewable resources. Accordingly the resources to be allocated for foreign investors should be determined after giving due consideration for environmental, economic, social concerns and also in the national interest.

Further it is also required to carry out a screening process and recognize the beneficial and detrimental foreign investments. In this respect the industrial know – how should be given a major consideration. In certain instances the outdated technology brought into the country by the foreign investors give rise to numerous environmental and health issues. Therefore, as the host state Sri Lankan government should take measures to permit the entrance of foreign investors who bring new technology with them. Most of the resource rich countries encounter severe environmental impacts simply because they tend to imitate the economic policies of other highly developed countries. Instead, the prominence should be given for ‘cutting edge industries’ depending on the geophysical characteristics and availability of natural resources.

The Strategic Environmental Assessment (SEA) should be incorporated into the National Environment Act specifying the required guidelines to be followed in carrying out such assessment. Accordingly, the district should be subjected to an environmental impact assessment and ultimately the particular industries that

should be located in different areas of the district should be determined giving due consideration to its natural resource concentration. Such details should be submitted to the Board of Investments who will then have to guide and instruct the foreign investors seeking entrance to Sri Lanka as to the exact zones or regions where they locate their projects.

In most instances the advanced and modern technology brought with the foreign investor is not transferred or diffused into the domestic economy. The local employees are not provided with the opportunity of acquiring the skills in management and those associated with the technology. Foreign investors are cautious enough to reserve such know-how and other skills with themselves. Hence joint venture agreements can be introduced in respect of certain significant industries so that domestic entrepreneurs also have a say on such projects. The joint venture system in the context of foreign investments is currently operating in India.

In addition it is essential to enact laws giving effect to the international principles on natural resource management. Further the Board of Investments should take measures to ensure the investor compliance with such rules and regulations.

IX. CONCLUSION

Natural resources are a blessing to a developing country like Sri Lanka. As argued throughout this paper, if properly harnessed the sustainable exploitation of natural resources by foreign investors could pave the way for the sustainable development. Hence, a stable legal regime is essential to achieve this objective. However, the foreign investment regime in Sri Lanka does not adequately provide safeguards for the proper management of natural resources. Hence, integrating the natural resource management into the foreign investment regime plays a crucial role in Sri Lanka's strive for sustainable development.

ACKNOWLEDGMENT

The author would like to thank the environmental lawyer Mr. Jagath Gunawardena and Dr Thusitha Abeysekera of Faculty of Law, General Sir John Kotelawala Defence University for the immense support and guidance given in compiling this research paper.

BIOGRAPHY OF THE AUTHOR



Chathurika Sisimali Gunasekera is a third year undergraduate at the Faculty of Law, General Sir John Kotelawala Defence University, Ratmalana. She has previously presented several research papers in both national and international research conferences (India). Her research interests include Administrative Law, Human Rights Law, Environmental Law and Intellectual Property Law. She is also a member of the KDU Mooting Team.

REFERENCES

- Amco v Indonesia (1984) 23 ILM 351
- Bulankulama v The Secretary, Ministry of Industrial Development [2000] 3 Sri L. R. 43
- Abeysekera, TB., *A Proposal for the Protection of Digital Databases in Sri Lanka* (PhD Thesis, University of Exeter-UK 2013) available at <https://ore.exeter.ac.uk/repository/handle/10871/14172> visited on 24/07/2015.
- GH, Brundtland, and World Commission on Environment and Development. *Our Common Future: Report of the World Commission on Environment and Development*. Oxford University, 1987.
- International Institute for Sustainable Development & United Nations Environment Programme. (2014). *Trade and Green Economy: A Handbook*. 3rd edn. Geneva: International Institute for Sustainable Development
- National environment Act, Sri Lanka No 47 of 1980
- North American Free Trade Agreement 1993 9 32 ILM 289, 605)
- Ravago M, Roumasset J, Burnett K (2008) Resource management for Sustainable Development of Island Economies. Working paper No 08-04
- Rio Declaration on Environment and Development 1992 (UN Doc. A/CONF.151/26 (vol. I) / 31 ILM 874)
- Shihata, I. (1988) *The MIGA and Foreign Investment*
- Sornarajah M (2010) *The International Law on Foreign Investments*, 3rd edn. Cambridge: Cambridge University Press