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Analysis of the World Bank Sustainable Environmental Management Development Policy Loan (SEM DPL) for Brazil

The World Bank & Development Policy Lending: Lessons for Revising OP 8.60

Vince McElhinny (BIC)

In March 2009, the World Bank approved a two tranche $1.3 billion Sustainable Environmental Management Development Policy Loan (SEM DPL I) to Brazil that was designed to strengthen social and environmental policy reforms at Brazilian National Bank for Economic and Social Development (BNDES) – Latin America's largest development bank and other government institutions. The SEM DPL I, with a planned $700 million follow on loan (SEM DPL II) was intended to build institutional capacity and enhance the country's environmental management system, integrate sustainability concerns in the risk assessment of investment in key sectors and help integrate Brazil's climate change agenda across all sectors.

The SEM DPL is "conditioned" on environmental and social policy advice that is largely consistent with the country's stated development plans and rewards those plans with large budget support transfers. The SEM DPL support for these reforms are in the form of "prior actions" or "triggers" – which refer to conditions in the DPL that are executed in association with the transfer of Bank funds to the Brazilian Treasury. The SEM DPL I conditioned the disbursement of funds in two tranches over two years on nine environmental and social policy reform conditions that were to be completed prior to the final disbursement.

Brazil is now a driving force behind standard setting for social and environmental sustainability in South America, particularly in the rapidly changing infrastructure and related agribusiness sectors that are considered to be the primary drivers of land use change. Change at BNDES will increasingly define the scope for influence and set the direction and pace for change at other institutions such as the World Bank or any others engaged in upholding sustainability standards in the Amazon basin. The surging confidence associated with the economic expansion underway in Brazil has also translated into a more complex government engagement with civil society and investors. The recently approved BNDES social and environmental institutional policy attests to the Brazil's increasing attention to institutional governance.

BNDES is on track to have a full fledged social and environmental policy in the coming years, taking significant strides in improving the formal aspects of environmental governance in the Amazon. A package of reforms approved at BNDES in the past year suggests promising improvements in the social and environmental management system at BNDES. Although BNDES reforms fall far short by most international standards, they represent a significant opportunity to strengthen standards for future investment in much of Latin American and the Andean-Amazon region in particular.

The SEM DPL emerged on a fast track in late 2008 in response to the financial crisis to anchor the World Bank's $15.3 billion Country Strategy with Brazil. The SEM DPL series follows prior World Bank analytical and financial support for the Brazilian government efforts to promote the sustainable management of

Amazon agricultural lands, forests, and water resources; reduction of deforestation in the Amazon; reduction of the environmental degradation of land, water, and other resources which are key determinants of the well-being of the poor; and promotion of renewable energy

From the outset, the SEM DPL was criticized by civil society for lacking adequate transparency, participation and accountability. A controversial $500 million second tranche disbursement in late December 2010 appears to lack evidence of full compliance with the loan's policy triggers and may have provided indirect support for the BNDES financing of the 11,000 MW Belo Monte dam. Greater scrutiny of the SEM DPL by civil society organizations, the Brazilian Federal Prosecutor's office in Pará and World Bank Executive Directors contributed to Brazil's decision to forgo the final $700 million SEM DPL II in March 2011.

The problems identified in the design and execution of the SEM DPL, analyzed in this brief, repeat many aspects of the experience of an earlier environmental DPL to Brazil, including the premature cancelation of the final programmatic disbursements and associated reform components.

This brief is the second part of a two part analysis of Development Policy Lending by the World Bank that explores the WB SEM DPL to BNDES as an emblematic example of this evolving and tenuous relationship between the World Bank and its largest, most influential clients. Part I of this analysis focused on the evolution and trends in DPL use by the World Bank as a reflection a rapidly expanding and complex dimension of the World Bank's relationship with its largest clients.[1] Since 2004, development policy operations (DPLs) have emerged as a preferred financial instrument for a growing number of World Bank clients, including many in Latin America. Despite the popularity of DPLs and innovative use in new areas such as promoting reforms in environmental governance, concerns are mounting about the effectiveness and accountability of these instruments.

DPLs have redefined the role of the World Bank in environmental and social standard setting in client countries. There are many that view the use of environmental DPLs as a forward looking and promising innovation by the World Bank and support the experimentation with these new instruments. DPL proponents hail the new instruments as opportunities for the World Bank to support the mainstreaming of sustainability commitments. Critics charge that DPLs lack transparency and accountability regarding attribution for results, and can be counterproductive to supporting social and environmental governance. The SEM DPL provides evidence for both views. As experiments, the Bank should emphasize learning and adjustment to fully maximize DPL potential. Unfortunately, documented learning and adaptive management represent missed opportunities rather than achievements of the SEM DPL.

World Bank clients complain that the perceived costs of their own prescriptive safeguards are crowding the Bank out from some of the high risk regional development opportunities now increasingly dominated by BNDES. In practice, the World Bank's operational safeguards apply to a smaller and smaller share of its own actual lending (about 50% in FY 2010, as shown in part 1 of this analysis). The DPL instrument was created as a hedge in the World Bank's survival strategy in response to increased competition for project finance. Latin America has been the largest World Bank client for DPLs, catalyzing the transformation in the Bank's portfolio toward an increasing share of non-project operations – and with it the evolution of related safeguard operational policies to suit this new demand.

[1] For more on graduation, see Part I of this analysis, "World Bank and DPLs: What middle income countries want" BICECA Bulletin, (Feb. 4, 2011) ***http://www.bicusa.org/en/Article.12351.aspx***

The first section of this brief surveys the emergence of BNDES within context of rapid growth in Brazil and the implications for change in social and environmental standards for development finance. In 2010, BNDES lending volume was close to 13 times the combined lending of the three most important MDBs, and twenty times as great as the World Bank annual lending of about $US 3.5 billion to Brazil. A decade ago, BNDES/MDB lending ratio in Brazil was less then two. This shift is all the more amazing considering that BNDES has only about one fourth the staff of the World Bank.

BNDES provides nearly 25% of the credit to Brazil's economy, although nearly 75% of Bank credit goes to the top 12 business groups. Calls are heard for greater transparency on the part of BNDES and a better assessment of the costs and benefits of subsidized lending. Change at BNDES will increasingly define the scope for influence and set the direction for change at other institutions such as the World Bank or any others engaged in upholding sustainability standards in the Amazon basin.

The second section examines the World Bank response to Brazil as a context for understanding the evolution of the SEM DPL and identifying the central issues at stake in assessing the effectiveness and additionality of this important World Bank investment. Brazil pre-paid $3.1 billion in debt to the World Bank in June 2011 to enable continued borrowing within the Bank's single borrower limit. Yet for Brazil, an additional $1.3 - $2.0 Billion in cash from the World Bank is not valued simply in terms of its added financial value. The additionality of the SEM DPL lies in a combination of knowledge exchange and political leverage to help move the policy agendas of the World Bank and Brazil forward.

It is worth remembering that Brazil is one of about 40 Bank member countries that has reached or exceeded the threshold established in the Bank's articles of agreement governing the graduation of borrowing countries.[2] An existential question lies ahead for the World Bank as its core revenue generating clients face greater scrutiny in terms of privileged access to the World Band concessional lending.

Many of the challenges for maximizing the effectiveness of instruments like the SEM DPL in Brazil depend on clear guidance for how to define core features of the DPL – which remain shrouded behind closed door negotiations and rest upon weak accountability structures. **As the World Bank begins to review its operational safeguard policies, DPL Operation Policy 8.60, which governs 40-50% of IBRD lending, should also be strengthened to ensure that DPLs work for their intended purposes and the Bank ensures consistently high standards across all of its financial instruments.** The SEM DPL provides compelling evidence that obligations and guidance in the areas of social and environmental assessment, transparency, consultation, and accountability are areas that require revisions.

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The third section of the brief reviews the evidence (official and unofficial) to assess the effectiveness and additionality of the SEM DPL. The analysis relies on nearly three years of communication with the World Bank and other stakeholders in Brazil by a small group of civil society organizations that have expressed a demand to participate in the loan design and implementation at all stages of the project cycle. One of the central failings of the SEM DPL is the inadequate responsiveness to these civil society demands. The brief also explores the consistency between World Bank statements of compliance, effectiveness and additionality for each of the eight policy action areas in the SEM DPL policy matrix for which BNDES was the primary executing agent.

Finally, the brief draws some lessons from the SEM DPL experience in Brazil at three levels: a) the performance of the SEM DPL according to its own results framework; b) the performance of the World Bank's Operating Policy for DPLs; c) the social and environmental risk management system at BNDES.

[2] For more on graduation, see Part I of this analysis.

Conclusions and Recommendations: The $2 billion World Bank Sustainable Environmental Management Development I & II Policy Loans were the centerpiece of the Bank's Amazon Framework to advance an agenda of reforms What might we learn from SEM DPL? The SEM DPL I completion report provides only 10 sentences of lessons learned, which avoid the candor and detail that would be consistent with the cost and scope of the operation.

The analysis that follows serves to present the information that is available and point to the gaps in what we should know to render a judgment on the effectiveness and additionality of the SEM DPL. Insight is offered not only to why the $700 million SEM DPL II was eliminated in March 2011, but also into the future effectiveness of World Bank support to social and environmental policy reform through DPLs and other instruments in the future. The pending performance questions left open by SEM DPL also highlight gaps in the Bank's Operational Policy 8.60 that deserve scrutiny and revision during the ongoing safeguard policy reforms. Finally, and perhaps most importantly, the evidence should highlight a number of areas of debate within BNDES about governance standards.

***SEM DPL Loan Performance - Policy Conditions and Progress*:** The key to understanding the World Bank SEM DPL loan with Brazil is the Development Policy Matrix that outlines the design and execution requirements for the SEM DPL and describes the nine objectives, prior actions, triggers and outcome indicators for both a first and second DPL. The SEM DPL central conditions are related to actions by BNDES in the formulation and application of a new Social and Environmental Institutional Policy. Disbursement of DPL funds by the World Bank is tied to the fulfillment of these conditions.

At issue is the question of whether the conditions in the SEM DPL that applied to BNDES (in part or fully) were complied with to public satisfaction in return for disbursement of both installments of the $US 1.3 billion to Brazil' treasury. A number of CSOs raised this concern in a letter to the World Bank Vice President Pamela Cox on December 20, 2011 after learning that the Bank had disbursed the remaining $500 million several days earlier. **After extensive communication with the Bank, BNDES and other officials in the Brazilian government and legislature, it remains unclear from the documentation disclosed that several central SEM DPL conditions were adequately fulfilled.**

The analysis suggests that for three of policy conditions for which BNDES was the primary executing agent, evidence is lacking to firmly substantiate compliance with SEM DPL prior actions and triggers. For the other six performance indicators, this analysis arrives at different conclusions than the World Bank. For most, the evidence suggest a lower performance ranking in terms of effectiveness and additionality than the Bank ratings of "satisfactory" to "moderately satisfactory".

Moreover, this analysis strongly suggests that considerable evidence is simply missing from the Bank's supervision and completion reports, and a fuller presentation of evidence that does exist runs counter to the World Bank conclusion that "*based on the careful analysis of the entire set of evidence presented by the borrower, we concluded that all of the six policy actions designated in the Loan Agreement as part of the second tranche release conditions have been carried out satisfactorily*." In part, the non-compliance is due to documentation that the World Bank and BNDES have refused to disclose.

For the six policy actions for which BNDES was the primary executing agent, and two other policy actions for which BNDES played a major role, the analysis of available evidence suggests that the $1.3 billion SEM DPL that anchored the World Bank's Amazon Framework delivered surprisingly low Bank additionality and was not effective in any resounding way.

Summary of SEM DPL Effectiveness and Additionality

SEM DPL Policy Action area	Effective Compliance w/ SEM DPL conditions	Overall World Bank Additionality
1: **Mainstream Climate Change** in public and private sector investments	**MODERATE** Positive adoption of climate change law, policy targets, reduced deforestation & emissions likely meets target (*outcome indicators likely defined too low, downplays reversible gains, not clearly attributed to BNDES, no references or detailed explanation of source information*)	**MINIMAL** Climate policy not responsive to DPL, Brazil rejected original WB LCDS reference scenario, forcing WB to align to a more conservative baseline
2: Improving **BNDES Environmental and Social Management Effectiveness** and Other Financial Institutions (SERG/ESP)	**LOW** Some progress on mainstreaming Green Protocol principles and elevation of Environment to Division, although evidence lacking on effective "application" – 100% screened, is completely lacking, no indirect, cumulative impact provisions, reporting, recourse mechanism for affected parties; new green BNDES lending programs launched – no data on actual performance.	**MODERATE** SEM DPL helped ensure approval of BNDES policy package in 2010, elevate AMA, which might not have happened as early as it did. Cancelation of SEM DPL II & non-consultation on sector guidelines suggests limits to SEM DPL additionality. Actual reach and continuity of reforms questionable
3: Improve Sustainability of natural resource management	**LOW** Modest new commitments: Public Forest Management Law led to small 1,500 km2 in concession in 5 years; Atlantic forest law led to 6 projects approved in 2010-2011 for $8.5 mn, 1359 ha restored toward 5,000 ha target; National Monetary Council Resolution 3545 slowed lending to agribusiness lacking env. permits; BNDES Program approval, but no reporting on performance, no explanation of BNDES forestry guidelines, including consistency with Sust. Resource Mgmt FSC criteria	**MINIMAL** Unclear attribution to SEM DPL; Public Forest Management Law passed in 2006, 3 yrs prior to SEM DPL I; or to CNM Resolution that has had significant impacts
4: Amazon Fund: Improve Rainforest conservation	**UNCLEAR-LOW** 5,000 km2 target far exceeded by 20,250 km2 share of ARPA II, suggests underestimate of target; actual conservation impacts only projected; ignores PA underfunding & roll back of some PAs, and role of AF within BNDES	**MINIMAL:** No apparent WB connection to Amazon Fund management; or clear independent attribution of Amz Fund for delivering ARPA II

5: Promote Renewable Energy	**MODERATE** objectives and targets were set too low, ignores conflicting evidence, ignores concession on AAE methodology, Belo Monte or BNDES hydroelectricity guidelines; does not adequately explain synergies (or lack thereof) between SEM DPL and other Bank sector investments	**MODERATE** Substantial WB knowledge services and technical assistance on energy sector reforms.
6: Reduce environmental impacts through improved water, wastewater treatment, and solid waste services	**UNCLEAR** Data cited of reduced pollution loans appears to have surpassed target; No evidence provided on BNDES SERG/ESP effect on reduced pollution loads; PRODES approved, but no evident way to validate performance data	**UNCLEAR** No explanation
Policy Action Areas For Which BNDES Are Relevant But Not Primarily Responsible		
1: Improve effectiveness of government agencies in implementing mandated Brazilian environmental and social management procedures.	**LOW** Outcome indicator was changed when Bank realized judicially challenged licenses could not be tracked; More EIAs not necessarily a positive progress indicator of IBAMA effectiveness. Missed MMA hiring targets, DPL spanned 2 fired IBAMA presidents, no data on change in frequency of licensing disputes despite 14 lawsuits against only 1 project license.	**MODERATE** Budget cuts & env. license politics tend to offset Bank advice, incentives
2: **Improve Amazon regional planning** for sustainable development and reduced deforestation (PAS/EEZ)	**MODERATE** Deforestation target surpassed, but largely ignores forest code reforms implications and the weaknesses of zoning (EEZ) in some states. *Increased land inequality, commodity crop expansion and conflict in the Amazon region not addressed.*	**UNCLEAR** Deforestation variation occurred prior to DPL & rates are reversing now; PAS and BNDES attribution for reduced deforestation not clear

***World Bank DPL Operational Policy 8.60 Performance*:**

Four areas of safeguard policy standards are discussed below as context for understanding and assessing the impact of the SEM DPL in advancing this reform agenda and possible areas where DPL Operational Policy 8.60 could be revised to maximize DPL effectiveness and World Bank additionality.

1. Transparency: In 2010, the World Bank began implementing what might be the most progressive access to information policy of any development finance institution. The SEM DPL clearly signals one of the major gaps in this new Bank policy. From the most elementary aspects, such as not translating any of the major SEM DPL documents into Portuguese, to the more complex aspects of not ensuring the demonstrated inclusion of learning from past operation performance at key moments in the design and execution of SEM DPL, transparency practices did not live up to the Bank's reputation. To read the final Completion Report (published on Sep. 14, 2011), the reader would have no indication that any civil society organizations had ever engaged the Bank or the government of Brazil to contest the validity of their assessment.

Perhaps the most flagrant gap in SEM DPL transparency was the refusal to disclose the policy matrix along with the full program document prior to Bank Board approval. The lack of access to information about the design of the conditionality within any DPL until after the appraisal has ended and the loan is approved represents a tremendous imbalance in access to strategic information that insulates the Bank's ability to negotiate sensitive commitments with the client without independent oversight. Civil society organizations have criticized this gap in transparency as significantly weakening DPL accountability at perhaps the most important moment in the project cycle.

Civil society requests for numerous documents that were referenced in the SEM DPL Program Document or during DPL implementation but not disclosed, included timely availability of past relevant project evaluations (ENV PRG, PPG-7, ENV TAL, ESTAL, etc), the first three Implementation Status Reports, and aide memoires of Bank monitoring missions.

The lack of disclosure left many of civil society questions unanswered. Most significant of these questions was how will the new BNDES social and environmental institutional policy, including some type of strategic environmental analysis, be applied to high risk projects such as the hydroelectric dams and meatpacking facilities in the Amazon? Citing client confidentiality, the World Bank refused to share documentation that was necessary to demonstrate that compliance with this policy action was satisfactory. Similar gaps in the evidence of SEM DPL performance leave compliance with other policy actions open to question. The SEM DPL performance monitoring system funded under a complementary World Bank ENV TAL failed, underscoring the lack of attention to core transparency issues.

Core concerns about the SEM DPL highlighted transversal issues that point to the wide discretion in the World Bank's operational policy 8.60 governing the necessary transparency requirements for ensuring the prevention of harm and the mainstreaming of sustainability through DPLs – such as how meaningful participation is defined, clarify about evaluation methods, and the relationship between high risk policy reforms and applicability of the Bank's traditional safeguard policies on involuntary resettlement, indigenous peoples, and risk management. The World Bank responses to civil society concerns, both in formal letters and in informal conversations, often sidestepped direct answers and attempted to outline the limits of Bank influence in Brazil.

Transparency has been lacking both in terms of the process of designing the SEM DPL and in the implementation phase. Despite its flaws, the welcomed idea of a MMA web portal to update the public on the progress of the World Bank technical assistance loan did not work well in enhancing SEM DPL transparency, but is worth rescuing and adapting to accommodate the supervision of ongoing monitoring of SEM DPL performance, which should continue for several years beyond the last disbursement. However, a more ambitious and essential reform for the SEM DPL would have been to promote and facilitate a robust access to information policy by BNDES, without which assessment of the core SEM DPL condition of policy application is merely speculative. The World Bank could provide greater leadership in this direction by fully disclosing all relevant documents related to the SEM DPL.

2. Consultation and Participation:

Civil society organizations first became aware of the proposed DPL in late 2008. As was the case for the entire duration of the SEM DPL, contact about the SEM DPL was initiated by civil society on multiple occasions to demonstrate interest and concern about the loan as well as offer ideas for improving SEM DPL effectiveness. On every occasion, the World Bank project team leaders reciprocated with information about the status of the loan, often devoted significant attention to civil society concerns. However, neither the Bank nor the Brazilian government ever voluntarily convened civil society organizations that had expressed interest in the SEM DPL in various letters to provide a space for consultation or feedback on the highly controversial loan.

Civil society organizations that expressed interest in participating in different stages of the SEM DPL and related reform processes at BNDES were never consulted or extended invitations to participate in any stage of the project cycle. The Bank makes clear that the SEM DPL was based on two decades of analytical work often coordinated with Brazil based NGOs and funded by the PPG-7 and GEF grant facilities. This is not the same as consultation on the SEM DPL and some of the named organizations have been similarly excluded from certain decision making spaces related to SEM DPL.

The project completion report was finalized without any outreach to civil society for what learning might be captured for future DPLs. While the Bank officials offered to meet with civil society, shared information in informal conversations, responded to letters, and disclosed some documentation, the desired level of participation (although not extraordinary by most standards) was denied by the constraints placed on requested information, the timeliness of engagement, and the narrow interpretation of SEM DPL policy conditions governing transparency and participation. The fact that most if not all actions by the Bank were reactive and limited, rather than proactive and predictable, produced a relation between the World Bank, BNDES and civil society stakeholders that was highly asymmetric and counter to good practice principles of participation that are suggested but not adequately specified in OP 8.60.

Throughout 2009-2010, the World Bank hinted at the prospect of BNDES plans for public consultation of its new social and environmental safeguard policies, but then backed away from this claim. BNDES ultimately decided against consultation, in part perhaps related to the decision to avoid making the social and environmental guidelines more prescriptive for borrowers.

Similarly, the prospect of civil society participation in the modification of the policy actions for SEM DPL II was offered by the World Bank, but was nullified by the decision by the Brazilian government to not renew SEM DPL II, thus cancelling the second DPL.

DPLs vary with respect to the number of tranches and the programmatic structure, which has implications for the type and level of participation that might be possible. More participation is possible with multi-tranche DPLs that benefit from policy frameworks designed for a programmatic series of operations. Weighing the value and opportunities for building greater civil society participation into the design and implementation of DPLs should be a consideration into the type of operation that is most suitable for a client's need. However, this consideration is currently not the focus of OP 8.60

With a separate, less prescriptive operational policy, DPLs have expedited the Bank's country systems approach by deferring a significant amount of authority in the decision making process to the client, thus diminishing the effective control of other stakeholders that was contained in the traditional safeguard policies. The Bank management argues that they are not obliged to formally consult the public with respect to the specific negotiation of DPL conditions, unless national law calls for such a consultation. Of course, few national laws exist that call for consultations on specific international debt instruments. Also, international commitments are often difficult to enforce. Best practice guidance provided by the World Bank is voluntary at key moments in this negotiation, and few if any DPL policy conditions have been opened for public consultation at these moments.

The lack of transparency and dialogue with civil society has been a definitive challenge during the entire process of preparation and implementation of the SEM DPL I and its key actions. Not only does inadequate public consultation on such a fundamental loan condition suggest violation with the World Bank operational policy 8.60, it diminishes the eventual legitimacy of BNDES policy by severely limiting public knowledge of the policy or its function.

The World Bank could have enhanced the effectiveness of the SEM DPL by establishing minimal criteria for consultation and participation in the related reform processes that leave less room for the discretionary participation that now prevails in OP 8.60 guidance. Reviving the concept of an advisory council that included direct representation of civil society might be a good first step. Including more robust participatory mechanisms as actions in any DPL would represent a stronger commitment to mainstreaming this undervalued dimension of environmental governance.

3. Accountability regarding the rigor of DPL prior actions and triggers:

In the draft CPS (2012-2015) now under consultation, the World Bank cites Brazil's keen interest in impact evaluation as a foundation for knowledge creation and dissemination through South-South dialogue. Yet, the SEM DPL experience demonstrates a surprising disregard for learning and accountability for results, which calls into question whether the appropriate lessons from Brazil's efforts to promote sustainable development will be transferred.

The absence of information or ambiguity in terms of explaining any proxy for a cost benefit analysis of DPLs represents a structural weakness of DPL accountability. While any cost-benefit analysis is challenging for policy reforms, there is no excuse for not providing any justification of the DPL amount in some relation to the ambition, scope or intensity of the policy actions.

For the SEM DPL, there has been inadequate effort to evaluate the impact in terms of effectiveness or additionality. In fact, the SEM DPL experience demonstrates a weak system for monitoring and evaluation of complex and expensive investments. The SEM DPL results framework is weakened in part by an observed gap in learning from past operations and the absence of robust accountability mechanisms as conditions. Questions remain about the relevance, rigor and completeness of evidence used to measure certain DPL outcome indicators as well as the choice of certain indicators themselves.

For a $2 billion investment in the context of the significant institutional capacity in Brazil, the SEM DPL set relatively low performance targets in the areas renewable energy and sustainable forest management or in the approval of policies and programs versus evidence of effective implementation. Other performance targets appear to be duplicative (i.e. CO2e emissions reductions and reduced deforestation), rested on ambiguous logic (SEM DPL impact on Amazon Fund operating policies leading to sustainable management investment of 500,000 hectares of Amazon or Atlantic forest) or were possibly counterproductive to sustainable outcomes for Amazon investment (20% reduction in disputed environmental licenses). The acceptance of MME use of the utilitarian basin inventory assessment (AAI) as compliance with prior action on the renewable energy policy action demanding an Integrated Environmental Assessment methodology signifies a clear backpedaling on standards.

The success of SEM DPL is defined partly in terms of new programs launched, policies approved, and protected areas established – without adequate attention to the sustainability of these measures that will ultimately determine whether any real change occurs.

As noted above, the suggestion that 100 percent of the projects submitted directly to BNDES screened, approved and monitored according to the new Environmental and Social Institutional Policy remains unverifiable lacking greater disclosure of evidence.

SEM DPL options for performance indicators that were dismissed are equally revealing about accountability. The World Bank might have compensated for the considerable level of risk in the design of the SEM DPL by incorporating one or several among a variety of robust accountability mechanisms. As noted in Part I of this report, a recent review of Bank's portfolio of Environment and Natural Resource Management (ENRM) investments suggest that accountability has been the least important of four critical pillars of strengthening environmental governance. Despite the recommendation that Development Policy Loans (DPLs) could be applied more directly to strengthen institutional accountability, these types of conditions have been rare. The SEM DPL contains no objectives that promote demand based accountability as in the support for institutions or local actors that can independently monitor, pressure and assist in problem solving related to implementation of reform mandates.

The results indicator for improving environmental and social management governance effectiveness was changed, without documentation to explain why, when it was learned that tracking evidence for judicially challenged licenses was impossible. Beyond the transparency concern of reporting when and how results indicators can be changed, the licensing performance is so complex that simple numerical increases in licenses may not indicate improved governance, but could in fact suggest the opposite. A detailed qualitative analysis of how investments in MMA capacity improved licensing and governance is required but unfortunately is absent from the SEM DPL supervision and completion reporting, as with all other indicators.

This is not to say that the SEM DPL was entirely ineffective, lacked innovation or did not convey Bank additionality to complex policy issues. Rather, the monitoring, evaluation and reporting of results have made it nearly impossible to draw solid conclusions about SEM DPL performance. There were multiple instances of missed opportunities to capitalize on the evaluation of outcomes and impact to improve the SEM DPL performance, which were inexplicably sidestepped. This pattern of avoided accountability for results in the context of the SEM DPL stands in stark contrast to the embrace of a knowledge agenda by the government of Brazil and raises doubts about the selectivity of knowledge to be transferred in South-South dialogue.

The Bank's case is weakened further simply by the format in which results were reported in an abbreviated fashion, without primary references provided, leaving significant gaps in how even the minimal quantitative evidence of compliance provided in the monitoring and completion reports might be validated. Much of what the SEM DPL achieved in a positive sense is not reported adequately in the supervision or completion reports. Accountability requires more robust reporting standards that document the continuity (or not) of the reform process before, during and well after the closing of any particular DPL.

The SEM DPL also points to the lack of adequate Operational Policy guidance by the Bank on using DPLs to effectively promote accountability for results. Better guidance on DPL results begins with a thorough, independent and rigorous evaluation of DPL performance – something the World Bank has yet to commission. World Bank guidance for DPLs could more directly promote institutional accountability and capacity building, particularly through the promotion of demand based governance mechanisms. Any future environmental DPL in Brazil would benefit from a more transparent and meaningful public discussion of the ambition and pertinence of the chosen outcome indicators and oversight mechanisms to monitor and support implementation. Recent Bank research indicates that such commitments are rare for DPLs and the SEM DPL reflects this trend.

4. Maximizing Coherence with other investments by the World Bank and other Development Agencies.

Policy change takes time and requires both a long time horizon and the careful articulation of the limited resources that the World Bank and borrowing governments can provide. Maximizing the effectiveness of Bank investments depends in part on ensuring this coherence. Given the increasingly limited influence of the World Bank in Brazil, DPL effectiveness is maximized when the loan is aligned with other Bank investments, and negotiated as a programmatic investment that seeks to sustain a reform process beyond the tenure of a particular government or public official.

The SEM DPL provided an anchor for the World Bank's Amazon strategy in Brazil. The government of Brazil cancelled parts of both the 2004 and 2008 policy loans prior to completion. Disrupted by a several year lapse and a discontinuation of certain policy components, the SEM DPL nevertheless helped extend the policy change time horizon for decision makers in Brazil for objectives first established in the 2004 Programmatic Loan. DPLs are likely to be most effective when planned as a series of predictable, iterative and accountable advances in the policy change and institutional capacity building

SEM DPL effectiveness was diminished by low internal coherence and the lack of a clear strategy for leveraging a number of relevant World Bank investments. In certain instances, World Bank investments that produced evidence that ran counter to the policy preferences of the client were simply ignored. Throughout the design and implementation of the SEM DPL, the IBRD and IFC failed to act in concert in the policy actions for WBG coordination might have been most important – such as the advisory services to the design and implementation of BNDES social and environmental policy.

While identified as a potential strength international cooperation within the Paris Declaration on Aid Effectiveness, the SEM DPL's uneven coherence and weak alignment with relevant World Bank Amazon investments, ultimately undermines the effectiveness of the SEM DPL. Coherence between the SEM DPL and other related Bank investments could be strengthened by addressing gaps in the full application of Bank and country knowledge of Amazon development in the adjustment of policy conditions and the diagnosis of delays in the most relevant complementary investments. Operational Policy guidance should place a premium on mechanisms that ensure DPLs maximize the entirety of World Bank investments within a particular country or policy area.

***BNDES Social and Environmental Policy Performance*:**

While conscious that BNDES is first and foremost a Brazilian bank for Brazilian clients, it is evident that BNDES is increasingly aware of standards for international best practice for development banks, such as the Equator Principles, IFI Operational Policies, Export Credit Agencies, other national development banks among others. BNDES is clearly striving to define those standards for public and private investment in sustainable development that are most suitable for Brazil.

While the information available regarding the new BNDES social and environmental policy (SERG/ESP) is limited, it strongly suggests gaps with international standards. Nevertheless, the new policy framework represents an important milestone in the bank's governance and institutional strengthening process that will undoubtedly continue forward.

BNDES is of course not alone in assuming responsibility for mainstreaming sustainability and preventing harm from social and environmental risk in highly complex, multi-stakeholder investment sectors. The often competing challenges of strengthening the level of management capacity, improving business performance and safeguarding people and natural resources of clients in different sectors of the economy requires the coordinated actions of a variety of public and private actors.

The effectiveness of a social and environmental policy depends in part on BNDES delineation of its share of those responsibilities. A central debate in the formulation of the SERG has been over what duties for ensuring respect for rights and laws are the responsibility of other Brazilian agencies, which ones fall to BNDES, and where there is overlap that requires certain checks and balances. Is the existence of an environmental license alone an adequate criteria for risk management, or does BNDES need an independent assessment of the licensing decision to ensure quality control? If BNDES policy promotes more independent and proactive checking of the compliance with national law, to what extent does this expose the Bank to legal scrutiny of Federal Prosecutor or the Federal Auditor? How are these institutional risks managed under the new social and environmental policy framework?

Of primary concern is the lack of concrete evidence of how the five principles of the Green Protocol for Federal Banks have improved the risk screening, management and monitoring practices of BNDES. BNDES does not explain how the SERG/ESP policy instruments are applied in a voluntary or mandatory way to shape the final project proposal that goes to BNDES Board for approval. This gap in knowledge, due in part to the non-disclosure of BNDES project documents, represents the most critical aspect of safeguard application in the project preparation phase.

Key areas of effective environmental and social risk management by BNDES remain unclear, including how the Green Protocol provides guidance for addressing indirect and cumulative impacts, the regulation of investments in highly sensitive areas (such as critical natural habitat), the incorporation of carbon and other ecosystem costs and benefits into cost-benefit analysis, and the definition of metrics for strengthening environmental management capacity and governance. Reporting standards for policy results at project, sector and corporate levels are also left unspecified. Inadequate detail is provided in the BNDES social and environmental institutional policy regarding the methods necessary to suggest how affected communities and other stakeholders are advised about a project's risks, have necessary recourse, and may participate in the monitoring and evaluation of those risks, as well as to validate the veracity of information provided by the client.

BNDES has clearly moved a safeguard policy reform agenda forward with the approval and publication of significant new policies. The analysis of the SEM DPL makes manifest BNDES intention to sustain a reform effort over the coming years with or without external support, with signs of clear progress but with many questions remaining. References in this report that benchmark what we know about BNDES policy standards with peer development institutions illustrate where BNDES social and environmental policy falls short. The true test of this reform initiative at BNDES will be defined in terms of economic, social, environmental results. More than the level of investment volume or aggregate growth in relevant sectors, the adequately explained project level results of BNDES investments will ultimately have the greatest influence on the perception of effectiveness of any new standards adopted by the Bank.

Recommendations

As the World Bank deliberates a number of profound governance reforms over the next year, the SEM DPL experience informs three recommendations:

1. **New Approach to Environmental DPLs:** Any future Development Policy Loan that targets policy change and capacity building for sustainable development, particularly in the context of high risk investments in fragile, complex regions such as the Amazon, should guarantee the highest standards for transparency and consultation, a monitoring and evaluation systems that delivers independently validated results. The Bank must begin to work more systematically with civil society as a partner in the environmental reform process, the particularly in terms of strengthening demand-driven mechanisms for environmental governance within DPLs and ensuring the proper accountability as a pre-requisite for eligibility.

2. **IEG DPL Evaluation:** The apparent missed opportunities to learn from the SEM DPL experience at different stages in the project cycle suggest a more widespread lack of knowledge about DPL performance that would benefit from a full, independent and rigorous evaluation of DPLs.

3. **Open OP 8.60 for revision:** OP 8.60 should be formally revised within the context of the ongoing Investment Lending Review and Safeguard Policy Review at the World Bank to improve DPL design and implementation guidance in the following areas:

    a. **Clarify Cost Benefit Analysis of DPLs –Justification of DPL Cost.** DPLs require better cost effectiveness accountability. All DPLs should include an explanation about how the total operation amount was derived, the type of DPL required and how the specific instrument was compared to other alternative instruments. If the DPL is associated with any budget allocations, this relationship should also be clarified.

b. **Improved consultation and transparency is necessary to ensure legitimacy and likely achievement of chosen DPL prior actions and triggers.** DPLs are not adequately transparent or properly consulted, which in turn undermines the quality of the design and outcomes. Improved guidance on minimal standards for acceptable transparency and consultation is required that establishes greater advisory capacity by a wider range of stakeholders at key moments in the project/reform cycle but provides flexibility for Bank-client negotiation. These standards should clarify reporting criteria for DPLs that include mandatory translation of program documents, disclosure of policy matrix prior to Board approval, qualitative evaluation techniques, wider use of stakeholder feedback mechanisms.

c. Guidance on **assessment of environmental and social impacts** in the design of DPLs under OP 8.60 is ambiguous and therefore subject to excessive discretion in the alignment of the DPL with the magnitude of risk. Compared to the Bank's safeguard framework for traditional investment loans, DPL Operational Policy provides significantly less accountability to affected communities that may want to defend or challenge the proposed DPL conditions or the process in which these conditions were negotiated or implemented. Guidance on DPL design should narrow this discretion by providing clear, mandatory criteria for assessing social and environmental risk and a country's institutional capacity to manage that risk

d. DPL Operational Policy has an **inadequate framework for measuring institutional capacity**, which diminishes the ability to demonstrate DPL effectiveness and clarify World Bank additionality. DPL policy should ensure evidence-based results that begin with a robust monitoring and evaluation framework differentiated by institutional setting but guided by standardized metrics that emphasize building demand for accountability.

No differentiation among DPLs regarding coherence with relevant Bank investments or planning commitment for longer time horizons. To sustain momentum for reforms, the Bank's use of DPLs might be more intentional in anticipating and compensating for the likely institutional instability that may precede or follow a DPL by privileging a menu of complementary support options for sustaining dialogue and the reform process itself within a framework that extends beyond a single DPL. This menu includes investment operations, technical assistance, fee for knowledge services, among others. Such an integrated approach should articulate DPLs better with other Bank instruments and invest more deeply in civil society based accountability mechanisms. While the SEM DPL attempted some of these measures, little of these efforts are adequately documents, which suggests greater attention to dedicated learning in this area.

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About the BICECA Bulletin

Building Informed Civic Engagement for Conservation in the Andes-Amazon

A Project of the Bank Information Center

Through this Bulletin, the BICECA project seeks to bring analysis and relevant news & information about particular aspects of projects and policies related to the International Financial Institutions (IFIs) particularly the World Bank Group and the Inter American Development Bank (IDB) and the Initiative for Regional Infrastructure Integration (IIRSA).

This publication is directed to a diverse audience of civil society organizations, indigenous groups, students, academics and other people or institutions that follow the policies and projects of international financial institutions in relation to forest governance, IIRSA and other sustainability issues. We welcome your comments, suggestions and corrections to Vince McElhinny BICECA Project Manager at *vmcelhinny@bicusa.org*

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