Working Group on Development and Environment in the Americas

Discussion Paper Number 14

Foreign Direct Investment, International Rules and Sustainable Development: Some preliminary lessons from the Uruguayan pulp mills case

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April 2008

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Introduction

This chapter focuses on the recent dispute between Argentina and Uruguay over the installation of two pulp mills near the Uruguayan city of Fray Bentos, on the bank of the Uruguay River (a resource shared by the two countries). At present, only one of the pulp mills (involving investment by the Finnish firm Metsä-Botnia Oy) is under construction at the originally planned location, since the other project (involving the Spanish company ENCE) has been relocated to another Uruguayan region. The Argentinean government claims that the Fray Bentos pulp mill will have severe environmental consequences, in particular for the nearby Argentinean city of Gualeguaychú, while the Uruguayan government argues that it will have no noticeable environmental effects.

This case has garnered increasing regional and international attention, as the dialogues, technical analyses, and legal disputes[i] of the past two years have failed to arrive at a solution to the bilateral crisis. In fact, the conflict has been intensifying over time. Bilateral relations have been deteriorating even within the framework of MERCOSUR, the regional trade agreement into which Argentina, Brazil, Paraguay and Uruguay entered (with Bolivia and Chile as associate members) in 1991.

In an attempt to move the analysis beyond the details of the conflict and the opposed views of the two countries, this chapter adopts a regional perspective. It aims to highlight the main lesson from this dispute: the need to strengthen the institutional and regulatory capacities of the region in order to guarantee sustainable development benefits from FDI, and, in particular, to effectively regulate the potential environmental impacts of expanding forestry-based industry. The failure, so far, to achieve a resolution to this dispute or agreement on a mechanism for monitoring and regulating the environmental impact of the Fray Bentos mill suggests that the region is not yet able to ensure that the expanding pulp and paper industry (or FDI in this sector) will contribute to sustainable development.

This view can be supported from two perspectives.

First, the failure to reach a solution to the conflict is somewhat puzzling given the existence of at least two institutions created, among other things, for this purpose -- the Uruguay River Statute signed by Argentina and Uruguay in 1975 and the regional agreements signed by Argentina and Uruguay in the framework of MERCOSUR (in particular, the Framework Agreement on Environmental Issues signed in 2001). The Framework Agreement on Environmental Issues agreement states that MERCOSUR member countries should cooperate for environmental protection and sustainable use of natural resources, as well as to meet international commitments on environmental matters (including through common policies). It also includes provisions to solve, through the MERCOSUR mechanism for dispute settlement, any controversy between

member countries on environmental matters. This regional mechanism, however, has not been invoked for this case.

Second, the need for regional cooperation in order to effectively deal with potential environmental impacts of FDI has been neglected in this case. This bilateral dispute should be viewed in the broader context of international rules that have profound effects on local and regional regulatory issues: 1) investment protection rules, mostly developed at the bilateral or regional level (through bilateral investment treaties (BITs) and investment protection chapters of free trade agreements (FTAs)), and 2) international environmental rules stemming from multilateral environmental agreements (MEAs), as a response to concerns about trans-boundary environmental impacts. Investment protection rules are important in this case since one of the foreign investors currently building the pulp mill in Fray Bentos, the Finnish company Metsä-Botnia Oym is protected by the BIT signed by Uruguay and Finland in 2002. Multilateral environmental agreements, meanwhile, are important since Uruguay (like all other MERCOSUR countries) has ratified the Stockholm Convention on Persistent Organic Pollutants. MERCOSUR countries are bound to design new regulations to curb "unintended" emissions of dioxins and furans (pollutants of which pulp mills are a potential source) and to promote the use of best available technologies and environmental practices.

Bilateral dialogue virtually stalled between March 2006 and April 2007, and no efforts are currently underway to design a joint regulatory response to the potential environmental impacts of the pulp mill. At the time this article was concluded, Spain was trying to promote renewed dialogue, but no preliminary agreement – nor even any specific proposal – is yet in sight.

The window of opportunity for building the necessary regional institutional capacity and crafting a coordinated regulatory response is quite tight: the Botnia plant in Fray Bentos is expected to start operations in September 2007. Similarly, regulations to curb unintended emissions of dioxins and furans from new sources should be put in place by Uruguay (pursuant to Stockholm Convention on Persistent Organic Pollutants) by mid 2008. This suggests that the concerned parties may only realize that cooperation on regulation and monitoring was the best (and unexploited) option when it is too late.

The discussion is organized as follows:

The next three sections present some basic information on the case under consideration. Section II below describes the economic importance of the MERCOSUR region for pulp and paper production. Section III discusses the implications of the ongoing debate on FDI, BITs and sustainable development. Section IV focuses on some stylized facts of the dispute and highlights the institutional weaknesses the dispute has revealed.

Section V discusses the commitments assumed by Uruguay and Argentina under the Stockholm Convention on Persistent Organic Pollutants and identifies two associated challenges. First, these commitments may lead to a potential conflict with foreign investors (due to the introduction of new environmental regulations after BITs were signed). Second, they pose an additional need for regional coordination of environmental policy in view of the limited national capacities to monitor releases of dioxins and furans.

To conclude, section VI discusses the most important lessons from the case.

The Southern Cone's Role as Pulp-and-Paper Producer

Since the 1980s, South America has been one of the most dynamic and promising regions for forest-based industries such as pulp and paper. The Southern Cone (Argentina, Brazil, Chile and Uruguay), in particular, has increased its share of world pulp and paper production since the late 1980s, due to a mix of favorable natural conditions (rapid growth and availability of low-cost land for forestry) and promotional forestry policies. So far, however, increasing "Southern Cone" output is mostly explained by rising production in Brazil and Chile, which jointly account for 70-90% of the sub-region's production.

Over the past decade, investment in Argentina has primarily taken the form of acquisition of existing pulp and paper plants, notably by foreign companies from MERCOSUR member or associate countries. For example, FANAPEL (Uruguay) took a majority stake in Celulosa Argentina; Celulosa Arauco (Chile) bought Alto Paraná (the main pulp producer) as well as Celulosa Puerto Piray. Another Chilean firm, CMPC, purchased the local company Papelera del Plata and began, in the 1990s, forestry operations in the provinces of Misiones and Corrientes. In addition, there some investment went into new paper product facilities, e.g., by Klabin (Brazil). Recent press sources also suggest that CMPC may have plans to build a pulp mill in Corrientes province.[ii]

Argentina, Brazil, Chile and Uruguay increased their world share in roundwood production from 7% in 1990 to 9% in 2004, during a period of stagnant world output. In paper production, their 3% share increased to 4% over the same span, in spite of mounting world production (which grew 50% during the period). Nearly all of the Southern Cone's increase was accounted for by Brazil (the regional leader). Most impressive is the case of chemical pulp production. The Southern Cone countries increased their share from 6% to 11% (with their share of world exports reaching 24% in 2004). In chemical pulp, according to 2004 figures, Brazil and Argentina exported 50% of their production, while this proportion reached 90% for Chile[iii].

Unlike Chile and Brazil, where local firms are the main participants in the forestry sector,[iv] Uruguay expanded this sector through FDI. In the 1990s, the country launched a broad strategy to attract foreign investment, comprising a new law for foreign investment (1998), adhesion to ICSID, the World Bank-affiliated international tribunal for investment-related disputes (1992), and the signing of 22 Bilateral Investment Treaties throughout the 1990s. In the forest industries, industrial and forestry-promotion policies also played an important role.[v] These policies have led to a surge of FDI inflows into the sector since the mid 1990s. The average annual inflow since then has hovered around US$300 million, i.e. more than double the previous peak of US$122 million (achieved between 1977-1982). The FDI stock more than tripled between 1990 and 2004 (from US$670 million to US$2,110 million) (Bittencourt & Domingo, 2000; UNCTAD, 2005).

Even if many other sectors grew under the new investment rules, the forestry case stands alone, since deliberate forestry-promotion policies have led to the rise of a previously nonexistent industry: eucalyptus-based forestry. This industry received most of the FDI going to the primary products sector in the first half of the 1990s. After nearly 15 years of planting, trees were ready for pulpwood production, spurring many pulp-processing projects. The two most prominent involve a Finnish company (Botnia) and a Spanish pulp producer (ENCE). Originally, the two projects were to be located near Fray Bentos (in the Department of Río Negro). These projects were expected to produce 1.5 million tons of eucalyptus bleached kraft pulp for the world market, and to lead to FDI inflows of US$1.5 billion (the largest investment ever hosted by Uruguay).

The ENCE project is currently being redefined both in terms of scale and location, after the decision not to build the plant near Fray Bentos. For this reason, this article mostly focuses on the Botnia project (aimed at producing of 1 million tons of eucalyptus bleached kraft pulp). According to recent estimates, the Botnia pulp mill will be ready to begin operations in September 2007. The two projects (or even the Botnia project alone) will rank Uruguay third among Latin American kraft pulp producers.

The Debate Over Investment Protection and Constraints on Environmental Policy

Since the 1990s, a growing international debate has explored the links between FDI and sustainable development and the effects of FDI-protection mechanisms on these links.

Many developing countries have signed bilateral treaties protecting foreign investment in the past 15 years. The "investment chapters" of free trade agreements (FTAs), such as NAFTA's chapter 11, have been another important kind of bilateral or regional (as opposed to multilateral) mechanism for investment protection.

In MERCOSUR, two separate protocols were drafted for investment protection (one for intra-MERCOSUR investment, the 1994 Colonia Protocol, and one for foreign investment, the 1994 Buenos Aires Protocol). Neither, however, has entered into force, since the required full ratification by members was not reached. Argentina, Paraguay and Uruguay ratified the Buenos Aires Protocol but it did not enter into force due to Brazilian nonratification; by contrast, none of the member countries formally ratified the Colonia Protocol.[vi]

Critics of both BITs and investment chapters of FTAs usually point out their bias towards the protection of investors' rights (e.g., through over-broad definitions of investment and expropriation that widen the scope for litigation), for generalizing benefits to all investors (via "most favored nation" clauses), and for "importing" institutions (in particular, introducing investor-state arbitration, by which investors may sue governments at international tribunals such as ICSID or UNCITRAL). More generally, critics argue that such agreements seriously constrain governments' policy latitude, and may lead to a virtual freeze on regulation in order to guarantee a stable business environment (and avoid conflicts with investors). For a more detailed discussion the interested reader is referred to Mann (2001) and Peterson (2003); Stanley (2004) offers an analysis of BITs focusing on Latin American countries.

In general, BITs and investment protection chapters of FTAs make no special provisions for areas in which governments may want to retain strong regulatory powers (e.g., environment, public health). Foreign investors have sued host countries because they considered new environmental regulations or policy decisions 1) indirect "expropriations" of their investments, 2) unjustified performance standards or 3) unjust treatment of investors according to minimum standards (Mann, 2001; Peterson, 2003).

In a number of cases, governments had to back down from their environmental policy decisions (e.g., *Ethyl v. Canada*, leading to Canada retreating from its ban on MMT imports) or compensate investors for economic losses due to environmental regulations, While this remains a concern in the environmental community, in the case *Methanex v. United States* , the Tribunal ruled that an environmental regulation cannot be considered an expropriation, reversing the precedent set in the earlier cases (Mann, 2001; 2005).

In addition, some environment and investment chapters of FTAs are evolving to recognize host countries' rights to protect the environment and natural resources. For example, in the FTA signed between the U.S. and Colombia, the environment chapter makes explicit reference to biodiversity protection and its importance for sustainable development, as well as to the parties' sovereignty regarding the use of natural resources. Furthermore, the investment chapter of this FTA states that investors may not sue the host country for regulatory changes affecting their activities if those changes pursue public-health or environmental-protection objectives.

Nevertheless, these exceptions are quite rare in the universe of outstanding FTAs and BITs. In some cases, environmental concerns have been included in FTA provisions or in specific protocols (e,g., those signed by Chile with the U.S. and the Central America Free Trade Agreement (CAFTA) with the U.S.), but without specific provisions to safeguard environmental regulations. Even more worrying, there is no international tribunal to adjudicate cases of noncompliance with the environmental provisions of BITs or FTAs (as mentioned by Mann, 2001, for the case of NAFTA).

The BIT signed by Finland and Uruguay made no specific provision for environmental regulations. Therefore, the Finnish firm Botnia could, in principle, sue Uruguay if the government established new environmental regulations for the pulp and paper industry (e.g., changing the standards set in the initial operation permits, denying a new permit due to a facility's inability to comply with more stringent environmental regulations, etc.).

Some analysts argue that such investment-protection mechanisms put too much emphasis on investors' rights and not enough on investors' obligations. In particular, foreign investors are granted "unlimited" protection through BITs or investment chapters in FTAs, but make only voluntary commitments on the environmental impacts of their operations abroad (i.e., they face no compulsory rules to meet the same environmental standards in their home base and foreign operations) (von Moltke & Mann, 2004). One example of this voluntary-commitment framework is the Revised OECD Guidelines for Multinational Enterprises (OECD, 2000), which allows complaints at national focal points (in investors' home countries or in host countries) in cases where companies fail to comply with environmental, human rights, or labor standards, or disclosure and transparency guidelines.

Foreign investors (and TNCs) face, in addition to local environmental requirements, those stemming from international financial institutions' project evaluations (e.g., those faced by Botnia and ENCE when they applied for International Finance Corporation (World Bank Group) funding for their pulp-mill projects) (see section IV below). However, both the OECD Guidelines' and international financial institutions' requisites rely on local legislation to determine the appropriate environmental standards. The World Bank Group's operational rules only required that the companies' environmental impact assessments indicated that they would apply best available technologies and meet national emissions standards (according to technology specifications, the evaluation of the local regulatory authority (DINAMA), etc.). This may not be sufficient in the pulp-mills case if national regulations do not fully acknowledge regional environmental impacts (discussed in section IV below). This may well call for the participation of regional institutions in order to address environmental concerns created by investment and trade within the region, something that did not happen in this dispute (MERCOSUR was hardly involved).

The pulp mills dispute

After more than a year of bilateral controversy, Argentina brought Uruguay to trial before the International Court of Justice (ICJ) under charges that Uruguay breached the terms of the Uruguay River Statute by unilaterally authorizing ENCE and Botnia (the local company name for the subsidiary of Metsä-Botnia Oy) to build the pulp mills. For its part, Uruguay presented claims both at MERCOSUR and before the ICJ due to road-blocking by Argentinean protestors, who interrupted traffic on the bridge connecting the cities of Fray Bentos (in Uruguay) and Gualeguaychú (Argentina) during most of the summer months over the past two years, severely affecting Uruguayan income from tourism.

It is puzzling that two partners in a regional trade agreement, with a long historic record of good relations, have failed to solve the conflict posed by the potential environmental impact of two pulp mills.

In principle, this is a controversy that could be solved at the technical and regulatory levels, provided appropriate technical institutions [???] are available and involved. MERCOSUR features many working groups for technical and institutional cooperation that are relevant for this case: 1) two technical subgroups (among ten that report to the Common Market Group), one on Environment (SGT Nº 6) and one on Industry (SGT Nº 7) issues, 2) one Specialized Meeting on Science and Technology, and 3) a Technical Cooperation Committee. It is puzzling that none of these bodies was involved in efforts to create a dialogue in this case, regardless of growing importance of this sector in the MERCOSUR region.

From a pure cost-benefit perspective, this case poses a regional policy dilemma.[vii] A preliminary analysis, mainly from the environmental impact assessments (EIAs) available, suggests that most economic and social benefits from the proposed pulp mills would accrue to Uruguay at the cost of some environmental impact (while some environmental risks may be not fully considered by Uruguayan authorities, as argued below), and that Argentina faces some environmental risk with no certain socio-economic benefits from the projects. Some potential economic gains were spurned by the Entre Ríos province (in which Gualeguaychú is located) when it recently banned wood exports to the Uruguayan pulp mills; however, other provinces with eucalyptus plantations, like Corrientes and Misiones, may still benefit from such exports.

The initial conflict, temporarily reduced has subsequently mounted over time (see Table 1 for a chronology). For almost a year, analysts have stressed that the bilateral conflict may seriously weaken MERCOSUR ties. Even if the characteristics of this particular case, which has been a political "hot potato," could explain the reluctance of MERCOSUR (in particular at the Common Market Council, the main political body) to get involved, it is still puzzling that the case was not eventually brought to consideration under MERCOSUR technical or advisory bodies, such as the Common Market Group and its subgroups (save for the Uruguayan claim on road-blocking presented at the dispute settlement mechanism).

The main argument of each party before international tribunals has been to show that its share of damages is too high and unjustified: For Argentina, in terms of environmental risk if the Fray Bentos plant is built and starts operations as planned; for Uruguay, if the Argentinean road-blocking protests, which inflict economic losses on Uruguay due to a fall in trade and tourism flows from Argentina, go on unchecked.

Even if each government wanted to put an end to the dispute, it might have faced high costs. In March 2006, Uruguay was in a difficult position to ask Botnia to halt construction and relocate its

plant after having granted the preliminary authorization for building (and after construction had started). This would have either required very expensive compensation or considerable risk of a formal complaint under the BIT signed with Finland. On the Argentinean side, given the general approval that protestors from Gualeguaychú have enjoyed in the country, ordering (or eventually forcing) an end to the road-blocking would have been politically difficult.

Table 1: Some stylized facts of the pulp mills dispute chronology

2003	October: Uruguayan government grants ENCE reliminary environmental authorization for the building phase (DINAMA, Res.342/2003). Civil Society representatives from Gualeguaychú express their concern over the environmental impact of the pulp mill to the Argentinean government Argentinean note of complaint to the Uruguayan government. Ad-hoc CARU meeting. Argentina questioned unilateral authorization by Uruguay for a project affecting a joint resource, regulated by the Uruguay River Statute.
2004	March: Talks between the two governments lead to an agreement to this initial dispute. April: The Foreign Relations Minister of Argentina declares in the Congress that, in the CARU Framework, Argentina will receive all the relevant information to determine whether to agree or not to the project authorization. Argentina agrees, in the CARU framework, to joint monitoring of building and operation phases. May: CARU meeting 01/04 [IS THIS A MEETING NUMBER, RATHER THAN A DATE?]. Uruguay argues that the transcript from the meeting reflects that Argentina agreed to the authorization and considered the dispute closed (no transcript is available for consultation).
2005	February: Uruguayan government grants Botnia preliminary authorization for the building phase (DINAMA, Res.63/2005) April: Botnia starts building works near Fray Bentos. May: The two governments agree on creating a joint high-level technical taskforce (GTAN) to evaluate the environmental impact of the pulp mills on the Uruguay River. June: The Argentinean government sends a note to the World Bank Group asking the institution to refrain from funding the Botnia project (knowing that an application for funding had been presented by the company in 2004). As a result, Uruguay postpones the first GTAN meeting. August: GTAN meetings start. December: World Bank Group releases draft cumulative-impact study. Protestors from Gualeguaychú start road-blocking at the San Martín Bridge joining Fray Bentos and Gualeguaychú. Sporadic road blocking also occurs on the bridges joining Colón (Arg.)-Paysandú (Uru.) and Concordia (Arg.)-Salto (Uru.) during the summer.

2006	February: The Argentinean Parliament approves the Executive Power decision to bring the dispute with Uruguay before the International Court of Justice (ICJ). Uruguay demands a special meeting of the Common Market Group of MERCOSUR to discuss the economic impacts of road-blocking in Argentina. Argentina (holding the rotating presidency of MERCOSUR) ignores the request. Uruguay files a case under MERCOSUR dispute settlement mechanism (for Argentina's non compliance with MERCOSUR rules of freedom of trade and transport). March: After a series of meetings and the exchange of information and notes, the GTAN could not agree upon a joint set of conclusions. Each government issues a separate report. Road blocking lifted on the bridges near Gualeguaychú (after 46 days) and Colon (after 34 days). The Uruguayan president invites Argentina for joint monitoring of the pulp mills. The Argentinean president asks his Uruguayan Counterpart to consider asking for a halt in construction on both plants for 90 days in order to give more time to assess their cumulative environmental impact. ENCE agrees to stop building, and shortly after announces that the plant (only terrain preparation had been undertaken) will not be built near Fray Bentos, but in another Uruguayan location. Botnia refuses to completely stop building. Bilateral talks came to a halt. April: Independent expert review of the draft cumulative impact study released by World Bank Group (Hartfield report). Argentinean NGO (CEDHA) presents a claim before the Finnish focal point arguing that Botnia's operations in Uruguay did not comply with the OECD Guidelines for Multinational Enterprises. May: Argentina presents two cases before the ICJ in relation with the bilateral dispute. One case demands the building at the Botnia facility stop, the other one accuses Uruguay of breaching the Uruguay River Statute by unilaterally granting authorization for building the pulp mills. July: ICJ refuses to grant (at the demand of Argentina) an interruption of building at Botnia. The jury states that building operations did not imply "irreversible damage" to Argentina. ICJ decision on the other case presented by Argentina (over whether Uruguay's unilateral authorization breached the Uruguay River Statute) is still pending. September: MERCOSUR Tribunal releases verdict over the Uruguayan complaint on road blocking is released. It recognizes that Argentina failed to fulfil its obligations under MERCOSUR by tolerating the road blockings but did not impose sanctions on Argentina (nor compensation for Uruguay). October: World Bank Group releases final cumulative-environmental-impact study. November: MIGA and IFC (World Bank Group) grant funding to Botnia project (US$170 million from IFC, and US$350 million guarantee by MIGA). Finland's Ministry of Trade and Industry (national focal point for the OECD guidelines for Multinational Enterprises) dismisses the case presented by CEDHA. It finds that Botnia was not in noncompliance with the above-mentioned guidelines. December:

	Road-blocking on the San Martín Bridge by protestors from Gualeguaychú resumes and lasts all summer (still in force in July 2007). Occasional blocking also occurrs on the other two bridges joining the two countries.
2007	January: The ICJ does not accept Uruguayan claims for compensation for road blocking. The jury finds that road - locking did not impose "irreversible damage" to Uruguay. March: Entre Rios Province enacts a law banning wood exports from the province to feed the Uruguayan pulp mills. April: Botnia announcs that the plant is expected to start operations in September 2007. Under the mediation of the Spanish Government, Uruguayan and Argentinean representatives meet in Spain for preliminary talks over the dispute.

Nevertheless, even when the conflict peaked in March-April 2006, no alternative to carrying on the dispute endlessly was apparently considered. The Argentinean report to the High Level Technical Taskforce in February 2006 identified many weaknesses of the EIAs presented by the two companies and of the standards set by the preliminary permit issued by the Uruguayan government. Most of the criticisms regarding the lack of information or precision in the EIAs were confirmed by the independent review carried out at the request of the World Bank Group (Hatfield Consultants, 2006). For its part, the Uruguayan government repeated the invitation to Argentina to jointly monitor the projects, Neither party, however, proposed joint work on revising information requirements and standards in the final building and operation permits.

This is even more worrying considering the results of the independent review commissioned by the World Bank Group (Hatfield Consultants, 2006). This report states that catastrophic environmental impacts are not to be expected with the technologies to be installed in the plants, but that assessing the actual environmental impact requires more detailed consideration of the plant design, contingency plans, environmental management and monitoring, as well as detailed regulatory requirements. The Hatfield report passes no judgment on local regulators' actions or their consideration of regional impacts (e.g., no comments on the unilateral building authorization by Uruguay are found, nor on whether environmental impacts on the Argentinean side were fully considered).

For almost a year (March 2006-April 2007), no political dialogue or joint technical efforts took place since each party set very demanding conditions for restarting talks. The Argentinean government demanded relocation of the Botnia plant, while tacitly accepting road-blocking in spite of the Uruguayan complaints before MERCOSUR and the ICJ. The Uruguayan government, meanwhile, demanded the end of road-blocking, while allowing building of the Botnia plant to continue in spite of Argentinean complaints that the environmental impacts (in particular on the Argentinean side and on the Uruguay River) had not been thoroughly considered by the Uruguayan authorities.

Pending environmental concerns

Even setting aside the catastrophic-environmental-impact claim, as suggested by the Hatfield report, some environmental concerns posed by Argentina regarding the Botnia project seem relevant. These are summarized below:

1) Water pollution risks near Fray Bentos (the Argentinean report from the GTAN also stresses that no details or quantified analysis of the expected impacts on the Argentinean side, in particular near Gualeguaychú, the closest city to Fray Bentos, is offered in the EIAs):

- The main concern is related to dioxins and furans release. The Uruguayan government agreed in principle to the company's decision not to monitor these releases after the EIA indicated that no noticeable emissions of these pollutants would result from the selected technology (i.e., the emissions standards allowed by the chosen production technology). On these grounds, the preliminary authorization has not set a standard on AOX (Halogenated Organic Compounds), a measure of the presence of dioxins and furans and other persistent organic pollutants (POPs) in water effluents.

- Another concern is that even if the Uruguay River is a relatively "clean" water course, the occurrence of eutrophization episodes has been regularly verified, in particular during the spring and summer months. The analysis of emissions standards for phosphorous and nitrogen compounds does not seem to take this into account and does not limit the risks of increasing eutrophization episodes (with the associated risks of fish mortality and of negative impacts on tourism due to the presence of algae and foam).

These two concerns could be managed and solved in the framework of the Uruguay River Statute (and CARU) if parties were ready to negotiate. Eventually, the arguments and evidence presented by the two countries on these issues will be considered by the ICJ before it makes a decision.

2) Air quality concerns:

The release of dioxins and furans could also occur through the air. The Argentinean government has made complaints about the monitoring requirements set by its Uruguayan counterpart. Even though a maximum limit for annual air releases of these pollutants was set, no specific requirements for monitoring such releases were indicated. This is cause for concern since Botnia has indicated in its preliminary monitoring plan that it does not intend to measure dioxin and furan releases continuously (on grounds that such emissions are expected to be negligible).

3) Possible threats to tourism:

A third major concern of the Argentinian government is the potential impact of the pulp mill on tourism (in particular on Ñandubaysal, the Uruguay River beach that is closest to Gualeguaychú). This relates not only to air and water pollution risks but also to other impacts, such as odor and visual disamenities caused by the plant. Uruguayan authorities have required Botnia to prepare a mitigation plan for all major visual effects.

The ICJ ruling will not address since it will only focus on environmental impacts on the Uruguay River (covered by the Uruguay River Statute). From this perspective, consideration of environmental concerns about the pulp mills in the framework of MERCOSUR could have been more thorough (involving all trans-boundary or regional environmental and visual effects).

Institutional aspects

It is remarkable that the institutional framework that could have prevented the conflict, but failed to do so, seems quite solid.

First, the uses of the Uruguay River in the area shared by Uruguay and Argentina are regulated by the Uruguay River Statute ratified by both countries in 1975. The Statute created the Uruguay River Administration Commission (CARU) to regulate bilateral cooperation in several areas (such as navigation, building works, ports building and operation, rescue operations, natural-resource management, pollution control, and research and dispute settlement). The water-quality and pollution-discharge standards are gathered in the Uruguay River Digest.

The Uruguay River Statute also incorporated other international principles and commitments, such as those adopted under MERCOSUR's Framework Agreement on Environmental Issues (2003). The Agreement aimed (among other things) at promoting sustainable development and preventing negative environmental impacts in member countries, particularly in border areas (FARN, 2006).

Under the Uruguay River Statute, each party must notify CARU of any building plan or project that may have an impact on the environmental quality of the river and must subsequently turn over all the information needed to evaluate this impact. Any party wishing to implement such a project should wait for the other party's comments before granting authorization, unless the other party fails to present such comments within 180 days. If the notified party finds that some relevant impact can be expected from the project, the parties have up to 180 days to solve the dispute bilaterally. After that period they may resort to the International Court of Justice (as both parties to the dispute did in 2006).

Second, the MERCOSUR Agreement on Environmental Issues adopted the MERCOSUR mechanism for dispute settlement (best suited for trade disputes). Uruguay resorted to this mechanism to file a complaint on road-blocking in Argentina. In addition, there is a specific permanent technical workgroup (SG Nº 6 on environmental issues made up by representatives from all member countries. This group provides a forum for dialogue and cooperation on environmental matters from a technical and legal perspective and meets at least twice a year. This technical forum was not involved in the controversy.

The ICJ will have to decide whether Uruguay breached the Uruguay River Statute when it gave preliminary authorization for building the pulp mills without previous consultation with Argentina. But there is more to this decision than is immediately apparent. If a project may pose environmental risks, the Uruguay Statute allows the party concerned about environmental impacts to demand information from the party promoting the project. The concerned party gets 180 days to present and sustain evidence of such impact. The lack of information on the dialogue between the two countries in the framework of CARU between late 2003 and the end of 2005 (no transcripts from the meetings are available) precludes us from saying whether Uruguay produced all the information necessary for Argentina to evaluate the pulp mills' environmental impact (after granting preliminary authorization for building) and if Argentina presented evidence of environmental impact in due time. This is probably what the ICJ will have to determine in the incoming months in order to rule whether Uruguay breached the Uruguay River Statute when it authorized the construction of the pulp mills. This tribunal already dismissed both the Argentinean demand for a halt in construction at the Botnia project and the Uruguayan claim on road-blocking in Argentina.

Both parties have failed to honor their regional commitments. If it is true that Uruguay failed to comply with the Uruguay River Statute by unilaterally granting authorization to build the pulp mills, it is also true that Argentina, by tolerating road-blocking, failed to comply with the rules of fluid movement of people, goods and currency agreed to in MERCOSUR.

In view of the previous decisions by the ICJ on this case, and given that building will soon be completed at Botnia's facility, it seems highly unlikely that this court will satisfy Argentinean demands to halt building and to ask Botnia to relocate the pulp mill, regardless of whether the Tribunal finds Uruguay guilty of breaching the Uruguay River Statute.

In such a context, what step should the Argentine authorities take next? First, the government should realize that the probability of a favorable ruling of the ICJ is quite low and face the need to switch to a new strategy. The best alternative would be to work in cooperation with Uruguay to guarantee protection of the Uruguay River environment (as well as environmental conditions around the pulp mill more generally) by reinforcing regulatory requirements for the operation phase – before the Botnia plant starts operations. The project has only received authorization for the building phase. To get an operation permit, the firms must successfully complete an Environmental Management Plan and a Monitoring Plan and the Uruguayan authorities must make a new decision (separate from the decision to authorize construction). As discussed below, setting operation permit standards and monitoring requirements poses important challenges in one particular regard: the release of dioxins and furans.

Environmental Protection v. Investment Protection?

Developing countries are responsible for the local implementation of their commitments under multilateral environmental agreements (MEAs). This implies the translation of international commitments into local regulations, as well as the enforcement of the latter. If any (foreign) investor fails to comply with such regulations, action has to be pursued through regular administrative channels at the national level. That is, institutions to safeguard environmental concerns covered by MEAs are not "imported" but domestic.

In regard to the pulp mills controversy, the most relevant MEA is the Stockholm Convention on Persistent Organic Pollutants (POPs). This convention set a list of 12 chemical substances that pose major environmental and health risks due to their toxicity, persistence (nondegradation), bioaccumulation, and trans-boundary impacts. These impacts stem from the transport of these substances through air, water and migratory species, which allows effects far from the release site. The list of POPs targeted for phase-out includes dioxins and furans, which are not produced for sale, but rather are generated as "unintentional" releases from production processes. Among the sectors and activities that may lead to such releases are waste incineration, secondary metal production, uncontrolled combustion of biomass and waste, and the pulp industry.

Uruguay and Argentina (as well as all other MERCOSUR countries) ratified the Stockholm Convention in 2004. As a result, they are required to incorporate the Convention's provisions into national legislation (both countries have) and specific environmental regulations (still pending). With regard to unintended emissions of dioxins and furans, the Stockholm Convention states that the initial focus should be to minimize releases from industrial and waste incineration sources, and that best environmental techniques should be required for new sources (plants) no later than four years after the Convention's entry into force for that country. Uruguay and Argentina also

have to present a National Implementation Plan (no later than two years after the Convention entered into force for that party) stating they will meet their regulatory commitments.

Uruguay issued its National Implementation Plan (NIP) in May 2006 (i.e., two years after the Convention entered into force), and is expected to institute best available technique (BAT) requirements for new sources of unintended emissions of dioxins and furans by May 2008. As stated in the NIP document, Uruguay faces many challenges to implementing the Stockholm Convention provisions (like most countries in the region) (Government of Uruguay, 2006). The first challenge arises from the lack of precise information regarding the actual releases of dioxins and furans in the country (the preliminary inventories of such releases, for the NIPs, resort to estimates following a standard toolkit developed in the framework of the Stockholm Convention). A second challenge stems from the fact that this environmental concern is new to the country (and not included in local environmental regulations). A third challenge relates to the lack of analytical capacities and equipment (in both the public and private sectors) to control and measure releases and concentrations of dioxins and furans. The lack of equipment is a more general concern in all MERCOSUR countries, as reflected in the Chilean NIP and as recognized by technical experts of the region (Government of Chile, 2005; UNSAM, 2006). Therefore, institutional and technical capacity-building will be necessary before the Stockholm Convention provision can be met at the local (and regional) level. The Uruguayan NIP stresses that, in addition to employing the necessary equipment, an inter-ministerial taskforce should initiate a process of evaluating and drafting new regulatory provisions, organize monitoring routines and requirements, and identify priority sectors and sources (Government of Uruguay, 2006).

As discussed in section III above, a government's ability to fulfill its commitments under the Stockholm Convention may be hampered if the country has signed BITs that either limit the country's freedom to set national environmental policy or increase the risks of litigation if new environmental regulations are introduced. This suggests that a conflict may arise between compliance with an MEA and compliance with a BIT. In other words, the "importation" by developing countries of foreign institutions aimed at investment protection and at tackling global environmental concerns may clash.

Within the region, Uruguay's vulnerability to constraints by foreign investors is only matched by Argentina's (in view of the low levels of foreign investment and BITs in other pulp producing countries in MERCOSUR). Argentina has a long record of low enforcement of environmental regulations and faces complaints from both locals and foreign countries for not effectively controlling pollution from pulp mills. (Paraguayan citizens on the other bank of the Paraná River are affected by emissions originated in Argentinean pulp mills) (UNSAM, 2006). A Chilean company accounts for most of Argentina's pulp production for sale, and Argentina signed a BIT with Chile in the 1990s.

Under the Stockholm Convention, some guidelines were developed regarding best available techniques (BATs) and best environmental practices (BEPs) that minimize the release of dioxins and furans from pulp production (UNEP, 2006). As the EIAs, the independent review commissioned by the World Bank Group, and the Uruguayan government documents state, the BAT list includes both the elemental chlorine free (ECF) bleaching process (to be used by both Uruguayan pulp mills) and the allegedly "cleaner" totally chlorine free (TCF) processes. Some BEPs are also indicated for phases of production other than bleaching (e.g., knot removal, avoiding pulping of wood contaminated with polychlorinated phenols, using precursor-free additives in applications such as defoaming solutions, etc). The approach to technology in the

Stockholm Convention is to update the list of BATs/BEPs regularly as more information becomes available (UNEP, 2006). National regulations in other (especially industrialized) countries that already control POP use and release, consider either ECF or TCF technologies acceptable. ECF pulp mills in developed countries usually have the capacity to convert to TCF processes (which is a source of flexibility in case future Stockholm Convention provisions insist on TCF technology). This will probably not be the case, however, in the case of the ENCE and Botnia plants to be installed in Uruguay. Eucalyptus bleached kraft pulp produced with a TCF method does not meet the required brightness standards of world pulp markets.

Lessons

The discussion above suggests that there is some potential for conflict, when it comes to host-country implementation, between FDI protection rules and multilateral environmental agreements. In particular, new environmental regulations (for the pulp and paper sectors, among others) required in MERCOSUR countries to comply with the Stockholm Convention on Persistent Organic Pollutants could clash with some countries' commitments to maintain stable rules for foreign investors.

This poses a major regulatory challenge for most MERCOSUR countries, but in particular for Argentina and Uruguay (where foreign investors have a key role in the forest sector). In addition, the previous sections indicate that the design and implementation of new environmental regulations to control for "unintended emissions" of dioxins and furans (POPs being phased out under the Stockholm Convention) pose many technical and regulatory challenges to these countries.

Uruguay and Argentina should have faced this challenge through regional concerted action (e.g., in the framework of MERCOSUR or CARU). One potential advantage of this course of action would have been to balance investors' rights with investors' obligations under the international treaties and environmental agreements signed by the host country. A second advantage would have been the ability to pool (scarce) technical resources and equipment for emissions controls and to develop a joint strategy to guarantee financing and secure the necessary equipment and training. Furthermore, such a strategy could improve individual countries' bargaining power in case of a controversy with a foreign investor over the introduction of a new environmental regulation.

Even though MERCOSUR features both a number of technical bodies (e.g., the Working Subgroup on Environment (SGT Nº 6)) and institutional arrangements (e.g., the Framework Agreement on Environmental Issues) well suited for joint efforts (such as dialogue and cooperation on environmental issues, or even joint regulation) it suffers from severe institutional weaknesses, particularly on non-trade issues. This could partly explain why MERCOSUR had little role in this bilateral dispute. All in all, the creation of regional rules (e.g., for the implementation of MEAs) and the strengthening of environment-related bodies in MERCOSUR should be a policy objective in itself.

The importance of finding a reasonable and quick solution to the bilateral dispute, in view of the growing importance of the pulp and paper industry in the region and the way this dispute could set a precedent for future environmental disputes among MERCOSUR members, was apparently overlooked by both parties to the dispute. The institutional failure evidenced in this conflict has been sadly neglected and constitutes the most worrying aspect for the future.

So far, the two governments seem to have paid little attention to environmental concerns and impacts. They apparently see the dispute as a matter of “national pride” with little consideration of its future implications. From their perspective, it is as if the final ICJ verdict could end both the conflict and the associated risks and problems.

By refusing to become involved in regulatory design prior to the granting of an operating permit to the Botnia plant, the Argentinean government may be running the risk of losing control over some environmental impacts. Bilateral or regional cooperation to guarantee minimal environmental impact of the Fray Bentos pulp mill through joint control seems the only practical solution to effectively tackle environmental concerns and risks.

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[i] The most relevant to cite are: the Administrative Commission of the Uruguay River (CARU); the Foreign Offices of the two countries -and the High Level Technical Task Force constituted by them-; the consultative process involved in the environmental impact assessment requirements of the World Bank and the International Financial Corporation; the International Court of Justice - two cases were presented by Argentina and one by Uruguay-, and the Finnish focal point for the OECD Guidelines for International Enterprises (who received a complaint of an Argentinian NGO).

[ii] As a result of the acquisition phase initiated in the 1990s, most Argentinian production of market pulp is carried out by a Chilean company (notably Celulosa Arauco/Celulosa Constitución), while the largest share of integrated pulp and paper production is in the hands of local companies (Papel del Tucumán, Papel Misionero, Papel Prensa, Massuh, etc.).

[iii] All production and export figures taken from FAOSTAT (2006 update), available on http://www.fao.org

[iv] As a matter of fact, in Chile, two local groups (Celulosa Arauco/Celulosa Constitución and CMPC) explain 100% of market pulp production, while in Brazil local companies hold the majority stake in all (seven) large pulp and paper firms. In some cases, atomistic foreign investors hold a large –but not controlling- stake of the companies (eg. Aracruz, Klabin, Votorantim (VCP), and Suzano). In one case (CENIBRA) a Japanese company was the cofounder and controls the company jointly with a Brazilian group (CVRD). Other examples of Brazilian groups operating in this sector are Jari and LWART.

[v] The former, dating from 1974 was amended in the 1990s, to extend tax reduction benefits to FDI and to a wider range of sectors. The latter, also involving tax reliefs for new investments, was issued in 1987.

[vi] Ratification information was obtained from the official web site of MERCOSUR: www.mercosur.int.

[vii] It is also important to note that no explicit requirement is made regarding cost-benefit analysis neither in each country's regulations (that only require EIAs) nor at the regional level (in the framework of the Uruguay River Statute or MERCOSUR).