

Concept Note

For an IEG Complex Learning Product on Environmental and Social Risk Mitigation in DPOs

January 30, 2015



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1. Background and Motivation

Development policy lending differs markedly from investment lending. The two instruments diverge in terms of what is supported by the loan, how development impact is intended to be achieved, the mechanism for disbursement of funds, and many of the specific requirements that govern the design and implementation of operations. Those requirements include approaches to addressing potential environmental and social effects. Development policy lending is governed by a separate Bank Operational Policy (OP 8.60),¹ which describes it as “rapidly disbursing policy-based financing, which the Bank provides in the form of loans or grants to help a borrower address actual or anticipated development financing requirements that have domestic or external origins.” The World Bank internal processing of Development Policy Operations (DPOs) also differs from that of Investment Project Financing (IPF).

DPOs were introduced in 2004 replacing a variety of adjustment lending instruments.² In doing so, the Bank moved to an approach of structuring budget support operations around policy areas with “prior actions” that are to be implemented by the borrower before the operation is submitted to the Bank’s Board, along with “triggers” for future policy actions when the loan is programmatic (or occasionally, in tranches).³ These are all summarized in a Policy Matrix. There is not supposed to be a direct relationship between the implementation of the policy actions supported by the loan and the use of the funds. Indeed, while investment operations finance specific investments and activities, under development policy financing (or DPF) “the Bank normally disburses the proceeds of the Bank Loan into an account that forms part of the country’s official foreign exchange reserves” (OP 8.60, para. 18).

While investment loans are typically implemented over a period of five years or more, individual DPOs occur over a much shorter time period; single-loan DPOs typically go to the Board, become effective, disburse, and close over a matter of months. However, DPOs are often combined into programmatic series that can span several years.⁴

The DPO instrument has been used in different ways by the Bank. Many DPOs aim to support economy-wide reforms, with the theme of Public Sector Governance being the most common for prior actions, followed by Financial and Private Sector Development (OPCS 2012).⁵ Though less common, in other cases, DPOs are designed to support policy reforms on specific themes, such as Human Development or Environment and Natural Resources Management. Although the amounts have fluctuated substantially

¹ We have used the latest version of OP 8.60 available, “Revised July 2014”.

² Before 2004, budget support was provided through other instruments, such as Structural Adjustment Loans (SALs) and Sectoral Adjustment Loans (SECALs).

³ There are also “benchmarks” which were policy actions but not disbursement conditions. Current practice discourages the use of benchmarks.

⁴ The last OPCS DPL Retrospective reported that of the 221 operations over the three-year period covered, 64% were part of a programmatic series, 32% were stand-alone, 4% were multi-tranche (OPCS 2012).

⁵ 2012 *Development Policy Lending Retrospective*, OPCS, The World Bank.

over time—peaking at times of international financial distress—development policy lending generally accounts for about one third of the World Bank’s overall lending portfolio.

DPOs are designed to support programs of "policy and institutional actions that promote growth and sustainable poverty reduction" (OP 8.60). Most DPOs are designed to help alleviate poverty or have other positive social impacts through macroeconomic or sectoral policy reforms, and some are designed to have positive environmental impacts by strengthening environmental policies or by improving incentives in environmentally sensitive sectors. However, in some cases there may also be risks of adverse environmental or social consequences from operations supporting policy reforms, and the Bank's policies require it to assess and ensure that borrowers manage these risks.

The 2004 introduction of OP 8.60 was also intended to address key emerging issues with budget support operations, including the treatment of poverty/social and environmental aspects.⁶ Because DPO proceeds are not designed to finance specific investments, it is assumed that there is no tangible investment footprint associated with DPOs. For an instrument designed to improve the development of countries through policy-measures, it was decided that the policies and procedures governing environmental and social risk management in Investment Project Financing (IPF)—the so-called “safeguards”—were not suitable. Hence, specific environmental and social requirements for DPOs were spelled out in OP 8.60. The main requirements are reflected in paragraph 9: Poverty and Social Impacts, and paragraph 10: Environmental, Forests, and other Natural Resource Aspects.

The contents of OP 8.60 paragraphs 9 and 10 mirror one another, and require the Bank to determine whether specific country policies supported by the operation are likely to have significant poverty and social/environmental effects. For Policies with likely significant effects, the Bank is required to summarize in the Program Document relevant analytical knowledge of those effects and assess the borrower’s systems for reducing such adverse effects and enhancing positive effects. If there are significant gaps in the analysis or shortcomings in the borrower’s systems, the Bank is required to describe in the Program Document how such gaps or shortcomings will be addressed before or during program implementation. OP 8.60 does not address environmental or social effects of the use of the funds by the borrower.

There are requirements in other sections of OP 8.60 that are also relevant for the mitigation of environmental and social risks in DPOs, including:

- Paragraph 3: Financing Criteria and Selectivity, which states: “The Bank’s decision to extend a DPF is based on an assessment of the Member Country’s policy and institutional framework—including its ... environmental/natural resource management, and poverty and social aspects”.
- Paragraph 5: Consultations and Participation, which states: “Relevant analytic work conducted by the Bank, particularly on poverty and social impacts and on environmental aspects, is made available to the public as part of the consultation process.”
- Paragraph 15: Risk Management, which states: “The Bank independently identifies risks associated with the program supported and ensures, when possible, that the operation contains appropriate mitigation measures.”⁷

⁶ Starting in 1999, SECALs were required to apply the Bank’s Environmental Assessment Policy, while SALS were not.

⁷ The previous version of OP 8.60 contained a footnote to the Risk Management paragraph that specified that risks “include...social, environmental, reputational...risks, as appropriate.” That footnote is not found in the most recent

All of this is to be described in the Program Document (PD), and draw on relevant analytical work.

On the other hand, in cases where countries are affected by crisis or conflict, where an unusually quick response is required by the Bank, OP 8.60 states that there may not be sufficient time or country capacity to adequately address issues like distributional or environmental effects.

With the help of sector technical specialists, OPCS has also prepared Good Practice Notes and Toolkits on Environmental and Natural Resources Aspects and on Using Poverty and Social Impact Analysis (PSIA) for DPOs. These provide more detailed guidance to task teams on addressing environmental and social issues, and encourage the monitoring and evaluation of environmental and social impacts.⁸ In contrast to the mandatory OPs/BPs that govern environmental and social safeguards in Investment Project Financing, the DPL environmental and social Good Practice Notes and Toolkits are written more as guidance.

For the *OPCS 2012 Development Policy Lending Retrospective*, the Bank carried out its own assessment of the application of the OP 8.60 social and environmental requirements in its DPO portfolio over the preceding three years. They considered the “direct and short-term effects only”, and found that 75 percent of prior actions were neutral from a distributional perspective, and 90 percent were neutral from an environmental perspective. Approximately 17 percent and 11 percent of prior actions were judged to have potentially positive social and environmental effects, respectively. Approximately 8 percent and 0.3 percent were considered to have potentially adverse social and environmental effects, respectively. Of the latter, the report determined that in 71 percent of cases with potentially adverse social effects, prior actions were underpinned by some form of poverty and social impact analysis, while 30 percent of those with potentially adverse environmental effects discussed relevant analytical knowledge of such effects and the country’s capacity to mitigate them.

The report will complement a number of existing or forthcoming studies by IEG. A 2010 IEG evaluation examined the effectiveness of PSIAs, and identified limitations in the implementation of PSIAs and tensions between their various operational objectives.⁹ IEG’s 2010 evaluation *Safeguards and Sustainability Policies in a Changing World* looked at the adequacy of the Bank’s safeguard system in relation to IPFs but did not include the management of environmental and social risks in DPOs. This report is part of a series of Learning Products IEG is producing in 2015 which focuses on a range of specific aspects of Development Policy Operations (see Annex A). This forthcoming series will contain two other studies of particular relevance. The first will consider the influence of core poverty diagnostics on the design of DPOs. A second will consider the intended environmental effects of DPOS in a separate Learning Product examining those operations that explicitly aim to improve environmental policies or outcomes.

2. Objectives and Questions

The main objective of this Complex Learning Product is to assess the application of World Bank policy, and identify lessons learned and good practices related to the implementation of the environmental and social risk mitigation requirements of OP 8.60.

This learning product has been classified as “Complex,” since it includes both accountability and learning aspects, and will therefore follow the full processing steps associated with a major evaluation.

version. However, the new Systematic Operations Risk-Rating Tool (SORT), which applies equally to DPOs and IPF operations, includes “environment and social” as one of nine risk categories.

⁸ As noted above, the environmental and social impacts of DPOs could be positive as well as negative.

⁹ IEG, 2010. “Analyzing the Effects of Policy Reforms on the Poor: An Evaluation of the Effectiveness of World Bank Support to Poverty and Social Impact Analyses”

Specific questions include:

- A. Are risks being identified? Is the Bank identifying potentially significant adverse environmental and social/distributional effects of Development Policy Operations in accordance with the requirements of OP 8.60? Are determinations of the presence or absence of risks of adverse effects based on adequate analytical evidence? Is the Bank undertaking adequate analysis of the borrower's systems for managing them? Were there consultations by the borrower with non-government stakeholders on these risks? Was relevant analytical work conducted by the Bank made available to the public as part of the consultation process?
- B. Are risks being mitigated? Where risks of significant adverse effects are present, and gaps are identified in borrower systems for managing them, did the Bank describe how such gaps would be addressed in the Program Document? Are the risks and the adequacy of borrower country systems monitored after approval and evaluated at closure where appropriate?
- C. Is guidance adequate? Do Bank task teams have sufficient guidance on how to identify potential adverse environmental and social effects, and on how significant gaps in analysis or shortcomings in systems should be addressed as needed? Are the guidance provided and the requirements of BP 8.60 clear, and consistent with OP8.60?
- D. What is the institutional system? What are the Bank institutional arrangements for ensuring that environmental and social risks are adequately managed in DPOs? For example, how does the Bank ensure that environmental and social risk mitigation is being addressed at important stages of the DPO operational cycle: preparation, review, approval, supervision, and evaluation? What is the role of grievance mechanisms?

3. Scope

The relevant portfolio includes the entire World Bank Development Policy Lending Portfolio since the inception of OP 8.60 in 2004. Active DPOs will also be included in this assessment to ensure that the lessons learned will be as up-to-date and representative as possible.¹⁰ The focus of the review is on Bank actions, policies and procedures. Unless existing evaluative evidence is available, the review will not attempt to assess the actual environmental or social effects of policy actions or mitigation measures on the ground; nor will it assess the performance of borrowers. It will also not provide a detailed assessment of the quality of background analytical work.¹¹

The review will not specifically validate the findings of previous World Bank DPL Retrospectives, though it will attempt to provide a comparator. While an evaluation of whether the requirements laid out in OP 8.60 are sufficient is beyond the scope of this review given that actual outcomes on the ground will not be assessed, to the extent that the desk review and accompanying interviews, focus groups and relevant material reviewed can shed light on the policy, this will also be reflected in the review.

The review will focus on the mitigation of potentially adverse environmental and social effects of DPOs. This should not detract from the fact that these loans are designed to have positive developmental effects,

¹⁰ This is particularly important for DPOs in programmatic series, which under current requirements are not evaluated until the series closes.

¹¹ Another Learning Product in the IEG DPO evaluation series will be on "The role and influence of knowledge on poverty in DPOs", which will include an assessment of the quality of poverty assessments and PSIAs.

be it through supporting sound macroeconomic measures, social welfare policies, or environmental policies and regulation. However, assessing effects on the ground would be a major undertaking that is beyond the scope of this Learning Product.¹² Nevertheless, the review will attempt to identify good practice examples in the mitigation of environmental and social risks in DPOs.

4. Methodology

This Learning Product will be based primarily on a review of existing documents and data, augmented by interviews with staff. No new field work is envisaged. It is designed to be carried out rapidly in order to provide a timely independent perspective in relation to the World Bank's next Development Policy Lending Retrospective, scheduled to be released in 2015. Given the time and budget constraints, direct field assessment and consultation with borrowers will not be possible. However, where appropriate, information will also be gleaned from IEG Project Performance Assessment Reports (PPARs, which include missions) of DPOs carried out for other purposes. To develop the report the team will conduct:

1. *A portfolio review of DPOs from 2004 to December 2014.*
 - The review will undertake a random sample of the full DPO portfolio.¹³ Sampling will be conducted at the series level, so if one operation in a series is selected then the entire series will be examined. Series will be weighted appropriately so that each operation has an equal chance of being sampled. This random sampling will be representative of the overall DPO portfolio, which will allow for portfolio-wide extrapolation of results. This will be complemented by analysis of 20-25 operations selected non-randomly as case studies being conducted as part of the larger set of IEG Learning Products on DPOs mentioned above, and by additional case study examples where evidence is available. These latter case study examples will not be statistically representative, and so they will be used as illustrative examples rather than being part of the random sample.
 - The assessment will consider all prior actions supported by the DPOs in the sample.
 - For the specific policies supported by each operation, the review will evaluate consistency with OP 8.60 and Bank DPO guidance. The Bank Good Practice Notes and Toolkits on Environment and PSIA provide frameworks and advice for assessing the potential adverse environmental and social impacts of different types of policy reforms. IEG will primarily use this guidance to assess whether or not Bank teams should have identified the potential for significant adverse environmental or social effects,¹⁴ whether direct or

¹² As part of the series of Learning Products on DPOs, IEG will conduct a separate review of DPOs that explicitly aimed to support environmental goals.

¹³ It may be that many DPOs will have little potential for adverse environmental or social impacts. These operations will be included in the sample for statistical representativeness, but will likely require little analysis beyond the initial screening.

¹⁴ OP 8.60 refers to "significant effects". There is no formal definition of what constitutes a significant impact. IEG's assessment will be based where possible on criteria laid out in Bank guidance, such as in the "Good Practice Note: Environmental and Natural Resource Aspects of Development Policy Lending" and "Toolkit for Assessing the Environmental, Forest, and Natural Resource Aspects of Development Policy Lending" on the environment side, and the "Good Practice Note: Using Poverty and Social Impact Analysis to Support Development Policy Operations" on the social side. These notes provide some additional detail for interpreting what constitutes a "significant" impact: the Environment Good Practice Note states that "Significant effects are environmental changes of sufficient magnitude, duration and intensity as to have non-negligible effects on human welfare."

indirect.¹⁵ If there is potential for such impacts IEG will assess (based on the documents described in the next bullet): the level of background analytical work; the level of public consultation on policy design; the degree to which risks were identified by the Bank; the degree to which the Bank assessed client capacity for managing these risks; actions taken by the Bank to support the client in effectively mitigating these risks; and monitoring and reporting on these risks after approval and at closure.

- Documents to be reviewed include Program Documents, Legal Agreements, comments submitted to review meetings, mission reports and ISRs, background analytical work (such as Poverty and Social Impact Analysis (PSIA) and Country Environmental Analysis (CEA)), Implementation Completion and Results Reports (ICRs), as well as IEG ICR Reviews and PPARs.
 - Where questions arise, the documentation review may be complemented by interviews with key stakeholders in the operation.
 - Any identified potential negative impacts will be reviewed by a minimum of two team members to ensure accuracy and consistency.
2. *A review of World Bank DPL policies, processes, institutions, and practices.* This will include reviews of relevant documentation as well as interviews with key stakeholders. Information reviewed will include documents accompanying the Board discussion of OP 8.60, the OP and BP themselves, and institutional arrangements for reviews and clearances.
 3. *An assessment of guidance available to DPO task teams and borrowers.* This will encompass a review of Guidance Notes and Toolkits, and input from specialists to draw lessons for possible enhancements.
 4. *Stakeholder engagement.* Time permitting, the task team will carry out targeted engagement with key stakeholders within the Bank using several methods. This may include individual interviews, focus groups, or just-in-time surveys of Task Team Leaders, environmental and social experts, operational policy experts, managers, and lawyers.

5. Audience

The main audience for this review will be World Bank Board members (and specifically CODE); staff and management who play leading roles in managing DPOs; and those in the new Environment and Natural Resources and Urban, Rural, Resilience and Social Development Global Practices and OPCS concerned with environmental and social risk mitigation in DPOs. The external audience will include Bank clients and civil society representatives with an interest in the environmental and social outcomes of World Bank support.

¹⁵ OP 8.60 does not make a distinction between direct and indirect effects. However, the Bank's Good Practice Note on Environmental and Natural Resource Aspects of DPOs notes that "the effect of policy reforms on the environment is often felt only indirectly", and the Bank's Toolkit for Assessing the Environmental, Forest, and Natural Resource Aspects of Development Policy Lending is designed to facilitate "systematic analysis of direct and indirect effects of development policy reforms on the natural environment and natural resources" and presents tools for analyzing indirect effects. These indicate the Bank's expectation that significant indirect effects of policies are intended to be considered.

6. Review processes.

As a Complex Learning Product, the report will have the same review requirements as an IEG major evaluation, including circulation of the Concept Note and final report to CODE for information, opportunity for WBG comment on the draft Concept Note and draft report, and public disclosure of the final report in line with IEG Disclosure Policy.

As with all IEG learning products, the report will not contain formal recommendations and will not be tracked in the Management Action Record process. It will provide advice and suggestions for the Bank to consider.

7. Task Team

The Team Leader is William Sutton (Lead Economist & Cluster Leader, Agriculture and Environment), and core team members include Stephen Hutton (Environmental Economist), John Redwood (Sr. Adviser on Environment, consultant), Cyprian Fisiy (Sr. Adviser on Social, consultant), Zeljko Bogetic (Lead Economist and DPF expert), Daniel Gibson (Lead Social Consultant), Gurkan Kuntasal (Sr. Environmental Specialist), Richard Carroll (DPO and distributional impacts specialist), and Jesse Torrence (data analysis).

8. Peer Reviewers

The Peer Reviewers outside of IEG are Kirk Hamilton (Lead Environmental Economist, retired), Erwin Tiongson (Professor in the Practice of International Affairs and Chair, International Development Concentration, Georgetown University) and Reidar Kvam (Senior Manager in the Environment, Social and Governance Department, IFC).

Annex A: IEG Learning Products on DPOs

IEGPS has developed a program of eight separate learning products on DPOs (budget support) to strengthen learning in the Bank and IEG, and to influence Bank debate on the design and use of DPOs as it prepares the next DPL Retrospective. Each learning product has been selected on the basis of recent discussions and analysis, including the previous, 2012 DPL Retrospective produced by OPCS. A synthesis of key findings will be prepared in FY16 based on the analysis.

The series of learning products consists of complementary, specific products covering salient areas identified in the 2012 DPL Retrospective and in recent discussions of DPO evaluation held jointly between OPCS and IEG. The purpose is to both deepen the understanding of the impact of budget support on leveraging transformative reforms, building capacity, and supporting higher development objectives such as greater efficiency in the use of public resources. It also aims to clarify differences across types of DPO instruments, in particular general vs. sector specific support, the complementarity of parallel DPOs, programmatic versus one-off operations, and coordination with parallel IMF operations. It further aims to shed light on Bank compliance with requirements of OP 8.60 such as environmental and social risk mitigation. The audience for this work includes the Board, external evaluation agencies, Bank staff and management, OPCS, IEG evaluators, and civil society stakeholders. The main evaluative questions focus on the overall effectiveness of DPO and factors influencing its design and performance.

The learning elements are organized around eight thematic tasks: (i) the quality of result frameworks in DPOs; (ii) Adequacy, quality, and risk in DPO macro-fiscal frameworks; (iii) public Expenditure Reviews and public resource allocation in DPOs; (iv) political economy analysis (PEA) and related factors influencing the success of DPOs; (v) the influence of core poverty diagnostics on DPO design and outcomes; (vi) risk mitigation of adverse environmental and social effects in DPOs; (vii) effectiveness of Environment Sectoral DPOs; and (viii) Effectiveness of Financial Sector DPOs.

Four of these thematic tasks are scheduled to be delivered in FY15, those focusing on macro-fiscal frameworks, results frameworks, public expenditures and resource allocation, and environmental and social risks. The remaining three—on poverty, political economy, environmental DPOs, and financial sector DPOs—are planned for FY16. At that time, a “capstone” synthesis will be prepared with main findings and lessons from this learning product series.