

FAST TRACK BRIEF

AUGUST 6, 2008

IEG's Evaluation of the World Bank/IFC/MIGA "Environmental Sustainability" was discussed by CODE on June 18, 2008

Supporting Environmental Sustainability: An Evaluation of World Bank Group Experience, 1990-2007

- ◆ The Bank Group's lending and non-lending support for environmental sustainability has increased and improved over the past 15 years. But the institution needs to raise the priority it accords to this area of rising concern, strengthen internal cooperation, and work more effectively with its government and private partners to help countries to get better results in addressing environmental challenges.
- ◆ The Bank, IFC, and MIGA should jointly develop and commit to a new environmental strategy and ensure that environmental priorities enter fully into their strategic directions as well as in regional and country assistance programs, focusing in particular on underperforming regions and sectors and countries with the most significant environmental problems.
- ◆ The Bank needs to improve its systems to identify, monitor, and evaluate environmental results and impacts of its lending and non-lending services. While IFC and MIGA have developed systems to evaluate environmental and social effects at the project and portfolio levels, they must also assess and respond to the environmental impacts of their operations from a local, country, and industry perspective.
- ◆ The Bank Group should step up its support for public-private partnerships and take greater advantage of the private sector's potential for technology development and transfer, transformation toward clean and low-carbon technologies, and sustainable supply chains, while continuing to help countries strengthen environmental governance.

The Bank Group and the Environment

Bank Group support for the environment was largely limited to assessing the potential impacts of selected projects until the mid-1980s, when external pressures helped induce a broader approach. By the early 1990s many countries were preparing National Environmental Action Plans with World Bank support, and IBRD, IDA, and IFC environment-related financing grew. Soon after the 1992 UN Earth

Summit in Rio de Janeiro, the Bank adopted a fourfold agenda comprising safeguards, stewardship, integration of environmental concerns into macroeconomic and sectoral interventions (mainstreaming), and global sustainability.

The Bank Group's first formal environment strategy was approved in July 2001. It placed the environment within the institution's poverty reduction mission and highlighted three objectives: improving the quality of life, enhancing the quality of

growth, and protecting the regional and global commons. The strategy also committed to facilitate partnerships between the public and private sectors as well as with civil society, to address environmentally sensitive issues, and to promote better environmental management both at the country level and globally. Over the past 15 years, Bank Group support for the environment has grown. It is now the largest multilateral source of environment-related financing, including administration of Global Environment Facility (GEF) grants, and an important source of advice to many country and private sector clients

Evaluation Approach

This evaluation assesses the Bank Group's support for environmental sustainability—in both the public and private sectors—over the past decade and a half. Different evaluative approaches and methodologies were used for the various parts of the Bank Group, reflecting their different roles, instruments, and information constraints. The assessment of World Bank interventions considered lending and analytical work intended for environment-related issues together with the evolution of country strategies and policy dialogue. For IFC and MIGA, IEG focused on the performance of all projects (finance and guarantees) in meeting project-level environmental standards, using the Environmental and Social Effects indicator and assessing IFC's and MIGA's environmental work quality at appraisal and supervision. Also examined were recent environment-oriented advisory services, complemented in the case of IFC by case studies in most of the same countries as the World Bank analysis.

The evaluation sought to answer five questions: (i) How and how effectively has Bank Group support contributed to improving environmental quality and sustainability? (ii) How well have Bank Group interventions been aligned with national environmental priorities and private sector needs, and how well have environmental considerations been mainstreamed into Bank Group assistance? (iii) Have the design and implementation of the Bank's environment-related investment projects improved, and, if so, what factors have contributed to this? And have IFC's and MIGA's investment and advisory services enhanced their private sector clients' management of environmental risks? (iv) To what extent—and how—have partnerships and World Bank Group coordination enhanced the effectiveness of its support for the environment? (v) What internal and external constraints have limited effectiveness of Bank Group support, and how might they be reduced?

Portfolio and Performance Overview

The Bank Group is involved with the environment in various ways, interacting with governments, other financial institutions, private sector clients, and civil society. The World Bank assists countries through analytical, advisory, and lending services to help them address environmental priorities and sup-

port policy reforms. IFC's and MIGA's engagement with the private sector has mostly sought to ensure that investments adhere to environmental standards, but during this decade IFC has launched several environment-oriented advisory service programs and developed partnerships with the Equator Principle Financial Institutions. Hence, while IFC and MIGA have fewer direct investment projects designed to improve the environment, all of their financing and guarantee operations, as is also the case for all World Bank investment projects, need to meet environmental due diligence requirements. Moreover, many IFC projects have built in environmental benefits, such as energy efficiency improvements.

Total World Bank commitments between FY90 and FY07 were \$401.5 billion in 6,792 projects. Of those, 2,401 projects involved environment and natural resource management (ENRM) for commitments on the order of \$59 billion. However, this figure is an approximation and appears to overstate the actual volume of resources going directly for environmental improvement. Environment-related Development Policy Loans (DPLs)—general budget support in exchange for policy reforms—were \$3.5 billion and ENRM commitments in investment projects considered to be at least 80 percent for environmental improvement were \$18.2 billion (the remainder of the \$59 billion was in projects with smaller shares devoted to the environment). The total includes Bank-administered GEF grants, Montreal Protocol projects, and carbon finance. An important part of this figure was for sanitation infrastructure. Because of the way Bank commitments are identified, it is unclear exactly how much lending has gone directly for environmental improvement. But the priority given to lending for environment and natural resource management appears to be modest.

World Bank environmental project performance, while slightly below the average for its portfolio as a whole, has improved over time, being better in the second half of the 1990s and thus far in the present decade than in the early and mid 1990s. This reflects learning and discontinuation of some approaches that have proven less successful. Performance of environmental projects has been weakest in Sub-Saharan Africa, but there have been a range of successful and unsuccessful operations in all Regions.

IFC's engagement with the private sector overall (that is, not referring specifically to the environment) has grown rapidly in recent years, with annual commitments rising from \$3.9 billion to \$8.2 billion between 2003 and 2007. From FY90 through FY07, IFC committed about \$56 billion. IFC's environmental support includes GEF projects for about \$1 billion and \$185 million in Dutch-funded carbon facilities. It also includes Advisory Services for Environment and Social Sustainability business line projects totaling \$208 million by end 2007, representing a quarter of IFC Advisory Services funding.

MIGA issued guarantees between FY90 and FY07 for a total exposure of \$16.7 billion in 510 projects (again an overall figure, not referring to the environment per se). The largest share of MIGA operations in the non-financial sectors has been in infrastructure, manufacturing, and the extractive industries. For both

IFC and MIGA, financing modern technologies in the private sector, while intended primarily to improve productivity and product quality, generally also reduces harmful environmental impacts given the older technologies they replace.

IFC and MIGA have increased their efforts to engage their clients on environmental issues in recent years. In April 2006 IFC established its Policy and Performance Standards on Social and Environmental Sustainability, which were adopted (and adapted) by MIGA effective October 1, 2007. The impact of these new standards cannot yet be assessed. However, environmental compliance and performance gaps in IFC projects over the past 15 years have been most notable in Africa, due in part to weaker sponsor capacity and sometimes wavering sponsor commitment to the sustainability agenda, and in some industry sectors. MIGA has likewise given increasing attention to environmental issues in its underwriting and has used its contracts to identify applicable safeguard policies, guidelines, and requirements for remedial action. But improvements are needed, particularly in less environmentally sensitive (Category B) projects whose potential impacts typically receive less attention..

Principal Evaluation Findings

The World Bank Group has made progress in including environmental concerns in its strategies and analytical and lending products since 1990 and increasingly since 2001, and has provided support for the environment through a range of financial and non-financial services, private sector investments and guarantees, regional and global programs and partnerships. When requested, the Bank Group has been generally able to help countries set environmental priorities (although this is ultimately the responsibility of the countries themselves) and private sector clients to identify and address potential direct environmental impacts. However, it has been far less able to integrate these efforts centrally into country programs, incorporate them as requirements for sustainable growth and poverty reduction, and provide lending to help countries address environmental priorities—often because of lukewarm interest in such support from the countries themselves.

Country strategies. The Bank's country strategies generally take account of national environmental priorities, although insufficient attention has often been given to longer run sustainability concerns. Treatment of ENRM issues in country strategies has improved over the past two decades in Brazil, China, and Madagascar, for instance. However, there have also been important cases to the contrary. For example, Bank strategies for Russia have reduced the priority given to the environment, reflecting declining central government interest in borrowing and receiving policy advice for environmental problems. Most Bank country strategies have not integrated IFC and MIGA activities in relation to the environment. However, environment has been a strategic priority for IFC and MIGA in recent years. IFC's Strategic Direc-

tions documents approved by the Board over the past decade have emphasized environmental and social sustainability. The importance of integrating depends on the extent of engagement by IFC and MIGA in the countries, the nature and scale of environmental impacts of their operations, and the degree of coordination needed between policy efforts and private sector investments. In many areas, such as avoiding deforestation, protection of biodiversity, and emerging efforts to address climate change in many parts of the world, it is essential that Bank, IFC, and MIGA approaches affecting the environment be better coordinated to improve overall corporate effectiveness.

Analytic, financing, and guarantee activities. World Bank nonlending activities have often had as significant results for environmental improvement as lending operations, as in the case of industrial pollution control in Indonesia and river basin management in China. However, even where environmental problems are particularly serious, they have sometimes been treated unevenly in Bank activities. Performance in this regard has been relatively positive in countries such as China and Brazil, but less comprehensive or well integrated (particularly in lending) in India, Russia, Egypt, and in the case study countries in Sub-Saharan Africa. Among the reasons for these differences are the size of and resources available for country programs, the lack of client demand, and the capabilities of national and local institutions.

Based on assessments of completed operations in the case study countries and a review of the Bank's ENRM portfolio, the effectiveness of different project types has varied. Land and watershed management operations, community-based forest management projects, and grants to reduce ozone-depleting substances, for example, have generally been satisfactory, as have most biodiversity conservation projects (although there were performance problems in the initial years with such operations). Water resource management projects at the river basin level and urban environmental operations, while not without shortcomings, have also been largely satisfactory based on overall project outcome ratings.

In contrast, Bank-supported operations to combat industrial pollution through credit lines have been only partially satisfactory from an environmental quality perspective. However, the Bank has learned from this experience and discontinued the credit line approach in most countries, instead using public disclosure programs, which have been more successful. Environmental capacity building projects have also often shown weak results, but such projects have generally been more successful when they have sought to achieve concrete environmental improvements rather than focusing mainly or exclusively on institutional development. Environment-related DPLs, in turn, hold potential to influence relevant policies and institutions. However, given that these are recent projects and that programmatic approaches have typically been applied, only changes in policies and institutions can be measured at this stage. Clearly it will also be important to measure environmental outcomes over the longer term to determine the success of these projects in achieving environmental sustainability objectives.

In Sub-Saharan Africa and elsewhere, integration of ENRM concerns into Poverty Reduction Strategy Credits (PRSCs) and the country-prepared Poverty Reduction Strategy Papers (PRSPs) on which they are based has not been given sufficient priority. Climate change is another critical area in which Bank Group interventions have been limited to date. The gap is especially serious with regard to the rising adaptation needs in Sub-Saharan Africa and South Asia. However, this is beginning to change, and much greater attention is envisaged by both the Bank and IFC to climate-related challenges in the years ahead.

Finally, even though the World Bank applies environmental due diligence to all of its investment projects, it presently lacks, unlike IFC, an aggregate monitoring and reporting system that would allow it to more systematically assess the environmental aspects and results of the projects it supports. This is a task that both self- and independent evaluation need to undertake.

About two-thirds of IFC's investment projects met their environmental and social requirements and standards. Significant gaps were found in investment projects in Sub-Saharan Africa, in part for the reasons mentioned above, and in the textile, food and beverage, tourism, and agriculture and forestry sectors. IFC has had a positive influence in helping its clients develop management systems to better address environmental and social aspects companywide. This is important considering IFC's increasing focus on corporate loans and equity investments that cover all of its clients' activities as compared with narrower project finance. The overall effectiveness of IFC/GEF initiatives was found by an external evaluation to be "satisfactory with mixed project outcomes." A partial review of environment-oriented Advisory Service programs and recent evaluations of completed projects found that they were effective at innovation and development of new services, and their development effectiveness was positive, but often there was not enough information to assess them against expected impacts.

IFC's environmental work quality at appraisal has generally been adequate, but supervision of financial intermediary (FI) projects has been insufficient. Project appraisal has been adequate in identifying direct environmental, social, and health and safety risks in real sector projects and in diligent translation of IFC generic requirements for FI projects to legal documents. But greater attention is needed to the assessment of indirect and induced environmental and social impacts, which can be significant in agribusiness projects, for example. IFC's 2006 Performance Standards provide new tools to help define projects' areas of influence, supply chain management, and cumulative impacts, and the new environmental and social review procedure in implementation since May 2006 includes risk-based appraisal and supervision of FIs. However, it is too soon to assess implementation of these standards and the impact they are having on environmental performance.

Currently, IFC's measure of project Environmental and Social Effects is confined mostly to environmental impacts and performance in meeting standards and requirements at the company level. However, as part of the Bank Group, IFC's impact importantly also includes the sectorwide or regionwide effects of the operations it supports. Therefore, both self-evaluation and independent evaluation should broaden their focus in the direction of assessing these broader effects going forward.

The performance of MIGA guarantee operations in meeting environmental requirements and standards differed between projects with more (Category A) and less (Category B) serious potential environmental and social impacts. For Category B projects, measures agreed in the early stages are not always being fully carried out, suggesting the need for additional support and monitoring. MIGA, like IFC, needs to give greater consideration to the broader environmental effects of the investments it supports.

More generally, differences with respect to project-level environmental requirements between the World Bank on the one side and IFC and MIGA on the other deserve assessment. The Bank follows environmental and social safeguards (operational policies, procedures, and guidelines), while in 2006 IFC adopted a new Policy and Performance Standards on Social and Environmental Sustainability. A similar approach was adopted by MIGA in 2007. Another key difference is the recourse to an independent Inspection Panel for external complaints in the case of the Bank, whereas IFC and MIGA rely on the Office of the Compliance Advisor Ombudsman (CAO), reporting to the President of the World Bank Group. The crucial question is the environmental impacts resulting from these differing approaches. They need to be evaluated and the findings incorporated into policies. The forthcoming IEG evaluation of environmental and social due diligence across the Bank Group could be helpful in this regard, but greater self-evaluation is also needed.

Need for more strategic and coordinated approaches. Government ownership of environmental objectives is of particular importance. In addition to enforcing its own legislation, the public sector needs to create an investment climate that will encourage and support environmentally sustainable private sector investment and growth. This is especially important for the energy, water, wastewater, and waste management and recycling sectors, which have significant impacts both on the environment and public health. Furthermore, mainstreaming environmental concerns needs to go farther. As most environmental problems are spatial externalities and involve more than one sector, they are often best addressed in a cross-sectoral and location-specific way. Many Bank-supported interventions at present do not go far enough in this respect. More coordinated action is frequently needed among public and private stakeholders, as well as across different investment sectors, areas where the Bank Group could be of greater assistance to interested clients.

In supporting sustainable development and poverty reduction, the Bank Group also needs to give more attention to the increasing transnational environmental impacts of rapidly growing de-

veloping – as well as OECD – countries, including the effects of rising trade in raw materials and agricultural and forest products among Sub-Saharan Africa and South America, on the one hand, and Asia, on the other, as well as within the latter region. Given associated global environmental problems, including the impacts of climate change and biodiversity loss, such pressures are being noted by various analysts as important and growing concerns.

Partnerships. The Bank Group has worked with and through a number of regional and global environmental programs and networks, including the Global Environment Facility, the Montreal Protocol, and the Poverty-Environment Partnership with other UN and bilateral assistance agencies. Such partnerships have often enhanced the effectiveness of Bank Group support for environmental sustainability. However, IEG visits to Egypt, Ghana, Senegal, and Uganda found that other donors sometimes view the Bank as an insufficiently responsive partner. On the other hand, Bank collaboration with environmental NGOs and other donors in Brazil, China, India, Madagascar, and Russia appears to have enhanced mutual effectiveness. One factor associated with these positive outcomes is the presence of Bank environmental specialists in the field, which varies according to the size and complexity of its portfolios in the countries involved.

IFC has sought to extend use of its performance standards for private sector investments in developing countries by working with commercial and other multilateral development banks. The Equator Principles, initiated by IFC in 2003, had been adopted by 60 of the world's leading banks by March 2008. These now cover the majority of large-scale project financing in the developing world. To assess their impact, however, financial institutions will need to demonstrate greater transparency and improved reporting with respect to implementation.

External constraints. Several significant constraints at the country and firm levels limit greater effectiveness of Bank Group and other donor support for the environment. A principal obstacle in many settings is insufficient commitment to environmental objectives, policies, and interventions at the national, subnational, and/or firm levels. Rapid population growth, economic expansion, persisting poverty, together with market, governance, and institutional failures, continue to play an important role, as do political instability and civil unrest, especially in fragile states. Notable too is the frequent inadequacy of information about and understanding of the nature and causes of environmental problems, unclear definition of the domestic environmental agenda and its links to economic growth and poverty reduction, and weak legal, regulatory, financial, technical, human, and institutional capacity.

Internal constraints. Among the constraints within the World Bank Group are competing priorities for the attention

of senior managers, insufficient staff technical and operational skills, and suboptimal use of limited administrative budgets. Organization of the World Bank into Country and Sector Departments, while helpful in many ways, nonetheless means that geographic and sectoral boundaries between management units represent potential barriers to more effective assistance, especially for regional and global challenges. Resolution of environmental problems often requires interventions across national or regional boundaries (as in the Mediterranean and Nile Basins). This means that certain internal inertias often need to be overcome.

Given the demand-driven nature of Bank programs at the country level, global public goods, including environmental quality and sustainability, tend to receive insufficient priority. Similarly, not enough attention is given to sustainable development obstacles and opportunities in Bank country and regional strategies. Addressing these constraints requires strong leadership at the corporate, regional, and country levels supported by high-quality analytical work and other tools.

An additional impediment refers to insufficient coordination within the Bank Group. For IFC and MIGA to operate effectively, adequate legal and regulatory frameworks need to be in place and enforced at the country level. This depends on government policies and practices, including transparency, areas in which the Bank often has greater leverage, although Bank influence varies significantly across countries and over time. IFC is also increasingly working with governments, for example, in providing advice on private sector sustainability, corporate governance, and public-private partnership reforms. The feasibility of private investments may also depend on adequate physical and economic infrastructure, such as facilities for treatment of industrial waste and wastewater, which is often undeveloped or nonexistent and provided by public utilities that are World Bank clients. In turn, regulatory reforms supported by the Bank can be made more effective with parallel IFC/MIGA efforts to induce its clients—and the private sector more generally—to comply with these regulations. Such opportunities for coordinated action in support of greater environmental sustainability need to be better identified and acted upon.

Achievement of the objectives of Bank Group strategies—including the 2001 Environment Strategy in which IFC and MIGA were not significant participants—depends in part on private sector actions to stem environmental damage and improve environmental quality, areas where IFC and MIGA can play a vital role. Good collaboration between the Bank and IFC is increasingly seen in several urban and rural programs. However, absent a common framework that allows the Bank Group to understand the full range of environmental effects of its interventions, there is a risk that the public and private sector arms of the Bank Group may be working with different criteria in relation to the environment. This could happen, for example, in the energy, transport, and agribusiness sectors. Thus, it is important that new investments in both the private and public sectors (for instance new power investments in Asia and agribusiness investments involving tropical forests in Africa, Asia,

or Latin America) meet the same environmental performance standards and consistently seek to reduce environmental damages, including deforestation and greenhouse gas emissions. Better intra-Bank Group coordination of strategies, approaches, and interventions at both the corporate and country levels are essential.

Recommendations

In view of the increasing importance of environmental sustainability for economic growth, poverty reduction, and human well-being, as documented in recent UN and Bank/IMF reports and the findings of this evaluation, the World Bank Group should seek to enhance the effectiveness of its activities in support of environmental sustainability. To help it do so, IEG recommends the following:

Increase the attention to environmental sustainability in the World Bank Group by ensuring that environmental issues enter fully into discussions of its strategic directions and in regional and country assistance programs.

Promotion of environmental sustainability (including, but not limited to, addressing climate change) should be a central pillar of the Bank Group's strategic directions in its efforts to support inclusive and sustainable globalization. The World Bank Group should jointly reformulate and update the 2001 Environment Strategy in light of the increasingly important role of the private sector, global public goods, and transnational environmental footprints. The WBG should likewise jointly consider both medium-term (5-10 year) and longer-term (10-20 year) approaches to strengthening environmental sustainability at the regional and national levels and should incorporate short-term (3-5 year) environmental programs into country assistance and partnership strategies where feasible, especially for countries with large investment portfolios and environmental challenges and carbon footprints of global significance. IFC should continue supporting market transformation towards sustainability with its Advisory Services and direct and financial intermediary investments, emphasizing technology transfer and development in clean production, energy efficiency, and sustainable supply chain management.

Move to more cross-sectoral and spatially oriented approaches to environmental support and strengthen staff skills.

The Bank Group should help its clients adopt more cross-sectoral and spatially focused approaches to addressing environmental challenges. Staff technical and operational skills for the delivery of environmental support also need to be strengthened. While the WBG must be responsive to client demand in its policy advice and lending, it can still be proactive in analyzing environmental issues and seeking to

identify strategic entry points in countries with significant environmental concerns.

Improve the Bank Group's ability to assess its support for the environment and to monitor and evaluate the impacts of its environment-related interventions.

The Bank Group needs to do a better job of measuring the environmental performance and impacts of its activities. The Bank needs to improve monitoring, evaluation, and reporting of environmental aspects and results of lending operations at both the project and portfolio levels. While IFC has evaluated its Environmental and Social Effects since 1996 and recently developed new tools to track and analyze environmental performance indicators at the project level and MIGA has scaled up its assessment and monitoring of project environmental and social performance, both institutions could improve their attention to baseline and performance indicators for later monitoring and evaluation. IFC and MIGA should also be concerned with and measure more fully the aggregate and supply chain impact—beyond individual project performance—of projects with large environmental dimensions, for example in oil, gas, mining; energy; or agribusiness projects in high-biodiversity regions.

The Bank Group needs to develop and apply methods to assess its environmental impact. Together with agencies such as UNDP and UNEP, it needs to help quantify progress toward achievement of the crucial Millennium Development Goal 7 on environmental sustainability, a goal that is not now being tracked adequately.

Improve coordination among the Bank, IFC, and MIGA and between the WBG and external partners (both public and private) in relation to the Bank Group's environmental mission and ensure consistent and effective implementation at the corporate and country levels.

Senior management across the World Bank, IFC, and MIGA needs to give greater attention to ensuring Bank Group consistency and effectiveness in this area. Mechanisms should be established at the top management, regional, and, where pertinent, country levels to promote, monitor, and report on intra-institutional coordination and collaboration with respect to environment-related strategies (including but not restricted to those concerned with climate change), policies, and interventions. Specific actions are recommended with regard to: (i) corporate strategies for the environment; (ii) environmental aspects of country assistance and partnership strategies; (iii) monitoring, evaluation, and reporting on environment-related interventions and outcomes; and (iv) assessing experience with differing approaches to environmental due diligence for lending, equity, and guarantee operations. Furthermore, strengthening external partnerships with both the public and private sectors should be a central theme in an updated WBG environmental strategy, as effective partnerships will be essential to success in addressing the world's urgent environmental concerns.

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The views expressed here are those of IEG and should not be attributed to the World Bank Group. The findings do not support any general inferences beyond the scope of the evaluation, including any references about the World Bank Group's past, current or prospective overall performance.

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