Executive Summary

The Congress has directed the U.S. Agency for International Development (USAID) to work with other key U.S. agencies to help the Multilateral Development Banks (MDBs) to set performance standards with an emphasis on environmental sustainability, economic viability, and indigenous peoples and to ensure that those standards are met. In this report we summarize these requirements, review current practices and trends, consider recent constructive criticism of MDB lending and identify options for improvement. We then review a sampling of loans posing risks to the environment and related values.

Key findings of this report are:

- MDBs continue to have a mixed performance in their environmental review of loans and in the effectiveness of the environmental and related performance:

- Nearly half of the money lent by the Multilateral Development Banks in recent years has been in "structural adjustment" loans. A large number of these and other loans such as loans for capacity development or financial institutions will promote natural resource exploitation, power production or highway development, all areas with potentially substantial environmental impact. The Banks generally do not do environmental assessments for structural adjustment, capacity building and many financial institution loans, even for those with substantial environmental impact.

- U.S. legislation requiring environmental assessment and review before the USED can vote in favor of any proposed MDB action that would have a significant effect on the environment is not being applied with regard to most structural adjustment and capacity building loans with probable substantial environmental impact. This is due, in part, to regulations that apply the statute narrowly. Given the wording of the statute and its legislative history we believe the scope of the regulations should be expanded.

- The U.S. agencies should examine how to include a broader set of expert agencies and other partners, within the constraints of limited resources.

- USAID continues to allocate the limited human resources available to address this issue so as to maximize their effectiveness. The Agency will assess the role of each mission and regional bureau in reviewing not only the occasional notices from the early notification system, but the Monthly Operational Summary updates of the World Bank[1], and similar summaries of the other MDBs. Missions and Bureaus will continue to be encouraged to investigate further, in consultation with Bank country or regional officers, any projects that are likely to have substantial environmental or negative social impacts.

[1] The MOS is available and renewed on the 16th of each month on the website beginning June 2000.

- For MDB projects that fall within the existing Treasury Department regulations requiring assessment, the review is usually later and involves fewer interested parties than the either the law or the regulations anticipate.

- The regulations promulgated by Treasury call for interagency review of proposed projects at three stages. The first, where leverage may be greatest, is intended to review the classification of projects between those requiring full Environmental Assessments and those requiring less. At present, this is done infrequently. Given the importance of proper assessment, we believe this should be a regular practice.

- USAID and its sister agencies would be more effective if they were more thoroughly engaged in the review process at an earlier stage. This is easier said than done, but USAID and its partners should press the MDBs for earlier loan information disclosure and evaluation. These partners should seek to obtain the necessary human resources for more active engagement.

This report recommends that USAID and its partners encourage the MDBs to:

- Publish draft assessments so that persons and agencies can provide in their comments evidence of better choices, and in final assessments MDBs should accept or reject each major recommendation, giving an explanation as is done in U.S. assessment and informal rulemaking.

- Evaluate proposed loans, and those carried out, according to the indicators and accounting measures used in the Bank's *World Development Indicators* and make adjustments in loan criteria accordingly.[2]

- Develop a strategy, including environmental and social screens, to guide the entire Bank family in its private sector investment in the developing world.

- On a strict schedule, shift lending to environmentally sustainable development and away from non-renewable energy and basic extraction, except for technical assistance to ensure that developing countries, on similar sustainability schedules and in the context of good governance, implement environmentally sound energy and extractive resource policies and benefit-sharing that would otherwise not occur.

- Expand current "negative investment" lists (areas in which investment should not occur) to include projects that cause potentially irreversible harm to the environment as defined by internationally recognized standards.[3]

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[2] USAID's environmental indicators for countries are set are set forth in the appendix. To these, USAID adds project specific criteria in order to select projects and evaluate performance. In 1998, a small foundation-funded project, Accounting for the Environment, developed a set of indicators that included both environmental and governance measures and ranked several countries against each other so as to compare the natural and human stewardship of countries at similar levels of economic development. Yale University has now also developed a sustainability index including non-environmental criteria and the Bank has completed its Genuine Domestic Savings ratings, first published on a limited basis in 1998's *World Development Indicators*. Various models in addition to the more traditional economic models can be used to consider natural resource and human capital more fully. For example, Millennium 2000, a not for profit organization, has a "T21" model of development that inexpensively illustrates development options.

[3] Such as those using Persistent Organic Pollutants, House Report 106-720, pp. 83-85.

- Institute a dynamic, participatory process to assess environmental and social impacts of structural adjustment loans, given the lack of assessments for structural adjustment, capacity building and other programmatic loans noted above.

- Create an incentives framework to ensure that safeguard policies are implemented in a consistent manner throughout the Banks, given the need to better incorporate environmental values into project and program selection and operation described within this report, and other reviews of MDB operations.[4]

- Strengthen of the role of internal Bank "networks" (*e.g.*, on environmental quality control) to better control operations.

- Expand the current information disclosure to include annual public financial disclosure beyond the Bank Vice Presidential level, to avoid the appearance of conflicts of interest, as required for most high-level officials under the Ethics in Government Act.[5] This disclosure might be reviewed for use by the MDBs and their borrowers with regard to those making decisions concerning the spending of funds from the MDBs. For transparency at an institutional level, similar disclosure could be applied to the process of bidding for, and acquiring the legal title to, properties that are the subject of MDB loans, as in mineral extraction and privatization.[6]

- Create new compliance units to ensure that no project is moved to the Board without prior certification as to compliance with all applicable policies.[7]

In essence, the Banks should ensure and demonstrate with substantial evidence that loans will not be likely to undermine the sustaining of earth's living natural resources or ecosystem functions and that loans selected for each country will provide the greatest benefit for the resources available according to widely accepted criteria. In mid-course reviews, corrections should be made if this performance is not evident.[8] Models are available to predict likely effects and remedies can be provided for reasonable risks. Effective remedies financed by performance bonds or insurance should be part of each loan and presented in the environmental and social assessments conducted by the Banks. These remedies should be made available for those harmed, if not through existing judicial systems, then through interim systems established for Bank projects. The World Bank's Investigations Panel and the International Finance Corporation's Ombudsman are major steps in the right direction and USAID congratulates the Bank and the IFC on their excellent work in establishing and empowering these offices.

The report reviews in detail the reforms listed above and related recommendations of the Congress, the General Accounting Office, the U.S. Executive Director of the World Bank, Non-Government Organizations, Departments of the MDBs themselves, and how these suggestions might apply to specific loans.

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[4] This item and the preceding four are virtually identical to those requested in the House report noted above. The USAID review supports these recommendations as fully warranted.
[5] For example, as implemented in 5 C.F.R. Part 2364.
[6] An additional and related tool is to clearly define conflicts of interest, which the Bank is doing in its internal seminars, and to require affirmative statements of no conflict of interest, as well as the more passive financial disclosure. Procurement reforms are well underway, but could be expanded.
[7] This recommendation and those concerning empowering the environmental and other "networks" and incentives for World Bank personnel were made by the US Executive Director of the World Bank in July. of 2000. They are needed.
[8] A typical loan-supported project might have a six year life-span but critics often assert that mid course and post loan corrections are too rare (see discussion of GAO, QAG, and other evaluations below).