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# **The Role of Multilateral Finance and the Environment: A View from the World Bank**

ANDREW STEER\* AND JOCELYN MASON\*\*

*Dr. Steer and Mr. Mason begin by noting that since funding for the Rio Earth Summit agreements has not been forthcoming, multilateral financial institutions (MFIs) have taken responsibility for advancing the environmental agenda set forth at the Summit. Dr. Steer and Mr. Mason note that MFIs furnish three crucial functions in implementing the global environmental agenda. First, MFIs are able to target investments in developing countries that involve important environmental issues. Second, MFIs are able to support policy reforms within developing countries to ensure environmental standards and issues are properly addressed. Finally, MFIs can multiply a small amount of funding into a significant amount. While developing countries are beginning to acknowledge the relationship between economic progress and environmental sustainability, MFIs, according to Dr. Steer and Mr. Mason, are presented with several challenges to continue advocating this relationship for the future.*

## I. INTRODUCTION

A growing concern for the declining health of the environment over the last twenty-five years has spawned a veritable alphabet soup of international conventions and agreements. At first sight, these conventions and agreements are among the weakest form of international law; they have no enforcement mechanisms and few countries are likely to spend much valuable political goodwill to persuade other countries to abide by them. Nevertheless, environmental agreements have had tremendously important effects. The 1992 Earth Summit held in Rio de Janeiro is considered a watershed, not only because almost all nations of the world agreed to the fundamental concept of

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environmentally sustainable development, but also because in the process of doing so, it enabled agreement around a general framework for action, Agenda 21. The Earth Summit spawned a number of international conventions that derive their authority from the Rio agreements, including the Framework Convention on Climate Change,<sup>1</sup> the Convention on Biological Diversity,<sup>2</sup> and the still unratified Desertification Convention,<sup>3</sup> and has spurred countries and development agencies--bilateral,<sup>4</sup> regional, and multilateral--to develop plans to put into practice the ideas expressed in Agenda 21. However, it has failed to generate the large amounts of additional official development assistance (ODA) that had been promised.

The decline in concessional funding predicted over the next few years is regrettable, not only because developing countries, especially the poorest, are unquestionably in need of help, but also because the decision to decrease concessional funding is often based on two inaccurate assumptions. First, the scale of required funding is too large for cash-strapped government budgets to handle. Second, in any case, concessional funding does not work. Small amounts of concessional funding can, however, make a big difference, as the discussion below of the Global Environment Facility will indicate.

Developing countries have enjoyed some spectacular successes over the last forty years, even though much remains to be done and not all countries have yet benefited. In the past four decades, developing countries as a group have performed better than Organization for Economic Cooperation and Development (OECD) countries as a group. The best performers among the developing group have significantly outperformed the best historical performances among OECD industrial countries.<sup>5</sup> More importantly, improvements in the developing countries' performance on the social front far outdistance anything known in the history of the OECD countries. Life expectancy has risen rapidly; illiteracy has declined; access to safe water has doubled since 1960; child immunization has increased approximately seventy-five percent over the past twenty years; and many previously endemic diseases

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1. U.N. Conference on Environment and Development: Framework Convention on Climate Change, May 9, 1992, 31 I.L.M. 849.

2. U.N. Conference on Environment and Development: Convention on Biological Diversity, June 5, 1992, 31 I.L.M. 818.

3. U.N. Convention to Combat Desertification in Those Countries Experiencing Serious Drought and/or Desertification Particularly in Africa, *opened for signature* Oct. 14, 1994, U.N. Doc. A/AC.241/15/Rev.7, 33 I.L.M. 1328.

4. For example, the U.S. Agency for International Development.

5. ISMAIL SERAGELDIN, WORLD BANK, NURTURING DEVELOPMENT: AID AND COOPERATION IN TODAY'S CHANGING WORLD 15 (1995).

are now controlled.<sup>6</sup> While it is not clear how much of this progress can be attributed to development aid, there is no question that such aid has played an important role.

## II. THE ROLE OF MULTILATERAL FINANCIAL INSTITUTIONS

Against this background, multilateral financial institutions (MFIs) are playing a unique and important role in elaborating on and promoting the global environmental agenda launched by the Rio Summit. Both their financial clout and analytical muscle are proving to be important assets. Put simply, MFIs provide three vital functions in helping to implement the global environmental agenda:

- Mobilizing and intermediating funds for sustainable development;
- Mainstreaming environmental concerns into development, policymaking, and project design;
- Multiplying the impact of international resources for sustainable development;

This paper will discuss each of these roles in turn. It will conclude with some indications for future directions, both for the development community as a whole and for the World Bank as the largest of the MFIs in particular.

### *A. Mobilizing Resources for Sustainable Development*

Financial flows to developing countries alone do not by any means ensure sustainable development, but adequate financial resources are essential for a sustainable future in these countries. There are two reasons for this, one general and one specific. First, economic development and environmental health are mutually dependent. While the links between population growth, poverty, and environmental damage are still not fully understood, the vicious cycle of poverty and environmental degradation is well-illustrated throughout the developing world.<sup>7</sup> The world's poor directly suffer from environmental degradation, in the forms of soil erosion, polluted air and water, and declining fish stocks, for example. While at the same time, people living on less than one dollar per day tend to cause much of the environmental damage, such as

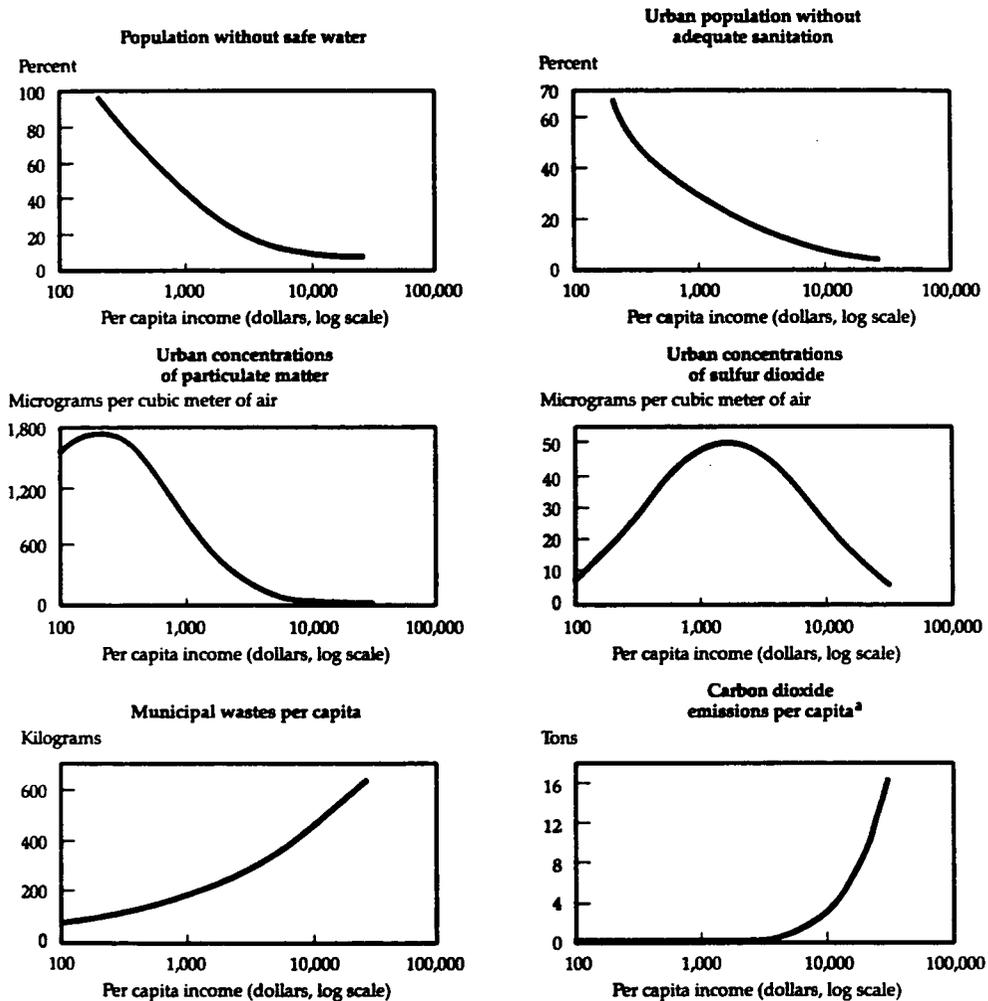
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6. *Id.* at 15-19.

7. For an exhaustive discussion on this topic, see generally KEVIN M. CLEAVER & GOTZ A. SCHREIBER, *REVERSING THE SPIRAL: THE POPULATION, AGRICULTURE AND ENVIRONMENT NEXUS IN SUB-SAHARAN AFRICA* (1994).

depleting agricultural resources, their only source of sustenance, by overworking marginal lands. Figure 1, which is drawn from empirical cross-country analysis undertaken at the World Bank, illustrates how rising economic activity may cause environmental problems but can also, with the right policies and institutions, help address them.

Figure 1<sup>8</sup> *Environmental problems may worsen or improve with income growth; some worsen, then improve.*



Note: Estimates are based on cross-country regression analysis of data from the 1980s.

a. Emissions are from fossil fuels.

Sources: Shaik and Bandyopadhyay, background paper; World Bank data.

Second, additional targeted investments, estimated by the World Bank to represent roughly two percent of Gross Domestic Product,<sup>9</sup> are required to address priority environmental concerns. These include programs to remedy past environmental damage, such as cleaning up waste sites and replanting trees, as well as programs to avoid future damage, such as creating protected areas or building wastewater treatment plants.

MFIs are currently reshaping their lending patterns to help meet this need. World Bank financing for targeted environmental programs has risen by \$5.6 billion since the Rio Earth Summit, to a total of over \$10 billion.<sup>10</sup> Because the World Bank only funds a portion of each project, this portfolio represents some \$25 billion in investments supported by the World Bank.<sup>11</sup> Moreover, because the World Bank, like all MFIs, finances its lending program by borrowing through the international bond markets, where its bonds are listed with the highest possible rating, it can provide loans at rates otherwise unavailable to developing countries. Thus, MFIs are the principal and most efficient mechanism for directing savings, mostly from industrialized countries, toward investments with high environmental and social, if not always short-term financial, pay-offs in developing countries. Finally, MFI investments have an important “multiplier” effect, as will be examined in greater detail below.

### *B. Mainstreaming Environmental Sustainability*

While financial flows are important, in the long run they are less important than the policy and institutional changes encouraged and enabled by such flows. Investments in air pollution control technology in the former Soviet Union, for example, are less important in terms of their long-term effects than reducing subsidies for energy or setting up a regulatory agency. Similarly, however plentiful the goodwill and financial resources directed at reducing deforestation in Africa, the creation of parks will fail if other incentives in the economy encourage people to cut down trees. Issues such as property rights, price regimes for farm products, and social equity all need to be addressed more broadly. Finally, ensuring that a specific project strictly adheres to Western environmental standards, such as environmental assessment

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9. *Id.* at 173.

10. WORLD BANK, MAINSTREAMING THE ENVIRONMENT: THE WORLD BANK GROUP AND THE ENVIRONMENT SINCE THE RIO EARTH SUMMIT 4-5 (1995).

11. *Id.* at tbls. 1.1, 1.2, 1.3.

requirements, is less important than developing standards appropriate to the country in question and building the capacity within that country to strengthen, monitor, and enforce those standards. MFIs play a unique role in supporting the policy reforms and institution-building required to achieve these wider objectives. First, MFIs' constituencies are the very economic, planning, and line ministries most able to effect the changes needed. Second, through initiating discussions with decisionmakers during project design, MFIs have a natural vehicle, or point-of-entry, for supporting such reforms. For example, the World Bank, through its energy loans in Eastern Europe, is aiming to promote the price regimes and regulatory frameworks that will increase energy efficiency and conservation. Similarly, loans to the Baltic States for the improvement of municipal water supplies and wastewater management have been used by the respective country's governments and supported by the World Bank as a first step in reconsidering comprehensive, regional strategies for river basin, wetland, and coastal-zone management. Third, their development experience and rapidly growing environmental portfolios and skills base give MFIs an important advantage, learning from experience what works and what does not. The World Bank is able to benefit from its experience in implementing environmental projects in sixty-two countries throughout the world. MFIs employ the largest group of environmental specialists in the world.

Surprisingly, MFIs are able to effect the most positive and durable changes through their technical and analytical work and not through their financial might.<sup>12</sup> Environmental assessments (EAs) are a particularly good example. Since 1984 the World Bank has screened all of its projects for their environmental consequences, and since 1989, those projects deemed to have a potentially serious impact on the environment are subject to a full assessment to identify and evaluate likely impacts, analyze alternatives from an environmental perspective, and provide mitigation and management measures to eliminate or minimize any negative environmental effects. Also since 1989, and particularly since the Rio Earth Summit, governments, other development institutions, non-governmental organizations (NGOs), and increasingly the private sector, have established EA policies and procedures and are implementing them in a wide range of development projects.

Indeed, it is now unlikely that any major investment decision will be made without taking potential environmental consequences into account. Moreover,

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12. This is despite the fact that financial might is an essential prerequisite in effecting positive change.

experience with EAs has grown rapidly. The World Bank has screened over one thousand projects since 1989, and roughly ten percent of those were subjected to a full EA. Also, the scope of the EA is expanding to include sectoral and regional assessments, which analyze the potential effects that changes within a whole sector or region have on the environment. These effectively shift the EA “up-stream” in the project design process and increase its effectiveness.

### *C. Multiplying Resources for the Environment*

The job of MFIs is to use the small amount of “paid-in” capital, taxpayers’ money, from their member countries to leverage large sums of private funding. Since the World Bank was founded in 1944, it has been playing this multiplication role, turning paid-in capital totaling roughly \$10 billion into total loans of \$250 billion and total investments in development of over \$500 billion.<sup>13</sup>

In addition to this method, there are three other ways in which MFIs play a multiplier role. First, systemic reforms of the type required to make development sustainable are not adopted overnight, nor is the new way of doing things accepted by all governments at once. By providing their “seal of approval” to the environmentally sustainable development paradigm, MFIs can lend their considerable authority and leadership, not to mention staying power, to reforms. This heightened comfort level is especially important when reforms are domestically unpopular, as they often are during transition periods, and when inevitable short-term uncertainty generates change, even if such change is positive.

Second, MFIs are able to play a crucial role in the active dissemination of ideas and techniques. Resettlement guidelines, guidelines on the treatment of indigenous people, and stakeholder participation, as well as EAs, are becoming more common throughout development practice, in large part because of their adoption by MFIs. The World Bank is now among the leading agencies in developing and piloting new techniques. The MFIs’ influence is due as much to their unique ability to be involved at the policy level with developing

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13. These figures only refer to the International Bank for Reconstruction and Development (IBRD), and not to its sister organization, the International Development Agency (IDA). IDA provides soft loans of approximately \$55 billion per year to the poorest countries, and thus necessarily draws more upon donor financial support. It should also be noted that a portion of IBRD profits are placed in IDA, making IBRD IDA’s sixth largest donor.

countries and donors as it is to the quality of their materials. For example, the Consultative Aid Group meetings that the World Bank chairs for most developing countries have become a principal forum to disseminate and elaborate good practices from around the world in country-specific discussions. In a similar vein, it was in the context of the ninth replenishment of the International Development Agency's (IDA's) fund that required all IDA borrowers to prepare National Environmental Action Plans.

Third, MFIs can help multiply environmental efforts at the international level by administering a wide range of international funds, most notably the Global Environment Facility (GEF). The GEF is jointly implemented by the World Bank, the United Nations Development Programme (UNDP), the United Nations Environment Programme, and the Multilateral Fund for the Implementation of the Montreal Protocol. MFIs can integrate these funds with other forms of funding, such as bilateral funds, into the broader development process.

The World Bank's role in the GEF illustrates this well. The \$2 billion committed to the GEF over three years is clearly inadequate on its own to have any real effect on the facility's areas of concern: the urgent global problems of climate change, biodiversity loss, pollution of international waters, and depletion of the ozone layer. Success of the GEF requires that these funds be leveraged to have an impact much greater than the core funds by being used to catalyze change within a much larger program of action. At the project level, a modest amount of GEF funding can be used to tip the scale and make a project with global environmental benefits financially attractive. For example, power generated by coal may be more cost-effective when judged by national interests. However, it might be more beneficial from a global perspective to avoid the global warming effects of carbon emissions from coal-generated power and invest in generating power from geothermal energy. In this case, a GEF grant can be used to fund the incremental cost difference between coal and geothermal energy production, thereby aligning national and global interests behind the less polluting alternative. Similarly, at the program level, GEF funding can be used to change the balance of costs and benefits for a whole group of investors. For example, the World Bank and its private sector associate, the International Finance Corporation, are currently developing venture capital funds for renewable energy and biodiversity protection. A principal barrier to attracting private investors to these areas is the uncertainty due to unfamiliarity and lack of reliable information. Modest support from the GEF, as well as the added confidence brought from

association with the Finance Corporation, is expected to help take these investments across the threshold of profitability and obviate the need for any additional concessional funding.

### III. DIRECTIONS FOR THE FUTURE

In the three years since the Rio Earth Summit, a discernible change has taken place as developing countries struggle to forge development paths that provide both prosperity for their citizens and good stewardship of the environment. They are rejecting the old-fashioned “development-versus-environment” paradigm in favor of a “new environmentalism” that recognizes economic development and environmental sustainability as partners. Five challenges stand out among those challenges facing the MFIs in promoting this new environmentalism. First, a great deal still needs to be learned. Essential lessons need to be distilled from the first generation of environmental policies and projects currently being implemented.

Learning to leverage financial resources more effectively is a second challenge. Initiatives like the venture capital funds previously mentioned need to be multiplied, as will other mechanisms for developing links with the private sector.

Third, with the growing scarcity of public funding and the increasing complexity of the challenge of environmentally sustainable development, resources must be used with greater care. Better partnerships within the international community, MFIs and bilaterals, among others, can use each institution’s comparative advantage and experience more effectively, as well as eliminate duplicative efforts. An example is the partnership the World Bank launched recently, which would consolidate the existing UNDP-World Bank programs and bring together key partners in the water supply, irrigation, and environment subsectors.<sup>13</sup> The partnership will build on the combined knowledge and technical ability of international institutions to develop more effective country-level programs and projects, and it will also provide support in developing the critical links between the various public and private actors necessary for countries to bring about often difficult reform.

Similarly, the fourth challenge is the need to build links with NGOs, whose numbers, experience, and importance have grown rapidly over the last decade. NGOs are now important repositories of practical experience and

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13. WORLD BANK, *supra* note 10, at 50.

scientific knowledge, and they can effectively mobilize community involvement in environmental projects and programs. Meetings held recently between the World Bank and the World Conservation Union, for example, have resulted in an *aide-mémoire* designed to encourage cooperation on a number of joint initiatives, one of which is the production of a report on a global system of protected marine areas.

Finally, MFIs must continue to develop alternative ways of measuring progress. Existing tools for measuring economic progress are not sufficient for effective decision-making, and national accounting practices will need to be expanded to integrate economic indicators with environmental and social considerations, such as “natural capital” and “human resources.” MFIs must also develop new practical methodologies for identifying and monitoring the environmental and social impacts of investments. This would include new approaches to analyzing the impact of development on natural habitats, the identification of the impact of economy-wide policy reforms on the environment, and the assessment of the social impact of investments. Improving the quality of environmental and social data in order to supplement traditional economic indicators will help governments and MFIs monitor the true progress of development.

