International Rivers Network
Linking Human Rights and Environmental Protection

The World Bank's Safeguard Policies Under Pressure

A Critique of the World Bank's New Middle Income Country Strategy

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Introduction

The lending of IBRD resources has dropped sharply since 1999. This is mainly due to the World Bank's move away from financing 'brick and mortar' infrastructure projects.

A new middle income country strategy (MIC strategy) proposes to reverse this trend. Entitled, *Enhancing World Bank Support to Middle Income Countries*, the strategy puts forward a series of recommendations. Most importantly, it proposes to rely on national environmental and social safeguard systems rather than on the World Bank's own safeguard policies, and to accelerate the process of doing so. It also proposes to tie the role of the Inspection Panel to national policies rather than the Bank's safeguard policies in such projects.

The MIC strategy says that relying on national safeguard systems rather than the Bank's policies would "remove obstacles to timely quality lending". It insists that the purpose of the proposed changes is not to dilute the social and environmental standards applied in World Bank projects. Yet a note that operationalizes the proposed changes includes far-reaching recommendations that are extremely disturbing.

The MIC strategy was discussed by the World Bank Board of Directors in an informal meeting on March 11, 2004. It seems to have raised strong concerns. In response, the document was revised and a new version was disseminated on April 20, 2004. The document is expected to be scheduled for approval in a formal Board meeting in late May or early June. The plan is for the new strategy to become effective on July 1, the start of the Bank's FY 2005.

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The MIC strategy has not been made available to the public, and civil society has not been consulted on it. This paper summarizes the main argument of the proposed strategy, and puts it into context from an NGO perspective.

The new MIC strategy contains several recommendations that are not related to the safeguard policies. They include making the Country Assistance Strategies more flexible, and abolishing the trust funds for foreign consultants. These recommendations are not discussed in this paper.

The background of declining IBRD lending

In financial terms, the role of the World Bank in middle income countries has been shrinking in recent years. New commitments of IBRD resources dropped sharply after 1999. With an annual average of $11.6 billion, lending in the FY 2000-03 period was only about half as high as in FY 1999, and 26% lower than in the 1990-97 period.1 This drop was mainly caused by reduced investment lending for infrastructure projects in middle income countries. (The World Bank defines middle income countries as countries that are eligible for IBRD funding.)

In response to the decline in lending for middle income countries, the Bank's proposed MIC strategy suggests that IBRD "needs to act urgently to reinvigorate its engagement in these countries".2 The strategy does not explain why such an invigoration would be urgent or needed. The MIC strategy states that "[t]he Bank should not be motivated by a desire to increase its lending and other services as ends in themselves".3 This statement was missing in the first draft of the document, and the MIC strategy creates the impression that IBRD intends to increase its lending in order to recycle the repayments from previous lending.

New World Bank funds for bricks and mortar?

The main reason for the drop in IBRD lending is that the World Bank moved away from funding hardware infrastructure projects during the 1990s. A Bank task force on middle income countries found in 2001 that "Bank Group support would be most effective when focused on helping countries implement the policy and institutional reforms needed for a healthy and stable private sector environment, institution building, and social development".4

The new MIC strategy acknowledges that the drop in investment lending after 1999 "is consistent with the shift in Bank support from the 'bricks and mortar' to the 'software' of development, which was described by the 2001 task force".5 The strategy does not provide

[1] MIC strategy, pp. 11f.
[2] ibid., p. 22
[3] quoted ibid., p. 22
[4] quoted ibid., p. 7
[5] ibid., p. 13

any arguments as to why it would now be important for the Bank Group to revert to the earlier 'bricks and mortar' approach in infrastructure.

The 'cost of doing business' with the World Bank

Although the move out of hardware infrastructure projects was deliberate, the World Bank attempts to link the reduction in IBRD lending to the cost of complying with its social, environmental and fiduciary policies. An internal Bank report of July 2001, entitled, *Cost of Doing Business*, estimated that the Bank's policies increased the World Bank's own cost of lending by $83 million in FY 2001. In addition, the policies increased the cost of borrowing for the client governments by an annual 50-60 million. The fiduciary and safeguard policies also caused "delay in project design, launch and implementation".6 The MIC strategy states that according to "statements from clients", "IBRD has been losing ground due to increasing compliance costs (and other costs of doing business with the Bank such as long processing times)".7

The 2001 *Cost of Doing Business* report found that the cost of the Bank's fiduciary and procurement policies (at $101-153 million) was roughly three times higher than the cost of the safeguard policies (at $36-56 million). The report recommended that decision-making processes be expedited "particularly in procurement".8 Yet ever since the 2001 report came out, the discussion has focused on the purported costs of the safeguard policies.

The Bank's safeguard policies under pressure

The *Cost of Doing Business* report found that the effect of fiduciary and safeguard policies "on project quality has been positive".9 The MIC strategy is more ambiguous. It states:

> "In countries with weak fiduciary and safeguard systems, incremental costs of compliance are justified by the development benefits that the use of Bank's guidelines and policies generates. But, in countries with good systems and acceptable standards, the incremental costs of adopting the Bank's systems for projects are not matched by incremental value added."10

The Bank has never documented cases of projects in which complying with Bank policies reduplicated efforts of borrowing governments in complying with their own standards. Yet ever since the *Cost of Doing Business* report was published, the Bank has used the report's findings to argue for a simplification of the safeguard procedures. The main thrust of the debate has been to shift the responsibility for implementing the safeguard policies from the

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[6] Cost of Doing Business, pp. 8f., vi
[7] MIC Strategy, p. 18
[8] Cost of Doing Business, pp. 8f., vi
[9] ibid., p. 3
[10] MIC Strategy, p. 18

Bank to borrowing governments, and to use national rather than Bank standards in the process.

A key element of this debate was an internal World Bank discussion note on safeguard policies prepared in October 2002. The discussion note said the following:

> "An important medium-term objective for the Bank is to develop a safeguard system that is based on agreed principles and can be applied broadly in client countries, uses borrower systems that respect these principles, and provides strong incentives for systematic and sustained improvement, as required."11

In January 2003, the Bank management issued guidelines to streamline the processing of projects that have "a relatively simple design, a lower risk level, and no controversial aspects" and that "are in countries with a good track record for fiduciary and safeguard issues".12 Management also proposed to expedite the processing of so-called repeater projects.

The proposed MIC strategy is the first effort to accelerate the delegation of the safeguard policies for the bulk of the Bank's lending. Accelerating this process is the first specific recommendation of the new strategy. Under the heading, "remove obstacles to timely quality lending", the recommendation of the MIC strategy reads as follows:

> "For countries that already have adequate systems and policies of their own (as ascertained through Bank assessments), the Bank should rely on them while monitoring their application. (…) Continued duplication of satisfactory country systems with Bank guidelines and policies imposes an unnecessary burden on borrowers – an additional cost of compliance not justified by additional development benefit. (…)The Working Group proposes that the Bank *accelerate the ongoing initiative to rely on certified national and safeguard systems in countries, and sectors within countries, where such systems are found satisfactory to the Bank*" (emphasis in the original).13

A threat to the Inspection Panel

The Inspection Panel is the main mechanism for holding the World Bank accountable for complying with its own safeguard policies. The safeguard policies are the point of reference for any Panel investigations and recommendations. The Bank has so far not clarified what the devolution of the safeguard policies to borrowing governments would mean for the purview of the Panel. The new MIC strategy tries to clarify this. It suggests the following:

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[11] Safeguard Policy Framework, paragraph 31
[12] Streamlined Processing, p. 4f.
[13] MIC strategy, pp. 24f., emphasis in the original

> "Management should clarify, furthermore, that Board approval of an operation relying on a certified safeguard system implies that the national system constitutes the reference point for any Inspection Panel discussion."14

The role of the Inspection Panel is to hold the World Bank to account, and not the borrowing governments. This would fundamentally change with the shift proposed in the new strategy. The shift would significantly weaken the accountability of the World Bank regarding compliance with its own safeguard policies. Since national safeguard systems may not match the Bank's policies, the shift would also weaken the role of the Inspection Panel.

If Bank projects are to rely on national safeguard systems, and if the Inspection Panel is to monitor compliance with national systems, the regulations and actions of borrowing governments will become the subject of international complaints and investigations. This is politically highly sensitive. It is a side-effect of the proposed MIC strategy that governments and the Bank management may not have fully considered.

The Panel was created, and the safeguard policies were adopted, by the Bank's Board of Directors. A far-reaching decision to weaken the policies and the Panel's powers should not be taken by the Bank's management (as suggested in the MIC strategy).

<u>How the new approach will be implemented</u>

The strategy does not recommend an immediate, wholesale delegation of responsibility for the safeguard policies to borrowing governments. A note on *Use of Country Systems: Operationalizing the Approach* includes the following clarifications on how countries and projects in which national systems will be used will be selected:

> "[O]perations are considered only in countries that have, or are in the process of developing, an appropriate legal framework, institutional capacity, and implementation track record, and where risks associated with such an approach are manageable."15

> "Much of the information that both Management and Executive Directors would need to guide their consideration of the Bank's proposed use of country systems comes from analysis of the country's applicable legal and regulatory framework and of its implementation capacity and practices (…). This upstream analysis is carried out by Bank staff or others (e.g., development partners, the government) as part of the ongoing country work program or as part of preparing for the CAS or for the operation itself."16

The scope of this analysis will include, among others, the following:

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[14] ibid., p. 25
[15] Use of Country Systems, p. 6
[16] ibid., p. 2

> "specification of any actions required to address identified differences that would need to be taken by the borrower and/or the Bank during preparation or implementation to ensure that the proposed requirements support the objectives of the Bank's policy framework".17

The suggestions on how the shift to country systems is to be operationalized are far-reaching. The following aspects are extremely disturbing:

- The World Bank considers not only relying on national safeguard systems in countries that have "an appropriate legal framework, institutional capacity, and implementation track record", but also in countries that are "in the process of developing [them]".
- The existing national systems will not be analyzed by independent experts, and not necessarily by the World Bank. The analyses can also be carried out by the interested governments themselves.
- Differences between the World Bank safeguard policies and the national systems do not necessarily need to be addressed before projects under national safeguard systems are approved, but can also be addressed during the implementation of projects.

The new strategy recommends that the Bank assess and certify national safeguard systems in at least three countries in FY 2004 (i.e., by the end of June 2004). It also recommends that Bank management present projects that rely on national systems in at least three countries to the Board before the end of FY 2005.

Pilot projects that rely on national safeguard and fiduciary systems are expected to be carried out in Mexico.18 At a regional briefing with the Board of Directors on South Asia, the Bank's management indicated that it also expected to bring "a number of projects with examples of simplified application of the Bank's policies (including safeguards) to the Board in the next 12 months".19

<u>Different opinions within the Bank's management and Board</u>

The emphases of the different versions of the MIC strategy and of the note that operationalizes the use of country systems vary significantly. These differences suggest tensions between the management and the Board, and within the Board, on the issue of the safeguard policies.

The first version of the strategy that was prepared by management was straightforward on the need to shift towards relying on national safeguard policies. It noted that progress with this shift "has been slow, particularly with regard to reliance on national safeguard systems". The

[17] ibid., p. 3
[18] see Mexico: Country Assistance Strategy
[19] see South Asia Region, Response to Directors questions, paragraph 1

strategy consequently proposed that the shift be accelerated “with particular emphasis on safeguard systems” (and not on the fiduciary policies, which cause higher costs than the safeguard policies).20

At the Board meeting of March 11, 2004, Executive Directors appear to have raised strong concerns regarding the impacts of the proposed changes. The revised version of the MIC strategy does not include the statements quoted above. Instead, it states that “[i]n responding to increased demand, the quality of lending and other services must be maintained and, where possible, increased”.21 The revised strategy furthermore includes the following new language:

> “To prevent a dilution of standards, which would be to the detriment of the country and would put the Bank’s reputation at risk, such a move [i.e., relying on national safeguard systems] should be based on a careful assessment of country systems, shared with the Board.”22

These language changes seem to be mainly rhetoric, in that they do not affect the substance of the proposed measures. The note that operationalizes the use of country safeguard systems furthermore includes far-reaching recommendations that would undermine the social and environmental standards of World Bank projects (see above).

Conclusion and recommendation

The shift to national safeguard systems will initially only take place in a few selected countries. The MIC strategy insists that a dilution of standards will be prevented. In spite of these assurances, the proposed new strategy (and the note that operationalizes it) is extremely worrying for the following reasons:

- The Bank’s safeguard policies have been developed to fit the operations of an international financial institution. It is questionable whether any national policies match them. The slow progress in shifting towards national systems (that was bemoaned in the earlier version of the MIC strategy) may reflect this gap. The new strategy does not consider the reasons for this slow pace, but puts pressure on the safeguard procedures simply in order to achieve higher lending targets.

- Evaluation reports have documented that the World Bank has not managed to mainstream social and environmental concerns into its operational strategy.23 Various investigations by the Inspection Panel demonstrated that the Bank’s compliance with its safeguard policies is still deficient. The World Bank needs to

[20] MIC strategy (version of February 26, 2004), p. 25
[21] MIC strategy, p. 23
[22] ibid., p. 25
[23] see Promoting Environmental Sustainability in Development, and Extractive Industries Review, p. 39

strengthen, mainstream and effectively implement these policies, and not weaken them.

- The World Bank assured civil society that it would not dilute its social and environmental standards when it converted its operational directives into brief operational policies after 1996. The Bank did not keep this promise, but significantly weakened its policies on involuntary resettlement and forestry in the process.

- The note that operationalizes the use of country systems includes measures that strongly contradict the cautious language of the MIC strategy. It will not be possible to uphold the present standards of the World Bank if national systems are accepted in countries that are only now developing the respective capacities, if these capacities are assessed by the governments themselves, and if the gaps between Bank and national standards can be addressed after a project has been approved.

- The Bank can be expected to tread cautiously as it approves the first projects that are based on national safeguard systems. Yet once the principle of relying on national systems has been accepted, it will be difficult to stop inadequate national systems from being accepted under political pressure, and to prevent the initial test cases from becoming general World Bank practice.

Internationally, there is a clear trend towards strengthening the social and environmental standards of financial institutions. Since June 2004, 21 international banks have endorsed the so-called Equator Principles and have thus committed to complying with IFC's safeguard policies in their project finance activities. Export credit agencies have recently taken some initial, coordinated steps towards strengthening their social and environmental standards. IFC is reviewing its safeguard policies, with a view towards strengthening them. MIGA's new executive vice president committed to reconsidering her institution's stance on safeguard policies at the 2004 spring meeting. And the UN Sub-Commission on the Promotion and Protection of Human Rights in August 2003 approved strict Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises.

It is unclear to what extent these commitments will be implemented. They still mark important positive steps in the field of international finance and investment.

The Extractive Industries Review recently recommended a strengthening of the World Bank's social and environmental standards. Yet in spite of these recommendations, and in a marked contrast to other financial institutions, the Bank appears to view its safeguard policies as "obstacles to timely quality lending" rather than an added value of its lending. The proposed MIC strategy responds to the drop in IBRD lending – a drop that was brought about by a deliberate decision to move out of lending for 'brick and mortar' infrastructure projects, and not by the safeguard policies. This creates the impression that the focus of the new MIC strategy is motivated by political reasons and institutional self-interests rather than by the lessons of experience. The hidden agenda of the strategy appears to be the desire to weaken the Bank's safeguard policies in an indirect way, and to move more money out of the World Bank's door.

It makes sense to harmonize the administrative procedures of different financial institutions. It also makes sense for borrowing (and lending) governments to strengthen their national policies and procedures. Yet the World Bank needs to remain responsible and accountable for the impacts of its own lending. The new MIC strategy promotes delegating this responsibility to borrowing governments – without assuring that the necessary capacities and the political will to accept this responsibility exist. Such a move would weaken the Bank's safeguard policies and the role of the Inspection Panel.

The MIC strategy appears to have raised strong concerns when it was informally discussed in the Board on March 11, 2004. Management revised the language of the strategy in order to incorporate the concerns of Board members. Yet the note that operationalizes the use of national safeguard systems does not reflect this prudent spirit. The Board of Directors should reject the proposed reliance on national safeguard systems when it meets again formally to discuss the MIC strategy. It should support processes to strengthen national safeguard systems, but should not weaken the Bank's own responsibilities and the purview of the Inspection Panel.

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