



Lessons and Practices No. 16

Operations Evaluation Department

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RISK AVERSION: SAFEGUARDS AND POST-CONFLICT LENDING

Preliminary 2001 evaluation findings reported by the Operations Evaluation Department (OED) and the Quality Assurance Group (QAG) raise questions regarding risk aversion in the Bank. Two sets of pressures may be affecting managerial and staff attitudes: (a) the more rigorous oversight of safeguard policies; and (b) the post-September 11 operating environment. This note presents lessons learned from experience on these two distinct aspects of risk aversion.

Do safeguard policies promote risk aversion in operations?

There is anecdotal evidence that some managers are discouraging their staff from tackling operations involving safeguard policies. An internal study on *The Cost of Doing Business* reported that procurement, financial management, and safeguard policies add about 20 percent to the administrative costs of Bank loans. Secular declines in lending for forestry, agriculture, water, and so on and long elapsed times (such as that of the Nam Theun II project in Laos) have been observed.

OED's 2001 review of rural poverty found that lending for agriculture had declined by 32 percent between FY93-95 and FY 98-01, despite economic rates of return that averaged 22 percent. Over the same period, agriculture had the highest preparation cost per project and more projects with Inspection Panel requests than any other sector. Other factors (including a lackluster performance record) also intervened to reduce rural lending, but the risks and costs associated with the more rigorous oversight of safeguard policies has certainly been a factor.

Box 1: How Bank Policies May Lead to Risk Aversion: The Case of Forestry

A specific policy link has emerged from OED's review of Bank lending for forestry. OED administered a questionnaire in 1999 to a sample of Bank staff with experience in forestry projects. Nearly 78 percent of the respondents reported that forestry projects entailed higher transaction costs than other Bank projects. Moreover, more than 82 percent indicated that the perception of higher costs for lower payoffs had led to fewer forestry operations than would otherwise have been the case, while 55 percent of respondents pointed directly at the Bank's logging ban as a contributor to this perception.

In the water and sanitation sector, OED's 2001 review found that borrowers frequently reported that meeting Bank safeguards is expensive, and that they lack the institutional, technical, and organizational support necessary to meet Bank requirements. The report

concluded that these conditions diminished the Bank's capacity to mainstream the environment into country programs and to implement safeguard policies effectively. The safeguard policies symbolize the Bank's commitment to environmentally sustainable development. Their implementation needs to become more efficient and results-oriented to avoid a "chilling effect" on high-leverage development interventions.

Bank management should encourage action on three fronts. First, the Regions and Networks should address the issues upstream, that is, in the country dialogue and Economic and Sector Work (ESW) program. OED's evaluation of the Bank's experience with large dams concluded that most of the controversy and uncertainty surrounding those projects could be traced to the inadequacy of the country's institutional framework and the lack of borrower ownership of safeguard policy directives. The report also concluded that reliable information, especially on resettlement issues, came too late in the project cycle.

Second, Regions should address these issues country by country rather than project by project. OED's evaluation of lending to Vietnam found that although that country has a national resettlement policy driven by a concern for equity and for alleviating poverty, it differs from the Bank's. OED has suggested—and the Region has endorsed—the exploration of a country-based initiative under which the Bank and the country would work together to agree on harmonized safeguard policies to be applied country-wide and not just to Bank-financed projects.

Finally, the Bank should build conflict resolution, adjudication, and verification into the design of its operations instead of expecting hard-pressed task managers to handle such tasks. OED's study of involuntary resettlement found that public sector agencies often lack the flexibility and experience to design income-generating options well suited to resettlers' capabilities and needs. Involving beneficiaries in designing resettlement programs, providing adequate resources to adjudicate compensation claims, and monitoring to verify that those resettled actually are the beneficiaries can mitigate the effects of large dams and other projects requiring resettlement.

How should the Bank manage its risks in dealing with the post-September 11 crisis?

On the one hand, the Bank needs to avoid large-scale "liquidity lending" under outside pressure and remain focused on development effectiveness and performance-based allocations. OED has shown strong evidence in the *2000 Annual Review of Development Effectiveness* and its work on IDA that when institutional quality and policy performance are high, satisfactory portfolio performance is much more likely.

On the other hand, use of appropriate investments to meet urgent needs (for example, rehabilitation loans) is an essential feature of effective risk management, as QAG has ascertained that components requiring long implementation periods are not suitable for emergency operations. Flexible application of procurement and disbursement requirements is essential for a fast response. Over specification of individual activities pursued by the Bank should be avoided.

OED's assessment of the Bank's experience in post-conflict reconstruction, validated at a workshop of leading development experts held in 1998, recommended that the Bank:

- Take an “early and active role” in aid coordination.
- Provide an economic dimension early in the post-conflict phase—as it did in Bosnia and Herzegovina and Guatemala.
- Phase in conditionalities in line with the host country's institutional capacity and political environment.
- Show flexibility in programming, design, and implementation.
- Give high priority to staffing and structuring post-conflict teams.
- Allocate sufficient resources for adequate monitoring and evaluation.
- Promote equitable development to mitigate the potential for further conflict.

The study found that the Bank should start early in planning its interventions for rebuilding the economy by having a “seat at the table” with other international financial institutions to advise on the economic consequences of specific provisions of peace accords, advising country leaders, and adopting innovative approaches (such as microcredit schemes, which can especially assist women, who tend to suffer disproportionately in conflicts). It also concluded that the Bank should promote equitable development by assessing the politics of the context, building multisectoral partnerships, and developing an integrated framework for addressing the reconstruction issues. Moreover, the study suggested that the Bank approach the task holistically rather than focusing exclusively on macro-economic issues, that is, giving adequate priority to rebuilding social and human capital by making social sector support a priority of post-conflict activity, notwithstanding its uneven performance evidenced in the OED case studies.

Box 2: A Good Practice Model from West Bank-Gaza

A good practice example of what can be done is the Bank's intervention in the West Bank-Gaza. The Holst Fund approach proved to be a flexible instrument for dealing with an “in-conflict” situation. The Bank took an appropriate risk in administering donor funds, and its intervention even before a peace agreement was reached may have helped delay the eventual derailment of negotiations. The Bank also was justified in focusing on shorter-term, visible developments such as infrastructure, though longer-term institution building should not be neglected.

The need for attending to the local political context and assessing social conditions is borne out by observers of the Bank's work in transition economies, where there were efforts to “force” the pace of development and reform beyond what the political and institutional capacities of the society could accommodate. In the same vein, the OED study on reconstruction in Cambodia pointed to the fragility of Cambodia's society and the general lack of trust resulting from the trauma of prolonged strife and lack of security. The risk of inflaming social relations and ethnic divisions through the insensitive application of economic conditionalities (“the folly of conventional wisdom”) was also highlighted.

Box 3: Human Capital Development in Afghan Refugee Projects

The importance of linking assistance to human capital development is supported by OED's 1996 impact evaluation of income-generating projects for Afghan refugee areas in Pakistan. Through nearly 300 subprojects in public works, forestry, and conservation, the projects provided employment, training, and skills to refugees. The skills developed by the refugees were later found to be useful in reconstruction programs in Afghanistan.

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