



Time for a new approach to environmental and social protection at multilateral development banks

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Key messages

- The environmental and social safeguard approach utilised by major multilateral development banks (MDBs) requires a deep rethink to address conceptual and practical flaws.
- Safeguards serve mainly to protect MDBs from criticism, and do not impact the majority of projects not funded by MDBs. Safeguards are expensive, complicated and highly bureaucratic, and offer no incentive for borrower countries to improve existing country systems.
- MDBs should instead focus on using country systems, and do so with meticulousness, rigor and transparency, thus encouraging a country to fully respect and implement its own laws and regulations and strengthen them through use.
- A country systems approach should be complemented with much more intensive and better-funded technical assistance to improve borrower country environmental and social oversight frameworks.

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1 Introduction

How multilateral development banks (MDBs) address project-related environmental and social impacts is a topic on many people's minds at the moment. The third round of the World Bank's environmental and social safeguard review consultations is due to end in March, after which shareholders will take up reform proposals.¹ Safeguards are also being hotly debated in the China-led Asian Infrastructure Investment Bank (AIIB)² and the New Development Bank operated by the BRICS states (Brazil, Russia, India, China and South Africa) (NDB BRICS), two MDBs just beginning operations in 2016.

¹ For more information on the World Bank safeguard review, see <http://consultations.worldbank.org/consultation/review-and-update-world-bank-safeguard-policies>.

² See Consultation Draft, Environmental and Social Safeguards, AIIB, 3 August 2015.

2 Safeguards: well intentioned but deeply flawed

One can only hope that AIIB and NDB BRICS find a better solution than the safeguards employed by existing MDBs – an approach that is well intentioned in its aim of protecting project-affected social groups and the environmental, but conceptually and practically flawed. It was put in place at the insistence of shareholders in wealthy countries and designed to ease criticisms of MDBs from civil society organisations and domestic legislatures³ rather than to find the best solution to serious development challenges.

Current MDB safeguards do not address the core developmental problem facing environmental and social oversight – weak legal frameworks and implementation capacity. Protecting against negative environmental and social impacts from infrastructure projects has often fallen short in many developing countries. Ignoring these impacts can not only threaten the effectiveness of an investment project itself but more broadly undermine a country's social fabric and environmental sustainability, with potentially global implications related to climate change, conflict and migration. While many countries increasingly recognise this and are strengthening their oversight frameworks accordingly, others continue to take a more short-term approach of pushing ahead with the project first and worrying about problems later.

Rather than addressing this very serious issue head-on, safeguards instead create a parallel universe of rules that apply only to MDB projects, allowing MDBs to defend their reputation. Safeguards allow (in fact, in many cases require) MDBs to bypass national frameworks, and thus have minimal impact on the vast majority of projects, which are not undertaken by MDBs. Borrower governments have no incentive to strengthen their systems, since they know that no matter how strong or weak they are, MDBs will use their own safeguards anyway.

Safeguards have numerous other weaknesses, including the following:

- Safeguards are imposed over and above national laws, which raises serious questions about sovereignty, country ownership and the degree to which a country has the right to define its own approach to these issues based on its priorities and socioeconomic context. ‘This is an extraterritorial imposition, and that does not fit with the treaty we signed

³ For more on this, see among others R. Wade, ‘Greening the Bank: The Struggle over the Environment, 1970-1995’, in Kapur et al. (eds) (1997) *The World Bank: Its First Half Century, Vol. II*. The imposition of safeguards by non-borrowing shareholders has invariably come as a quid pro quo during negotiations over general capital increases and replenishments of concessional lending windows, over the objections of borrower countries.

to join the bank,’ said one Latin American executive director of the Inter-American Development Bank. ‘We have our own laws’.⁴

- Safeguards at the major MDBs are one-size-fits-all, legalistic and inflexible policies covering every MDB project in every borrowing country, an approach that does not recognise the vastly different quality of legal frameworks and enforcement capacity across developing countries.
- Safeguards are time-consuming and expensive, and these costs are borne by the borrower. The average direct financial cost of safeguards on a World Bank project to borrowers is \$13.5 million for most projects.⁵ The extra time to undertake required assessments and consultations is also considerable – several months or even two years in some cases, according to borrower government officials⁶ – followed by obligatory public comment periods lasting up to six months before a project can move forward.
- Non-borrower MDB shareholders – who can dictate policies at the major MDBs through their voting power – have felt free to impose safeguard standards that in some cases exceed requirements in their own countries. On resettlements, for example, even illegal squatters must in many cases receive financial compensation. In other cases, governments are required by safeguard policies to consult non-governmental organisations (NGOs) with no legal standing, which many countries strongly object to. A World Bank executive director from a borrowing country complained, ‘I’ve been involved in some discussions with NGOs that have no legal status, we don’t know who they are or who they represent. They get together a handful of people from the area and stop a project that can benefit hundreds of thousands of others. There has to be some balance’.⁷

As a result, borrowers increasingly avoid using the World Bank and the major regional MDBs when a loan is likely to trigger safeguards, particularly for large infrastructure projects. Dozens of borrower government officials have told me in interviews that they no longer look to the major MDBs when it comes to transportation, urban resettlement and energy projects, in large part due to safeguards. The World Bank itself found in a 2010 study that ‘[t]wo thirds of managers interviewed reported that some clients had avoided or were dropping a Bank project because of safeguard policies.’⁸ In many cases, borrowers are willing to pay higher financial costs and forgo valuable technical assistance simply to avoid the hassles of safeguards. ‘We had a lot of problems with World Bank safeguards in the past, but we’ve learned our lesson,’ a Colombian official told me. ‘If we think a project will trigger the bank’s safeguards, we don’t even ask them, we find the money

⁴ Interview, January 2012.

⁵ See World Bank Independent Evaluations Group 2010, *Safeguards and Sustainability Policies in a Changing World*, pp. 74-75. Data is for projects rated in categories A and B, which accounted for 53% of all World Bank projects. This does not include the Bank’s own administrative costs, which are in the end also borne by borrowers through higher interest rates on loans.

⁶ Based on interviews with over 100 borrower government officials in 12 Latin American countries during 2012-2014.

⁷ Interview, January 2012.

⁸ World Bank Independent Evaluations Group 2010, *Safeguards and Sustainability Policies in a Changing World*, p. 73.

elsewhere.⁹ If safeguards lead a country to avoid an MDB altogether, one has to question whether they are achieving their intended results.

This does not mean that MDB safeguards are a complete failure – far from it. Clearly safeguards have had a very positive impact by improving how MDBs design and implement projects such that negative social and environmental impacts are reduced and are redressed when they do occur. Local communities are much better informed about MDB projects, and have institutional means to voice their grievances. And government officials have told me that safeguards can be useful to them in some cases, with MDBs providing political cover to the government in high-visibility or socially conflictive projects. However, from the point of view of many borrower governments these benefits are outweighed by the drawbacks outlined above, which endanger the relevance and involvement of MDBs, especially in the major infrastructure projects where their financing and knowledge can have very positive impacts.

⁹ Interview, June 2012.

3 Country systems: the foundation of a new approach

The best way to protect the environmental and social rights in developing countries is to build on countries' existing legal and regulatory frameworks, not design safeguards to allow MDBs to sidestep them.¹⁰ MDBs have made some efforts to use country systems, particularly in the wake of the 2005 Paris Declaration on Aid Effectiveness. But these efforts have largely failed, mainly because non-borrower shareholders have not allowed them to move ahead meaningfully. The ongoing World Bank safeguard reform is a case in point: even modest provisions to begin using country systems in some limited cases has led to an uproar among NGOs and resistance from major shareholder countries.¹¹

Unquestionably, environmental and social oversight leaves much to be desired in many developing countries (and more than a few developed countries). But country systems are strengthened through use. Environmental and social rules that look good on paper are in many countries routinely ignored via irregular means such as corruption or political pressure. The World Bank, the major regional MDBs and new MDBs like AIIB and NDB BRICS have the standing and resources to lead by example. They should make every effort to follow national laws and procedures whenever possible.

MDBs should use borrower country systems and employ an extraordinarily high degree of meticulousness, rigor and transparency when doing so, thus encouraging a country to fully respect and thoroughly implement its own rules. Every single mandated process should be followed, documented, and made public. Many of the weaknesses or gaps in country systems would then quickly become apparent, providing a much stronger basis for reform. MDBs should offer generous technical assistance to support reforms – funded by grants from trust funds or a share of an MDB's annual net income, or with subsidised loans to make them attractive to borrower governments. This technical assistance occurs to a degree already but should be greatly intensified. Accountability mechanisms such as the World Bank Inspection Panel that give recourse to those impacted by projects would continue to be necessary and should be maintained.

¹⁰ A point also made by Yuan and Gallagher, 'Greening Development Finance in the Americas' (2015) and Griffith-Jones et al., 'The Asian Infrastructure Investment Bank: What Can It Learn From, and Perhaps Teach To, the Multilateral Development Banks?' (2016).

¹¹ See for example Civil Society statement on World Bank Safeguards, October 2014, accessed at <http://nebula.wsimg.com/93718c692cf0e2e9451e4572e32ef5e9?AccessKeyId=BBECBE2DB5DCCE90DECA&disposition=0&alloworigin=1> on 29 February 2016 and NGO letter to World Bank Committee on Development Effectiveness (CODE), 22 June 2015, accessed at <http://nebula.wsimg.com/f6689f3d966731d37460f66b08d254f9?AccessKeyId=BBECBE2DB5DCCE90DECA&disposition=0&alloworigin=1> on 29 February 2016.

MDBs should set clear, publicly announced standards for a country's systems, below which they will not be used. If a country's laws and regulations relevant to a specific project do not meet certain predefined minimum standards, an MDB should not be able to invest in the project. Or if a project moves ahead but serious flaws become apparent during implementation, an MDB may have to cancel or suspend a project, and publicly explain its reasons. This might mean that an MDB cannot go ahead with a highway project through an environmentally sensitive area, or an urban renewal project where resettlement provisions are inadequate. Lending for other projects not impacted by the relevant laws and regulations could continue, so that a country is not entirely cut off from MDB support.

The exact definition of an MDB's minimum standards would be highly contentious. They must be drawn up in such a way that balances the need to protect the environment and human rights with the legitimate right of countries to set their own priorities and development paths rather than have these dictated to them. Striking that balance would certainly be no easy task, but it is where the contention should be – determining whether countries' environmental and social frameworks are sufficient for MDB projects to go ahead or not, rather than creating a separate, special system just for MDBs while everyone else is forced to use a dysfunctional or inadequate national system.

One could argue that the results of these steps would not differ so much from what is already occurring: countries would avoid MDBs on projects where MDB standards conflict with their own systems, and instead go with less demanding sources of financing, like private lenders or non-traditional bilaterals like China and India. But the reality is that many countries would like to involve MDBs, especially on major infrastructure projects. MDBs offer excellent financial terms (no small advantage for tight developing-country budgets); they are highly transparent and give confidence to private investors who may want to join in on a project; and – most importantly – they offer superlative knowledge and assistance to design and implement high quality projects. Government officials continually point to the ability of MDBs to help design top quality projects as a key advantage of working with them.¹² Countries don't want to lose these benefits.

MDBs can remain relevant and have a positive influence on environmental and social standards, to the benefit of borrower governments, their citizens (especially the poor) and the sustainability of the planet. But to do so, a new approach is needed that respects a country's own developmental priorities, reduces the bureaucratic burden and costs, and offers substantial support to strengthen a country's own systems.

A committed use of country systems would bring many benefits, including the following:

- The 'stick' of MDBs not lending where systems are insufficient, coupled with the 'carrot' of offering intensive technical support to build country system capacity, would better align incentives for countries to change their environmental and social frameworks while still deciding for themselves on the exact direction of change.
- Rigorously using a country's own systems would help strengthen them, thus impacting all activity in the country – public and private – that utilises these systems, not just a few MDB projects. Hence the

¹² Based on interviews with over 100 borrower government officials in 12 Latin American countries during 2012-2014.

developmental impact would be much greater than the current safeguard approach.

- Using country systems would eliminate the use of the same one-size-fits-all safeguard policies for all developing countries, which makes no conceptual or practical sense. Instead of forcing government officials to learn external safeguards, it would force MDB staff to dig into the details of national laws and regulations – which is where the effort should be, to highlight weaknesses and promote change.
- Using country systems respects the sovereignty, social priorities and developmental path of each country – an important and long overdue change in dynamic between MDBs and developing countries.
- MDBs would still be able to ensure that their projects meet their social and environmental standards, by reserving the right not to lend if a country's systems do not meet predefined bottom-line standards, and would thus mitigate risk arising from failed projects and/or criticism from external groups.
- The tremendous knowledge and experience built up by safeguards staff at MDBs on the environmental and social impacts of investment projects would be extraordinarily valuable to convince governments of the advantages of addressing these issues up front, and to provide practical assistance and best-practice examples to help strengthen country oversight frameworks.

A shift to country systems would mirror what is already underway in procurement, another area of long-standing tension between MDBs and borrower countries. For years, MDBs have insisted (again at the behest of non-borrower shareholders) that borrowers bypass their own national laws and systems, and instead use specially designed and highly restrictive MDB procurement rules. Recently, however, some MDBs have come to realise that not only is this system cumbersome and inefficient but it is also not the best way to achieve what should be the ultimate development goal: transparent, cost-effective procurement systems that impact all government purchasing, not just ones related to MDB projects. As a result, MDBs are moving towards procurement that uses national systems whenever possible – what the African Development Bank's new procurement approach (2015) calls 'building by using'¹³ – coupled with more intensive technical assistance and training to strengthen those systems.

The World Bank's private sector division, the International Finance Corporation (IFC), has attempted to build a new system that (although still flawed in several ways) could be the basis for a more gradual move towards country systems. Rather than impose blanket safeguards on all projects, IFC utilises 'performance standards', which essentially make use of national systems when the IFC deems them to be adequate.¹⁴ Where a country's systems do not meet IFC standards, the borrower company must use IFC-mandated systems to fill the gaps. In some countries this can mean using 90% national systems, while in others IFC systems are used almost entirely.

¹³ See African Development Bank, 'Comprehensive Revision of the ADB's Procurement Policy and Procedures', October 2015, p. 4.

¹⁴ See Performance Standards on Environmental and Social Sustainability, IFC, 1 January 2012.

IFC performance standards have the virtue of not imposing a one-size-fits-all policy but recognising the differing quality of national legislation, regulation and implementation – a key improvement over the standard safeguard approach. However, like safeguards, the performance standards give little incentive for governments to strengthen their own systems, and thus they have no impact on the many projects not funded by the IFC. Performance standards mainly serve as a more efficient way of moving IFC projects ahead compared to safeguard processes of other MDBs, while still protecting IFC from criticism and leaving country systems undisturbed.¹⁵

The IFC's innovation of building on existing country frameworks could serve as the basis for a transitional phase towards full country systems use. But it would need to be accompanied by concerted technical assistance resources to help countries strengthen their own systems, and incentives (like the possibility of losing MDB funding after some defined time period) to encourage them to do so, if they chose. Should a country not wish to change for whatever reason, an MDB would eventually be obliged to restrict lending in the relevant sector to protect itself and to incentivise change.

¹⁵ As well, the business-oriented culture of IFC staff has led to criticism that the performance standards are little more than window dressing so IFC investment can go ahead. See for example the scathing criticism of an audit of an IFC investment in Honduras by the IFC Office of the Compliance Advisor Ombudsman, 20 December 2013.

4 Conclusion

The era when the World Bank and other MDBs could dictate to developing countries is gone, and it is time for legislators, officials, and NGOs in wealthy countries to come to terms with that. The last 20 years have seen a huge increase in global private capital flows, a growing influence of new non-traditional bilateral financiers, and strengthened fiscal balances in much of the developing world. Many countries – especially the large middle-income economies, where most major infrastructure is being built – vote with their feet, and seek alternative financing to avoid safeguards. As a result, development suffers: borrowers pay higher loan costs and lose valuable MDB knowledge and assistance to design and implement top-quality projects that protect the environment and vulnerable social groups.

The actors for whom a change in mindset on safeguards may prove most difficult, but who are at the same time essential for progress, are the NGO community and the domestic legislatures of major non-borrower shareholders. Most NGOs are committed defenders of social and environmental standards, and they are to be commended for that. Their dogged criticisms of ill-conceived and ill-executed projects in developing countries – MDB-financed and otherwise – play a valuable role in protecting the environment and the people impacted by the projects. But their successful efforts to pressure MDB shareholders via domestic legislatures have led to a dysfunctional system that does little to strengthen national laws and implementation capacity, and perpetuates a neo-colonialist approach of dictating western standards to the developing world. Until NGOs and wealthy country legislatures accept the need for a new approach, MDB shareholders will not have the space they need to make meaningful changes to environmental and social oversight in MDB operations.

MDBs and other development financiers will lose relevance if they are unable to find a way to make the legitimate aspirations of developing countries compatible with environmental and social sustainability. The safeguard system as currently designed is not achieving the best development results, and this is increasingly a reason for countries to avoid MDBs entirely for projects that may trigger safeguards. It is time for MDBs to find a new approach, one that focuses on strengthening the national laws and regulations of developing countries rather than protecting themselves against criticism. Such an approach implies a major shift in policies and operations at MDBs, but most importantly it requires a shift in thinking about how to achieve the best development results for the good of our planet.



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