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Cost of Doing Business

Fiduciary and Safeguard Policies and Compliance

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COST OF DOING BUSINESS
FIDUCIARY AND SAFEGUARD POLICES AND COMPLIANCE

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ATTACHMENTS

ACRONYNMS

AfDB	African Development Bank
AsDB	Asian Development Bank
APL	Adjustable Program Loan
BP	Bank Procedures
CAS	Country Assistance Strategy
CDF	Comprehensive Development Framework
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Reviews
EBRD	European Bank for Reconstruction & Development
ESSD	Economic and Social Sustainable Development (Network)
ESW	Economic & Sector Work
FM	Financial Management
IADB	Inter-American Development Bank
IDF	Institutional Development Fund
LACI	Loan Administration Change Initiative
LIL	Learning & Innovation Loan
LOA	Loan Administration Department
MDBs	Multilateral Development Banks
OED	Operations Evaluation Department
OPC	Operations Policy Committee
OPN	Operational Policy Note
OP	Operational Policy
PCD	Project Concept Document
PMR	Project Management Report
QACU	Quality Assurance and Compliance Unit - ESSD
QAG	Quality Assurance Group
RAP	Resettlement Action Plan
SAI	State Audit Institutions
SIL	Sector Investment Loans
SOEs	Statement of Expenditures
TA	Technical Assistance
TF	Trust Funds
WBI	World Bank Institute

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EXECUTIVE SUMMARY

1. In recent years, the World Bank has increased significantly its attention to the development effectiveness, sustainability and financial integrity of the activities it supports. Requirements for greater transparency in procurement and financial management have grown. Safeguard policies, intended to ensure Bank-financed projects do no harm to the natural and social environment have been applied more rigorously. Oversight mechanisms to enhance project quality have been added. Evaluations indicate that the results have been positive—better-designed individual lending operations, a stronger project portfolio, more rigorous oversight and significantly improved project outcomes.

2. At the same time, questions have arisen whether these requirements have been expanding faster than the capacity of many borrowers to manage them effectively, and whether they might be affecting some clients' interest in borrowing from the Bank. At the same time, some shareholders have questioned whether the Bank has been demanding enough. In a period of tight budgets, this has produced a dilemma—improving quality amidst growing requirements, declining resources, higher expectations of some borrowers and other shareholders.

3. This underscored the need to gain a better understanding of the current situation and to improve the value/cost relationship of these policies. Thus, the Bank established a task force to examine recent experience in the application of Bank's policies on procurement, financial management and safeguards. The task force conducted its work in two phases. In the first internally-focused phase, it examined 50 projects under implementation that reflected both positive and negative experience, the policies of other multilateral development banks (MDBs), budget data and the policy-making processes within the Bank. In the second phase, the task force consulted with clients in 10 selected countries[1] which together represent roughly 40% of the Bank's FY01 portfolio/pipeline and include four IDA-eligible clients.

Principal Findings

4. The principal conclusion of the overall two phase review is that these policies have a positive impact and are valued by borrowers, when they are applied in an appropriate manner. Properly implemented, they improve project design to mitigate environmental impacts, avoid social costs, improve participation and commitment to development outcomes, reduce costs through competitive bidding and assure greater transparency and financial integrity in public finance. Borrowers are strongly committed to the objectives and principles embedded in these policies. They recognize that the costs to them and to the Bank of non-compliance can be very high. They also note that the benefits from Bank policies often have a positive influence on other activities not financed by the Bank. They

[1] Consultations held during April-May 2001 in Argentina, Brazil, China, India, Mozambique, Philippines, Romania, Russia, Tanzania and Yemen.

appreciate the Bank's commitment to full, cost-effective implementation of its current policies. This commitment is seen to have a positive impact on raising national standards in some cases, though the incidence is quite scattered, unsystematic and indirect.

5. The review found that safeguard and fiduciary policies have enhanced project quality and sustainability when they: (i) are applied early enough in the project cycle to affect project design, (ii) save the client money, (iii) raise national standards toward the level of good international practice by "pushing the envelope" in a measured, realistic manner and, consequently, (iv) are capable of being implemented by the borrower, with necessary capacity building assistance. The task force found many cases where implementation of these policies helped increase their development impact.

6. In the cases where the implementation of these policies has been ineffective and unnecessarily costly, the task force found that it was due primarily to: (i) over-ambition—requirements that were simply beyond the capacity of the borrower to implement without great cost; (ii) ambiguity—policies that were overly complex and difficult to interpret; (iii) indecision and delay—policy interpretation that sometimes took months to resolve at substantial financial cost to the Bank and opportunity cost to the borrower; (iv) rigidity—"legalistic" policy interpretation rather than professional judgment; (v) risk aversion—a growing tendency within the Bank that results in over-specification and "perfection" in design and avoidance of activities that might generate criticism; and (vi) capacity depletion—requirements applied to a "ring-fenced" Bank-financed project have absorbed resources at the expense of other priorities for the application of often limited national capacity.

7. The task force estimated that in FY01 the cost to the Bank of applying these policies was about $83 million or about 20 percent of the total administrative budget for lending services. The most significant were the costs associated with procurement, which affects all operations throughout their life. The task force estimated that the cost to borrowers of applying these policies was greater than the cost to the Bank. Borrowers as a group spend about $118-215 million annually to comply with the Bank's requirements for project preparation and implementation. It is estimated that roughly 60% of this amount is incremental, as all borrowers incur costs for public procurement, financial reporting and safeguard work, even if no Bank financing is involved.

8. Borrowers generally felt that the direct and indirect value obtained from these policies exceeds these administrative costs, but they also believe that these costs can and should be reduced. Borrowers were also unanimous in their view that the single most critical and yet un-quantified element of cost is that of delay in project design, launch and implementation. Most delays are associated with the process of arriving at mutually agreed balanced judgments when it comes to fiduciary and safeguard policies, as opposed to sectoral policies. Borrowers accept that their own processes contribute in part to the delays. The one possible exception are environmental policies, whose processes allow for case-specific solutions to achieve policy goals, and which are well mainstreamed. Key actions sought by clients were: (i) to reduce policy ambiguity and enable local case-specific solutions to achieve policy goals; (ii) speed up decision-making in all policy areas, particularly in procurement; (iii) enhance up-stream attention to high safeguard risk operations; (iv) improve continuity of team leaders and effective coordination among them, lawyers and thematic experts; (v) better manage risk aversion at task, managerial and institutional levels; and (vi) increase delegation of authority to Country Offices.

9. Borrowers were equally clear that it is possible to enhance the value of the effort and reduce costs associated with the implementation of these policies. Three measures had wide support: building national fiduciary and safeguard systems by building on demonstrated client capacity; mainstreaming innovations seen under current policies to extend their support to national/sector wide programs; and, pursuing bottom-up country level policy harmonization effort, one policy at a time.

10. The consultation process with the clients confirmed that the overall volume of lending by the Bank was not materially affected by these policies nor by the less numerous or rigorously applied policies of the other MDBs. Specific country circumstances—exposure limits, portfolio condition, IDA availability and other factors tended to determine lending volumes.

11. However, there is feedback from clients that the willingness of IBRD borrowers to pursue Bank lending for certain kinds of infrastructure—electric power, dams, slum upgrading, transportation—is affected by the clients' desire to avoid the costs, and the "hassle," of certain safeguard policies. Given other opportunities for financing, IBRD borrowers articulated an explicit hierarchy of preference for official borrowing in these infrastructure sub-sectors: domestic resources, bilateral donors, Regional Banks and lastly, the World Bank. The task force concluded that an important part of the 30% decline in Bank lending over FY95-FY01 to infrastructure (Energy Sector decline of 65%, Transport of 28%, Urban of 25%) is attributable to client perceptions of the Bank's application of safeguard policies. This decline in one sense reflects a success in attracting other lenders into segments of traditional Bank lending, and is re-enforced by the Bank's strategic emphasis on social sectors.

12. The task force does see some risks that the Bank faces in withdrawing - or being de-facto excluded - from important infrastructure sub-sectors such as energy, transport, and urban: the risk of being absent from areas essential to growth and poverty alleviation, the risk of a pipeline which is costly to develop and of having a portfolio composed primarily of the most difficult and complex operations and the risk of losing a global development perspective that is the Bank's major comparative advantage as a knowledge institution. Inadequate attention to client concerns about delays and costs and inefficiency in lending business practices due to risk aversion, would likely have a corrosive effect. The Bank, working with clients, has to address these issues to continue to remain an eminent development institution that the clients want it to remain.

Key Recommendations and Status of their Implementation

13. Given these circumstances, the real challenge is to find ways to enhance the benefits of these policies while reducing the costs, particularly by reducing the cost of delay. The task force recommendation of a short to medium term approach to dealing with the dilemma consists of measures discussed below. These include internal measures and those that will engage Bank clients. During the work of the task force, work had begun on implementing some of these recommendations. Their status is also indicated in italics.

- **Continue Reforming Current Policies and Procedures.** (i) implement the simplification and rationalization of the LACI financial reporting and disbursement systems; (ii) introduce risk-based and single audit approach in order to strengthen the quality of fiduciary assurance while reducing fragmentation, duplication and delay; (iii) complete the conversion of the safeguard policies on resettlement, indigenous peoples and physical cultural resources to remove ambiguities and permit case specific solutions to achieve policy goals; (iv) revisit Bank's procurement practices, especially related to procurement of IT and review of consultant contract "no objection" procedures and (v) pursue enhanced delegation of authority to strengthen field offices.

(The OPC has reviewed proposals from the FM Board to streamline LACI which is to be rolled out starting FY02; the FM Board is reviewing the current audit system to identify ways in which it may be possible to eliminate fragmentation and duplication, reduce cost, and improve the overall level of assurance received by the Bank on the use of its funds. CODE has reviewed the proposed clarification in social policies and steps are underway to complete external consultations and codify changes in FY02; the procurement board has developed an action plan to review and develop suitable responses to client concerns; and institutionally led effort is underway to develop by January 2002 the next step of functional decentralization. Further progress will continue to be monitored).

- **Strengthen Internal Processes.** Clarify accountability for high risk operations, providing one-stop authoritative policy interpretations, clarify decision process for making judgments in application of policy requirements; and integrate all safeguard policy applications into a single risk assessment process under the umbrella of the environmental assessment.

(A Bank wide safeguard process harmonization effort has been underway since July 2000; it includes pipeline risk assessments, joint RVP/NVP accountability for high risk tasks, structural harmonization across regions for safeguard functions; a one stop shop for authoritative policy interpretations and a helpdesk. The safeguard system is now being reviewed by IAD to further adjust and strengthen, as needed).

- **Enhance Bank Capacity to Ensure Continuing Compliance.** Provide adequate budgets for lending and supervision tasks to ensure the Bank can carry out its due diligence functions fully, including full cost of all policy revisions and intensify program of staff training and client capacity building in fiduciary and safeguards systems.

(The FY02 budget aims to increase overall lending and supervision coefficients by 9% and 4% respectively, provides special resources for increased capacity building and staff training and funds sector boards/legal department to provide high quality timely support in policy interpretation. Actual delivery of these resources to fiduciary and safeguard work for high risk tasks, is through a process of pipeline risk assessment. This aspect will be monitored closely)

- **Reduce delays by Moving Safeguard Assessments "Upstream."** Initiate assessments of environmental and social impacts at the earliest possible time in project processing; provide funds for upstream safeguard work for high risk operations, especially in the PSI sector.

(Initial FY02 budget allocations in the Regions indicate a continued adherence to pipeline risk assessments combined with "off-the-top" incremental allocations for "up- stream" safeguard work on high risk operations. The regional process for pipeline fiduciary and safeguard risk assessments needs to be harmonized into a Bank-wide process in FY02. Further work on reducing factors contributing to delays is needed).

- **Help Build Client Capacity to Manage Policy Implementation.** Launch a pilot program to help build borrower capacity for progressively managing specific aspects of safeguard and fiduciary responsibilities—Bank to help assess current capacity, help strengthen capacity by delegating specific aspects to national agencies with demonstrated competence, and monitor policy outcomes.

(The fiduciary Sector Boards are encouraging an increase in the numbers of CPARs and CFAAs to assess capacity and as justified to raise thresholds for prior review. The safeguard Boards are developing a customized capacity building pilot program with WBI, with the objective to help clients who demonstrate capacity to undertake more policy implementation work under Bank supervision. During the client consultation phase, some countries came forward to work on these ideas with the Bank.)

- **Scale-up development impact of these policies through continued innovation, and codify such practices into future policy.** Further encourage and support on-going innovation; move systematically from ring-fenced project-based compliance to support systematic improvements in borrower's institutions, while maintaining agreed policy goals.

(Concerned Sector Boards need to take stock of these innovations and to promote these concepts through their quality support functions and training programs; lessons of experience need to be studied with a view to develop a process to codify the more successful practices into future policy statements.)

- **Deepen the Process of Policy Harmonization.** (i) Intensify the on-going effort to develop common policies and standards, at the level of international good practice, among MDBs at the "macro" (global) level for procurement, financial reporting and environmental assessment; and (ii) launch pilot efforts for "micro" harmonization among MDBs and with national policies at the country level, one policy at a time.

(During the client consultation phase, a number of countries volunteered to be included among the early pilots for a "bottom-up" harmonization effort. These countries are being considered for inclusion in a pilot effort led by the relevant Sector Boards, to complement the ongoing "macro" policy harmonization effort.)

20. While many elements of the proposed agenda are moving forward as indicated above, the overall direction of change is complex, including the way the Bank relates to its borrowers in these areas. Specifically, it calls upon the Bank's managers to (i) encourage balanced judgments, (ii) reward high impact activities where risks have been carefully assessed and managed, (iii) invest explicitly and early in risk assessments, public participation and consideration of design alternatives, and (iv) make timely decisions that will maximize development impact. Both clients and Bank staff endorse the concept of building capacity and delegating aspects of policy implementation to borrowers that demonstrate capacity. The challenge is to move systematically with specific programs that help build permanent capacity. It is an agenda that will only be realized with perseverance, flexible instruments and resources. But it is the only way forward if the Bank's fiduciary and safeguard policies are to become what borrowers expect them to be—instruments of sustainable and effective development.

COST OF DOING BUSINESS
FIDUCIARY AND SAFEGUARD POLICES AND COMPLIANCE

Introduction

1. In the past decade, the Bank has increased significantly its attention to the development effectiveness and sustainability of its activities. As a result, project design and implementation requirements have grown substantially. The potential negative consequences of development projects have been addressed systematically through application of "do-no-harm" safeguard policies. Concerns about corruption and financial misconduct have resulted in new requirements for procurement and financial management. And oversight mechanisms to ensure quality and compliance have also increased. Both quality at entry and of supervision ratings of QAG and satisfactory final outcome ratings of OED, have shown significant improvements.

2. At the same time, questions have arisen whether these requirements have grown faster than the capacity of many borrowers, and the Bank, to manage them effectively. The Inspection Panel and some external critics also cite examples of projects where some of these policies have not been adequately addressed. At the same time, there is a sense that many innovative approaches adopted by Bank clients with the Bank's support to enhance the development impact and sustainability of Bank policies have received little attention and been replicated inadequately.

3. There is also the sense that budget costs of the expanding agenda have only recently begun to be systematically assessed and are not adequately funded even though an increasing share of the task budget has been allocated to these requirements at the expense of other fundamental elements of project design and analysis and has increased staff stress.

4. To understand better the real costs and benefits of doing business with the Bank, a Task Force of regional managers and experts designated by Sector Boards, was asked to analyze the cost effectiveness of the application of the Bank's safeguard and fiduciary (procurement and financial management) policies. The major objectives were to assess (i) how well these policies added real value to lending operations relative to their incremental cost; (ii) how their application influenced the demand for Bank lending; and (iii) how their application could be made more cost-effective.

The Methodology

5. The task force addressed three basic questions: (i) are these policies generally reasonable and effective in enhancing project quality and sustainability or, while technically excellent, do they tend to exceed the capacity of many borrowers to implement and consequently have limited impact; (ii) no matter how valuable they may be individually, have these policies through their cumulative cost, made the Bank less attractive to our clients than other sources of finance; and (iii) is it possible to apply these policies more cost-effectively with enhanced development impact while achieving the basic goals of these policies?

6. To address these questions, the task force undertook its work in two phases.

(a) In Phase I, the focus was on internal processes and team leader's experiences. This phase involved:

(i) Project Review. Fifty projects, mostly approved during the last 3 years, were reviewed to draw lessons of experience. The projects were selected because they represented operations where the policies either: (i) added real value to the outcomes; (ii) detracted from the development outcomes because of added costs, delays or other "hassle;" or (iii) caused the Borrower to seek other sources of funding altogether (See Attachment I).

(ii) Review of the Policy Development Process. The development and processing of two Bank policies, for financial management (the so-called LACI initiative) and involuntary resettlement, were examined to see how the Bank's policy-making process has resulted in pursuit of actions that are sometimes difficult to implement on the ground. This included a comparator review of the policies of other MDBs and some industrial countries with Bank's requirements in practice.

(iii) Analysis of Available Cost Data. The Bank's operational budget, staffing patterns and lending patterns were examined to assess the cost implications of the implementation of policy requirements.

(b) In Phase II, following consultations with the OVPs and informal feedback from the Board, a series of clients consultations were undertaken. Consultations involved ten borrowing countries across the Bank's regions: Argentina, Brazil, China, India, Mozambique, the Philippines, Romania, Russian Federation, Tanzania and Yemen. These countries account for about 40% of the Bank's portfolio and FY01 lending, and include four IDA eligible clients. (See Attachment II, Summary of Consultations, Pg. 37).

I. Internal Review Phase [2]

A. Requirements have Grown and Have been Applied Rigorously

7. There have been significant increases in the Bank's analytical and policy requirements in the past decade. Project analysis once covered economic, financial, technical, administrative and environmental factors. Today it also includes social, poverty, institutional and risks analyses as well as monitoring and evaluation requirements. The same is true in the area of fiduciary and safeguard policies:

- **Safeguard policies** have been applied more rigorously and in some cases progressively strengthened to ensure that Bank-financed projects avoid damage to the natural, social or cultural environment. There are ten such policies and some are currently under revision.
- **Fiduciary requirements** have multiplied under the provisions of the 1998 LACI initiative that requires financial management specialist participation on all

[2] Undertaken from July-December 2000, and discussed with EDs in March 2001

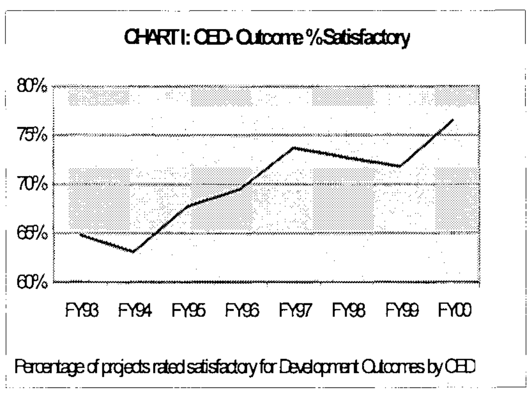
appraisal missions and certification of the borrower's financial management capacity, dual sign-off authority by the financial sector on all Project Appraisal Documents, enhanced financial reporting requirements and the option of a new disbursement mechanism related to project progress. Procurement has increased in emphasis on a greater use of national systems, with potential savings to the borrower; however, the Bank's pro-active anti-corruption agenda has not permitted any reduction in the burden of reviewing transactions and monitoring.

- **Oversight mechanisms** have increased substantially, with the establishment of the Quality Assurance Group (QAG) and the Inspection Panel joining OED to scrutinize operational performance.

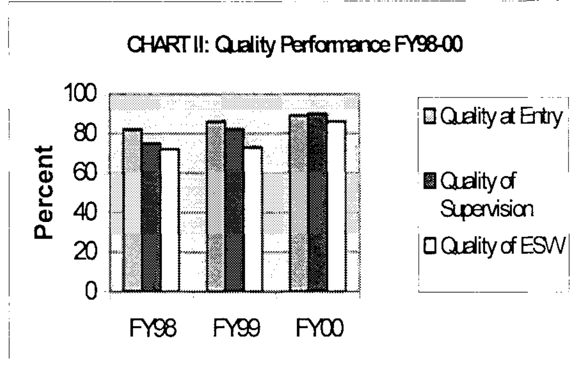
8. In a qualitative sense, these requirements and mechanisms reflect the growth in the expectations of the Bank's contribution to a complex and diverse development agenda. Poverty alleviation, policy reform, capacity building, governance, community-driven development are initiatives at once more demanding and more difficult. As the recognized leader in development, the Bank has been generally raising the bar, which is the essence of the development process; this applies in fiduciary and safeguard areas as well.

B. Effect on Project Quality has been Positive

9. By almost any measure, the overall quality of the Bank's operational products has improved significantly over the past three years. OED assessments of satisfactory project outcome show major improvements. The QAG evaluations of Quality-at-Entry, Quality of Supervision and Quality of ESW more recently show annual improvements in each of the past three years. The application of these policies at the earliest stages of project processing appeared to be particularly beneficial, as they helped identify risks and illuminate design options to mitigate those risks. (See Box 3, Pg.19)



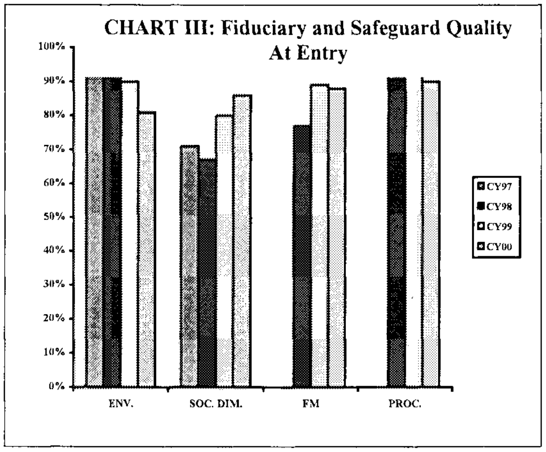
Source: Operations Evaluation Department



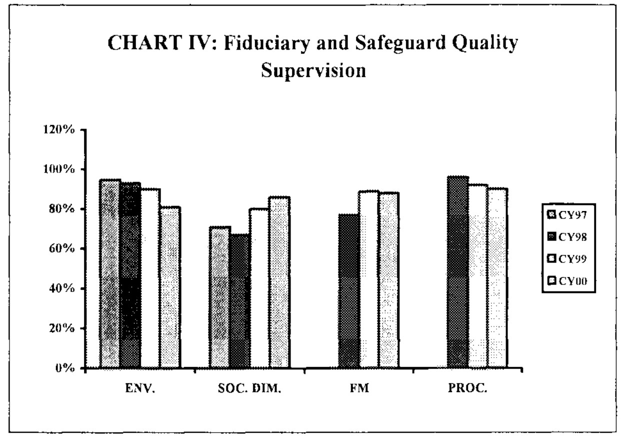
Source: Quality Assurance Group

10. While overall project quality has improved, two concerns remain: first the performance, using QAG methodology, of social safeguard and financial management aspects tends to be rated somewhat lower while, on the more mature policies (procurement and environment) the performance appears to be better. The former policies are believed to have a higher degree of "normative" content, unlike the other two policies, which are

more process based and allow for case specific solutions to achieve policy goals to be developed and agreed upon.



Source: QAG



Source: QAG

11. The other concern relates to OED findings that the quality of Bank portfolio does not correlate with the quality of country performance. "Development effectiveness at the country level depends on the adoptions of strategies and instruments to country conditions, not on project performance". The multiplier effect of the improved quality of the Bank's portfolio needs to be increased. In the fiduciary area, CPARs and CFAAs are aiming to extend the scope and focus of Bank support to strengthen national systems even as these instruments are further improved. Similar instruments in the safeguard areas such as Strategic Environmental Assessments and Social Analysis, are less well developed.

C. Examples of Real Value Added in Policy Implementation

12. In a number of instances, application of safeguard and fiduciary policies contributed significantly to project success. In one case, the application of the Bank's procurement requirements led to project savings to the borrower of several hundred million dollars. In another case, early assessment of a project's potential environmental and social impacts led to design changes that avoided significant resettlement and other mitigation costs. In a third case, the Environmental Assessment resulted in a design change which reduced the project's encroachment on productive land and avoided income losses to farmers.

Box 1: Cost of Non-compliance with Social Safeguard Policies

By one estimate, about 250 projects with which the Bank has been associated have led to involuntary resettlement of 2.6 million people. Another 180 projects are said to be impacting over one million indigenous peoples. The majority of these 3.6 million people are poor and at risk of further impoverishment by development interventions unless their interests are protected by the application of social safeguard policies. Since many Borrower countries lack effective safeguard policies, the Bank has formulated its own social safeguard policies to protect these people from such risks. Adherence to these polices is driven in part by the intrinsic risk of impoverishment if these policies are not followed.

In addition to these intrinsic risks, external stakeholders continue to press the Bank for even greater rigor in compliance with these policies, as in the recent report issued by the World Commission on Dams. Expectations of full compliance with safeguard policies are high among civil society and among the Bank's shareholders, and will be carefully scrutinized as part of the IDA replenishment. The Bank's ability to offer preferential credit to its poorest borrowers is thus predicated, in part, on the successful application of its safeguard policies.

13. There were three common characteristics in these examples that led to successful application.

- First, each application of the policy saved money rather than merely adding to project costs. The safeguard policies were applied early enough in the project cycle to assist in design decisions. Consequently, clients saw value added in their application rather than an imposed, burdensome procedure.

- Second, the policies were consistent with good national—and international—practice. In these cases, they were not "pushing the envelope," beyond realizable norms. Bank procurement procedures, in particular, are in line with prevailing international practice, and environmental process requirements are similar today among all five MDBs and in many developing countries.

- Third, the policies could be implemented within a government's existing processes and procedures without major modification. Environmental assessments are also now reasonably common in most borrowing countries. All countries have procedures for public procurement, and the Bank accepts national bidding arrangements where it finds them adequate. National policies on resettlement in many developing countries are not yet fully consistent with the Bank's resettlement policy.

14. In general, safeguards and fiduciary requirements contributed best to project outcomes when they reflected the self-interest and, consequently, the commitment of the borrower. They were applied as a part of the basic project analysis rather than an "add-on" to satisfy the letter of the law. They were also more helpful when they focused on countrywide or sector-wide questions and longer-term capacity building rather than on specific projects.

D. Examples of Opportunities Lost

15. By contrast, the task force reviewed several examples some cited by borrowers, where the safeguard and fiduciary requirements were applied neither effectively nor efficiently, and contributed to project difficulties. Discussed below are three projects where the

policies either went beyond the borrower's ability to implement or were applied in rigid ways, leading to delays, cost increases and conflict with the client.

16. In the first project, the Bank sought to apply the financial accounting and reporting requirements and disbursement procedures according to the LACI model. The LACI provisions, while technically superior, have proven difficult to implement in practice. The reporting requirements conform to almost no national systems. The PMR-based disbursement procedures require MIS systems not found in most developing countries. Even to meet the Bank's financial reporting requirements using the system, requires borrowers to make significant investment in new financial management systems (between $50,000 and $80,000 per project). Consequently only about 5% of projects approved since July 1998 when LACI was introduced, currently report in this manner.

17. The second example describes the consequences resulting from (a) lack of sufficient clarity in a policy, (b) failure to make timely decisions to resolve issues and (c) excessively "legalistic" interpretations of the policy. To avoid a project-related "reputational risk" the Bank in such case may have engendered a different type of reputation with this borrower--as an indecisive and timid partner. In this particular project, the delay cost the borrower an entire construction season.

18. In the third case, Bank procurement requirements were felt to be unreasonable in the eyes of the borrower. Although the amounts were small and the irregularities in bidding minor, the Bank insisted on re-bidding twice, leading to a four-year delay in the supply of the equipment and the project benefits. The cost of delay was significantly greater than the benefits from re-bidding. In this case, the Bank failed to tailor its response to the modest risk and even more modest value of the goods involved.

19. In general, the cases studied suggest six principal reasons why policies subtracted value and added to borrower cost:

- Over-ambition: Some policies are too demanding for the local environment and simply cannot currently be implemented given the capacity of the borrower. To comply would involve unacceptable costs and exceed standards even in some industrial countries;

- Ambiguity: Some policies have complexities, over-specifications, and ambiguities that need to be reworked;

- Indecision: There has been no clear corporate authority to provide definitive interpretation and resolve differences on safeguards (although this is changing—(See Para 49). Delays occur and add cost;

- Rigidity: Policies have been interpreted literally and "legalistically." There is no differentiation relating to circumstances, project size, local competence or perceived risk. Professional judgment has given way to playing by the book;

- Risk Aversion: The Bank has become so risk averse, according to some borrowers, that it would rather do no project than risk criticism; and

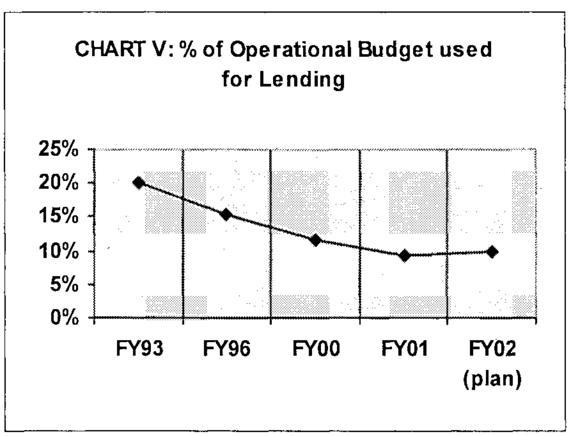
- Capacity-Depletion: "Ring-fencing" Bank-financed projects can result in misalignment of resources and enclaves of privilege without helping to build systems to cover similar circumstances elsewhere in a country. (In India, it is said that 98% of all resettlement takes place outside Bank-financed projects, yet more attention is often paid to perfecting the 2% affected by Bank financing than to improving the remaining 98%). When applied to specific operations, the "capacity" is often provided by external consultants at considerable cost and may actually deplete national capacity.

20. The task force studied 6 specific projects identified by the Regions as examples of projects dropped before reaching the financing stage. The two procurement cases demonstrated the effectiveness of the policy at work; to reduce the risk of subsequent non-compliance and to ensure adherence to a strong anti-corruption standard. In other areas, there were two cases in which the clients did eventually come back to the Bank, but there was evidence of the cost of delays, negative impact on relationships and waste of resources when Bank requirements are:

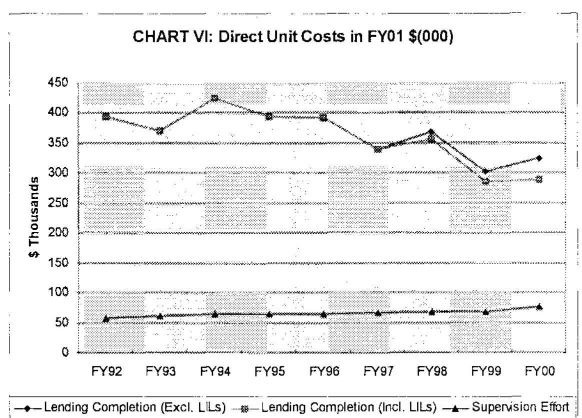
(i) under major review as in LACI, but remain a formal requirement;
(ii) ambiguously defined calling for extensive internal consultation; and,
(iii) are perceived by clients to be significantly misaligned with their own policies or those of other MDBs, especially in implementation.

E. The Bank Lending Budget is Diminishing and Compliance Costs are Rising

21. Despite these growing requirements, the proportion of Bank's operational budget devoted to lending has declined over the past several years in real terms. This has impacted task level budgets as well. The average lending completion costs (the cost of processing a project from identification through Board approval) has been declining for several years while requirements have been increasing. FY02 is expected to be a turnaround year for task level lending budgets.



Source: Corporate Resource Management June 2001
Direct Lending Cost Relative to Full Operations

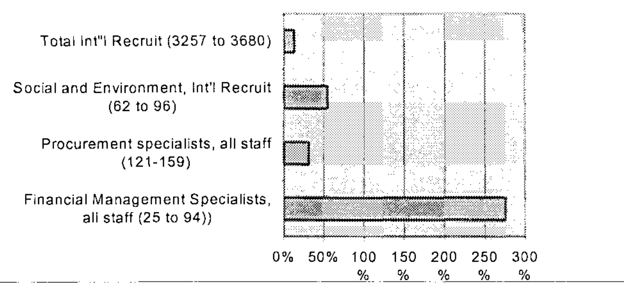


Source: Corporate Resource Management, Dec 2000

22. Individual safeguards add between 15 and 25 percent to the cost of project preparation, and when several apply, they can all but overwhelm the preparation budget. Virtually all task teams interviewed indicated that core preparation and supervision budgets had become seriously underfunded, in part due to these increasing compliance-related demands on a shrinking resource envelope[3]. Doing more with less has only been possible by increasing individual staff workloads. A survey conducted for this study indicated unrecorded staff overtime has increased from 18% to 25% of recorded work time between late 1998 and early 2000.

23. The principal cost drivers for the Bank are staff costs. During the period of the Strategic Compact (FY98-FY00), there have been significant increases in the number of staff dealing with financial management, procurement and social safeguards in particular reflecting the Bank's determination to strengthen its safeguard oversight and meet its fiduciary responsibilities. At the same time, there is a sense that despite this injection of new staff, the Bank is still short of expertise in some new areas (such as cultural resources).

CHART VII: Increases in Safeguard and Fiduciary Staff FY96/97 to FY00



24. There are about 340 operational staff engaged in procurement, financial, environmental and social policy development, maintenance and oversight, or roughly 20% of Regional and Anchor staff. Many other staff devote part-time to procurement and financial oversight as certified specialists. The total estimated cost to the Bank of safeguard and fiduciary compliance is about $83 million annually.

Table 1: Estimated Administrative Costs to the Bank of Safeguard/Fiduciary Policies

Policies	Specialized Staff	Of which: International	National	Full time Equivalent Staff	FY01 Base Costs ($m)
Social	46	29	17	28	9
Environment	44	36	8	22	10
Other Safeguards	-				2
Procurement	159	90	69	159	42
Finance	94	50	44	94	20
TOTAL	343	205	138	303	83

25. In the aggregate, these costs raise the issue on how the high costs associated with procurement policies can be reduced. The Compact funded significant increases in staff for financial management, procurement and social development. One promising development has been the increased proportion of fiduciary and social safeguard work done from field offices. About 80% of resettlement activity and of financial management

[3] A view confirmed by the FY01 Annual Review of Portfolio Performance

oversight over nearly 80% of the portfolio are now done by field-based staff. Not only are auditing and accounting obligations being met in a more timely fashion, but country office based Bank staff are increasingly helping build local capacity on financial management and social protection.

F. Borrower Costs are Rising and Sources of Trust Funds are not Expanding

26. It has proven difficult to extract reliable and totally consistent cost data especially on the client side. Projects are unique and country circumstances vary widely. Bank and borrower MIS systems typically do not track costs for application of these policies. The task force has made its best possible estimates from a sample of operations, but these are presented as a range because the task force believes that the estimates are useful if treated only as orders of magnitude rather than definitive amounts, to guide strategic discussions.

Table 2: Estimated Client Costs ($ Million)

Estimated Annual Costs to Countries of Bank Safeguard and Fiduciary Policies	**Costs of Policies**	**Incremental Costs (%)**
1. Social Safeguards, Resettlement, Indigenous Peoples, Cultural Resources	25 –35	40-60
2. Environmental Safeguards	15-25	30-40
3. Procurement	22-40	30-35
4. Financial – Audits, Duplicate Systems	55-110	60-70
5. Disclosure Requirements	1–5	78
TOTAL	118-215	50-60

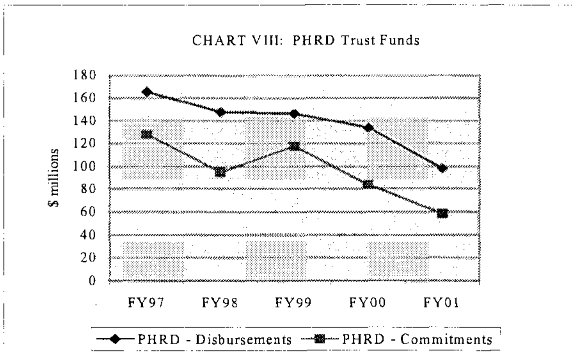
Source: Approximate costs estimated by Bank staff based on a typology of operations and estimated costs of typical EAs, EMPs, IADPs, social assessments etc; and from available client cost data sheets.

27. The most significant costs relate to meeting the Bank's fiduciary requirements, including procurement units in PIUs and audit requirements (some 6000 annually), and the potential cost of developing new financial management and reporting systems to meet the LACI standard (up to $12 million annually). Procurement and financial management requirements apply to virtually all operations, whereas environmental assessments take place on about 50 percent of investment operations and resettlement on about 25 percent.

28. Not all of these costs are incremental. Borrowers have normal procurement and audit requirements, often require mitigation of environmental impacts and some forms of compensation for social impacts. However, Bank requirements are often more stringent and consequently more expensive. The Task Force estimates that Bank procurement requirements add about 30-35% to borrower's normal costs, while social and environmental standards add perhaps 40-60% to normal borrower costs and meeting the Bank's financial reporting requirements would be up to 60-70% more costly. In addition, Bank guidelines require that the standards of these policies apply to all project components whether or not the Bank funds them. Compliance with this extended requirement adds substantially to borrower costs. While these costs are judged to produce

commensurate benefits, there are mechanisms to reduce them, and these need to be pursued.

29. The costs of project preparation activities, including environmental assessments and resettlement action plans, have traditionally been funded by the PHRD Grant Facility or Project Preparation Facility (especially for IDA borrowers). PHRD commitments have diminished significantly in the recent past (see Chart IX) and will impact disbursement in the next few years. Borrowers will need to find alternative sources to help them meet the Bank's safeguard requirements.



G. Other MDBs Have Fewer Safeguard Requirements

30. The Bank has the more favorable lending terms of the five Multilateral Development Banks (MDBs). At the same time, Bank safeguard and financial requirements and other business practices tend to be more comprehensive, more stringent and more consistently enforced and are perceived by clients to add costs. The table below compares the number of Bank safeguard policies to those of the other four multilateral development banks. (It should be noted that some MDBs combine several of these policies under the environmental assessment process, and others have safeguard policies where the World Bank does not, such as treatment of nuclear waste).

Table 3: Bank and Other MDB Policies

Safeguard Area	AfDB	AsDB	EBRD	IDB	IBRD/IDA
Environmental Assessment	Guideline	Policy	Policy	Guideline	Policy
Forestry	Policy	Policy	NR	Policy	Policy
Involuntary Resettlement	NR	Policy	NR	Policy	Policy
Indigenous Peoples	Policy	Policy	NR	Guideline	Policy
International Waterways	NR	NR	NR	NR	Policy
Dam Safety	Guideline	Guideline	NR	NR	Policy
Natural Habitats	NR	Guideline	NR	NR	Policy
Pest Management	Guideline	NR	NR	NR	Policy
Cultural Resources	Guideline	Guideline	NR	NR	OPN
Projects in Disputed Areas	NR	NR	NR	NR	Policy

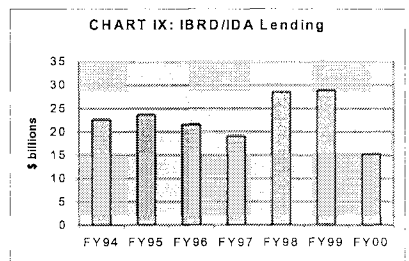
NR - No Requirement; OPN – Operational Policy Note; being converted into policy

31. Efforts are being made to "harmonize" policies among the development institutions. The MDBs have drafted standardized bidding documents for procurement of goods and agreed in principle on documents for civil works and consultants. The general approach to basic financial management, environment and some social policies are broadly comparable among MDBs but important details and rigor of enforcement vary.

32. However, there are also some major differences. The Bank has generally the most demanding requirement in most of its policies on consultation with affected peoples and on disclosure of information. The Bank's requirements on involuntary resettlement, particularly compensation levels and the treatment of "squatters," is also often more demanding than other donor policies. The financial reporting obligations for PMR-based disbursements under LACI require information systems not found in many industrial countries.

33. Another significant difference is the degree of supervision the policy requirements receive during implementation. Comparing the numbers of staff in other MDBs dealing with the environment and social protection leads to the inevitable conclusion that World Bank oversight is significantly more intensive. (One Bank has only three staff working on the environment). As the Table 3 above indicates, not only do the other MDBs have fewer policies overall, they have greater flexibility in interpretation where there are "guidelines" rather than formally adopted policies.

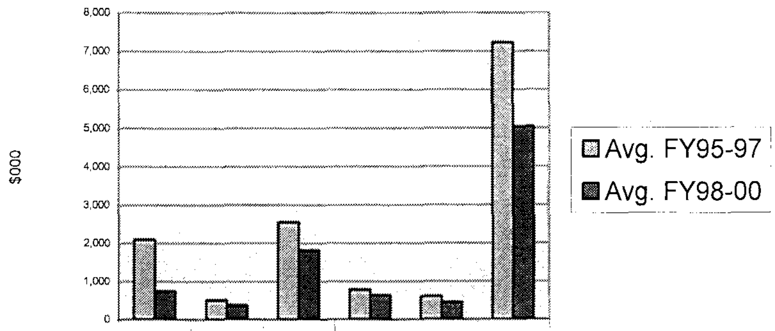
H. The Effect on Lending



34. Apart from the exceptional circumstances of FY98 and FY99 resulting from the global financial crisis, the Bank's new commitments have declined in absolute terms between FY95 and FY00. There has been a steady decline in lending for infrastructure, urban development and agriculture, and a growth in the amount of non-project lending.

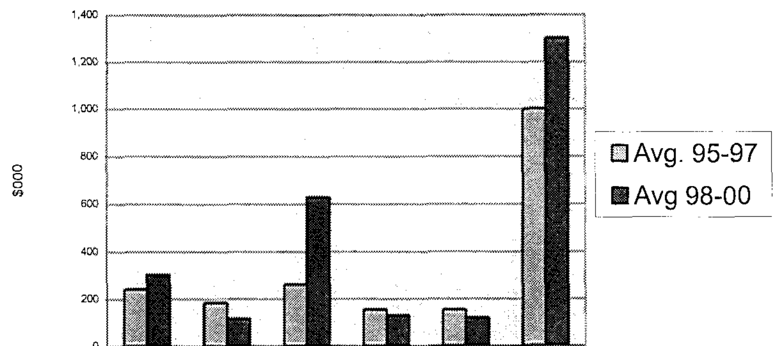
35. There has been a significant shift in IBRD lending for infrastructure over the past five years. Lending for electric energy and power has dropped from an average of about $2 billion in the mid '90s to about $750 million over the past three years. Transportation lending fell by an average of 28% in the same period. And lending for water and sanitation has declined by 25%. On the other hand, IDA lending has increased or declined much less (See Charts X and XI). During this time, the access of Middle Income Countries to private financing of infrastructure has increased. At the same time, the number of projects in PSI subject to environmental assessment has grown over the same period from less than half of all projects to almost 60%. In terms of delays leading to slippage which has been a key concern of clients, the PSI sector in FY01 had the highest slippage rate (50%) compared to 20% for the overall pipeline. Nevertheless, clients broadly supported the application of the EA process on Bank-financed projects, while providing strong indications that the manner in which these requirements were imposed had often reduced their inclination to borrow from the Bank for the more traditional types of projects—roads, water and sanitation, and power generation (See Para 57c)

Chart X: Average IBRD Commitments in PSI



	Electric Power & Energy	Private Sector Devt	Transportation	Urban	Water Supply & San	Total PSI
Avg. FY95-97	2,105	515	2,554	786	613	7,223
Avg. FY98-00	755	379	1,827	635	458	5,041

Chart XI: Average IDA Commitments in PSI



	Electric Power & Energy	Private Sector Devt	Transportation	Urban	Water Supply & San	Total PSI
Avg. 95-97	242	186	263	156	154	1,001
Avg 98-00	302	117	630	131	121	1,301

Box 2: The Energy Sector: An Interesting Case of Decline in Lending

The decline in Bank lending to the Energy sector makes an interesting case study. From an average of about 12% of annual lending in FY97, the sector share has gone down to about 4% in FY01. In parallel, the staffing numbers has declined from about 5% to nearly 3% of Bank resources. The sharp decline among IBRD borrowers contrasts with a modest increase among IDA clients.

The shrinkage in Bank lending is, according to clients, being filled by private sources in counties with market access or by other donors and Export Credit Agencies. These investments are typically associated with a high level of safeguard requirements, due to their significant environmental and social impacts. The relevant safeguard provisions for these alternative sources of finance are either host country requirements, or those in the foreign investors country or those of the donor agency. Clients and private investors believe that the requirements and processes of these alternate sources involve less delay and effort than those of the Bank and these factors play a role in their willingness to engage with the Bank.

Clearly, any Bank effort to help countries strengthen their national safeguard systems or harmonize policies with other donors has a significant multiplier effect on safeguard issues beyond that of the Bank's financing activity.

In terms of its economic growth, human development, poverty, environment, health and gender linkages, the energy sector is perhaps second to none, though few CASs explicitly recognize this. It is estimated that about 1.6 billion people do not have access to electricity (or gas or kerosene), only 10% of Sub-Saharan Africa population has access to electricity, and 85% of the large cities lack acceptable quality clean air, in which the energy sector is a major contributor. In sector terms, sector regulatory framework needs considerable improvement in 65% of the countries and on increased privatization and competition, there is a longer way to go.

Energy is an important factor for growth, development and poverty alleviation. The Bank needs to find ways to overcome any client concerns over delays in safeguard policy applications, and seek to increase its involvement in this sector. In the process it would support a significant part of our clients' unfinished development agenda and maintain our relevance as an institution of high class global expertise in all major aspects of development, which clients continue to desire.

From "Topical Briefing to the Board on Energy": Energy Sector Board.

36. The changing composition of Bank lending, among sectors and between "programmatic" and investment lending may or may not be influenced by borrowers' attitudes toward safeguard, procurement and financial management policies. There are many factors at work, including better access to alternative sources of finance and a strategic shift in Bank priorities to increase support for social sectors. The task force sees some risks which the Bank needs to take note of. The Bank's comparative advantage comes from its unique global perspective and its experience in virtually every aspect of the development process. It is what makes the Bank the preeminent "knowledge institution." This in-depth knowledge comes from sustained, long-term engagement with partner institutions which is typically in our investment operations. For the Bank to withdraw—or be excluded-de facto—from certain core development activities such as urban development, electric power, natural resource management or dams, particularly because of borrower frustrations over the application of policies whose objectives they support, carries with it serious, and unnecessary, risks. There is a risk that the benefits of these policies will not be realized on the one hand, and that the Bank will be less able to support and influence the development agenda on the other. There is a risk that the Bank will be seen as the preferred donor only for the most complex and risky operations, which, in turn, could influence the overall quality of the Bank's portfolio. Actions need to be taken to reduce delays, help countries develop stronger systems for fiduciary and safeguard policy and pursue policy harmonization with other sources of finance. As indicated in Chapter IV, the lessons of experience in the application of these policies and the clarity of the message from the clients, offer guidance on the road ahead.

II. Recent Actions Taken

37. To begin the process of reducing transaction costs and increasing the benefits in the application of these policies, internal actions have been initiated since the taskforce started its work in July 2000. These actions provide for (i) clarification, simplification and integration of Bank policies, processes and procedures, (ii) strengthening of internal process and capacity within the Bank (iii) ensuring adequate resources to front line operations.

A. Clarify/ Rationalize Current Policies

38. Establishing and applying policies that promote sustainable development is one of the Bank's most valuable and powerful contributions to the development process. By setting demanding but realistic expectations, the Bank assists countries in raising their own standards. But if Bank-mandated policies are too ambitious or too far ahead of generally accepted norms, they may lead to a diminished impact. As several borrowers noted during the consultations, adopting in a narrow project context standards that may significantly exceed national requirements or financial and institutional capacity is not sustainable development.

39. A review of the Bank's policy development/revision process by the task force suggested that this process needs to be guided by several principles that were very helpful in some of the recent policy revision exercises:

- Fundamental goals and binding processes should be spelled out clearly and separated from desirable procedures and good practices;
- Policies should have the flexibility for specific solutions to match specific client situations and types of operations, while achieving basic goals;
- Role of Bank and obligations of Borrowers should be distinguished;
- Policies should be developed in full consultation with all relevant stakeholders; especially borrowers and other multilateral lending institutions and should be tested for feasibility before formal adoption;
- The costs of new or revised policies to the Bank and the Borrower should be estimated and fully budgeted;
- Policy development process within the Bank should be more client-oriented and involving more input from operational leaders;
- Policies on safeguards and fiduciary management should be oriented toward building institutional capacity of the borrower; and
- Safeguard policies should be melded into an integrated framework combining, for example, policies on natural habitats, forestry, pest management and physical cultural property into an integrated environmental assessment process, now well mainstreamed by most borrowers.

40. Financial Reporting: The Bank's project based financial reporting requirements have always been demanding and have become excessively so as old approaches have been appended to new situations. The Bank's audit system is fragmented: on average, every project requires four annual audit reports including those for Statements of Expenditures (SOEs) and Trust Funds (TFs) and for various project entities. The LACI initiative introduced new systems of financial management, reporting and disbursements, that required borrowers to invest in new financial and MIS systems. The real benefits that have come with the LACI initiative in terms of assessing borrower financial capacity and helping to build greater competence has often been lost in the acrimony over LACI reporting formats and other subsidiary preoccupations. In the past three years, only 5% of new projects have been certified as LACI-compliant for disbursements against an expectation of 60%.

41. The Financial Management Board has completed a review of the LACI system and initiated work on the audit system. The proposed changes in LACI would be rolled out in the coming months and should result in significant savings to borrowers:

- Streamlined financial management assessments, with a more structured approach to assessment of risk, carried out early in project processing;
- Reporting requirements that can either be PMR-based or based on the project agencies' own needs, subject to minimum requirements on identifying sources and uses of funds;
- Disbursements can be made on either PMR-based reports or the borrower's own reports (subject to Bank approval); and
- Oversight within the Bank will be simplified with the elimination of multiple clearances and vesting clear accountability for ensuring compliance with Regional Financial Management Advisors.

42. A review of the current audit system has also been launched by the FM Board. It has noted the fragmented nature of the Bank's current requirements which results in numerous audit reports covering small amounts of disbursed funds, considerable duplication in efforts, and lack of timely completion. The FM Board is now focusing its efforts on: (i) identifying some quick wins to improve the value/cost relationships, and (ii) examining the feasibility of a risk-based and single audit approach to provide a higher quality of fiduciary assurance while reducing cost of duplication, fragmentation and delay.

43. <u>Social Safeguards</u>: The on-going conversion process for social safeguard policies aims to reduce ambiguities in current policies, codify past Management decisions not reflected in existing policy statements, incorporate key recommendations of OED and provide clear guidance in areas where the policies may not have been fully complied with in the past. The new draft of the resettlement policy OP/BP 4.12 also provides guidance on the application of the policy in situations involving the two main triggers of the resettlement policy – land taking, and restriction of access to parks and protected areas. These clarifications are valuable assurances for project-affected peoples, but could also raise Bank and client costs if interpreted in a narrow, normative and legalistic manner.

44. Economic rehabilitation is often a difficult, long-term process, which works well under favorable macro-economic conditions. Income restoration measures need to be crafted carefully for each situation. Often such skills do not exist in project implementing agencies and hence, special local support is required (civic organization, micro-enterprises, job training and recruiting agencies, etc.). Unlike Part I countries, markets in many developing countries are inefficient, tenure rights not formally recognized and property ownership records inadequate. With this view Bank policies favor non-cash compensation in situations where the affected people do not have access to efficient markets, which may increase the cost of implementing the policies in developing countries. Thus, the long-term approach should promote a process-oriented framework so that local consensus-based judgment is made to resolve project related social issues. However the success of this approach depends on two factors: (i) adoption of better policies by borrowers and strengthening of capacity to implement policies, and (ii) flexibility and judgment by the Bank in interpreting these policies to fit specific contexts.

The OP/BP 4.12 on Involuntary Resettlement is scheduled for Board consideration in 2001.

45. The other two social policies being converted from Operational Directives or Notes to Operational Policies are Indigenous Peoples and Physical Cultural Resources. Both policies take a process-oriented approach. The revisions to the cultural property policy note builds on the experience with other policy changes. It seeks to harmonize Bank policy with national policies, to initiate early consultation if not harmonization with MDBs, and to use existing safeguard mechanisms, in particular Environmental Assessment (EA). It may be the precursor to a longer-term effort to reintegrate several separate policies such as Forestry, Natural Habitats, Pest Management and Dam Safety within the umbrella of the EA process, with considerable savings, potentially, for the Bank and the Borrower.

46. ESSD has completed and shared with operational staff a two page "safeguard policy matrices" for each of the 10 safeguard policies. These matrices describe objectives, policy triggers and compliance requirements at all stages of the cycle. Efforts are underway to simplify safeguard requirements for LILs and CDD projects; these are expected to be finalized in September 2001.

47. Procurement Policies. In the internal phase of this review, procurement policies were not considered a major cost driver. Only two areas for action were identified: (i) implementing more rigorously the current policy on thresholds for prior review by the Bank in order to reduce client and Bank costs on reviewing transactions; and (ii) reviewing and systematically adjusting above thresholds based on client capacity assessments during appraisals and Country Procurement Assessment Review (CPARs).

48. Borrowers during consultations provided a stronger feedback on procurement policies (See Para 57 e) and identified six areas in which the implementation of the procurement policy should be reviewed: (i) Translating the results of the Country Procurement Assessment Reviews (CPARs)[4] into explicit decisions for greater delegation of responsibility to borrowers (ex-ante review limits, ex-post review frequency, use of NCB, etc), (ii) honoring the delegation of authority to country agencies implied by these ex-ante thresholds, (iii) reducing the multiple clearances on technical assistance procurement, (iv) accelerating the pace of IT hardware and software procurement, and (vi) harmonizing policies with other MDB and national procurement requirements, at the country level. (See Para 60 for the Procurement Sector Board's response)

B. Strengthen Internal Processes

49. In safeguard areas, the Bank has initiated an action agenda which aims to ensure more effective and efficient execution of the Bank's safeguard policies, provide timely authoritative interpretation in complex situations, apply common sense and cost effective solutions based on sector wide knowledge and reduce delays in decisions making. Improvements currently being implemented fall into four areas:

[4] An ongoing QAG review of about 20 CPARs, aims to help improve the effectiveness of this instrument.

- Clearly defined accountabilities-including clarification of the roles of key players in Regions, ESSD Anchor and Legal in normal risk and special risk operations and establishment of standards for timely resolution of issues;
- The Quality Assurance and Compliance Unit (QACU) has been strengthened as a "one stop" shop for providing authoritative advice on interpretation and application of safeguard policies;
- A "safeguards help desk" has been established to address questions from operational staff on the ten safeguard policies. The help desk, manned by a coordinator, relies on safeguard policy specialists and their back-ups to address specific queries; and
- An integrated safeguards data sheet has replaced the Environmental Data Sheet to promote a balanced, upstream treatment of all safeguard policy issues. It will be simultaneously viewed by the regional safeguard teams and QACU.

C. Ensure Adequate Resources for Bank to Honor its Commitments

50. To meet fully fiduciary and safeguard oversight responsibilities, requires additional task level budgets and staff resources. These were estimated in the internal phase and included in the FY02 budget process. They included resources for increased lending and supervision at the task level, especially for upstream safeguard work on high-risk operations, staff training, client capacity assessments and capacity building as well as for the Sector Boards to support timely policy interpretation. On the basis of these internal phase estimates and the response from the Regions and Networks, FY02 budgets and operational plans provide for the following:

Table 4: Planned FY02 Additional Resources to Implement Recommendations ($m)

Additional Resources for:	**Recommended Increase**	AFR	EAP	ECA	MNA	LAC	SAR	ESSD	OCS	**Total**
Lending and Supervision tasks	**22.8**	7.6	5.0	2.9	0.1	4.7	1.5	n/a	n/a	**21.8**
Capacity Building	**4.0**	1.1	0.4	0.9	0.3	0.3	1.0	0.8		**4.8**
Sector Board Anchors' Support for policy interpretation, development and monitoring	**2.2**	n/a	n/a	n/a	n/a	n/a	n/a	1.2	0.7	**1.9**
Total	**29.0**	8.7	5.4	3.8	0.4	5.0	2.5	2.0	0.7	**28.5**

Source: Regional and Network submissions based on current plans: 19 June 2001

51. Safeguard Areas: Based on safeguard risk assessments of the pipeline and the portfolio, it is expected that preparation and supervision budget for projects with safeguard issues would be adequately funded. Specifically, full implementation of the current Resettlement Policy is estimated to require an additional $2.5 million and the changes in the revised policy are estimated to require another $1.0 million. Similarly, while implementing, the current Indigenous Peoples Policy is expected to cost $3.3 million, the revised policy, which calls for early consultation and mandatory social assessments in situations involving adverse impacts on indigenous peoples, would require an additional $1.0 million. (Incremental cost to Borrowers is expected to be $5.5 million). In the case of the revised Cultural Resources policy, about $2.4 million will be needed to fully comply with current policy and an additional $0.8 million to comply with the proposed

revisions, to support cultural assessments within the environmental assessment process and improve project supervision. (Incremental cost to Borrowers are estimated at $5.8 million). The current portfolio of projects is being adequately supervised for projects which have an environmental rating of "A", and the additional resources would allow better supervision of "B" projects which was seen as less satisfactory in recent QAG reviews.

52. Fiduciary Areas: The Procurement Sector Board would undertake the review of the feedback from clients and recent developments in international public procurement. Based on a risk assessment of the pipeline and the portfolio that the FM Board is expected to undertake in FY02, it is expected these resources would lead to additional work in the area of financial management (costing about $4 million) for:

(i) Better compliance with present policies, especially oversight over estimated 4000 Trust Funds; and
(ii) More complete follow-up on project audits.

53. Staff/Manager Training: In the complex area of safeguard and fiduciary policies, especially when the Bank is expected to provide leadership, the need for staff and management training is constant and large. Training of staff in safeguards is expected to be expanded from the current level of about $2.0 million a year to about $3.0 million. Programs of training targeted at managers, and focusing on institutionalizing safeguards in sectoral and country strategy are planned. Training in procurement would need to focus on institutional analysis and building national systems with a special attention to field based staff and on the needs of specialized sectors. FM training needs are also changing, away from a focus on the mechanics of PMR based disbursements to the needs of national financial system development.

54. Regions: Enhanced task budgets would be translated into increased fiduciary and safeguard work based on pipeline and portfolio risk assessments, to ensure that incremental efforts and resources are targeted where most needed. Included in this would be to move upstream more of the safeguard work on high risk operations. As indicated in the Box below, early attention to social and environmental risks can reduce project costs and uncertainties.

Box 3: Early Prevention is Better than Later Cure

Anticipating potential problems and mitigating the risk through better project design or site selection is very cost-effective but all-too-seldom done in Bank-financed projects. Encountering an archeological site in the course of construction where there had been no prior assessment or investigation can have catastrophic consequences on project implementation. Using environmental assessments to rationalize decisions already made rather than illuminate choices reduces their potential value in saving the client money, time and "hassle". Leaving critical safeguard issues unresolved until late in a project cycle can result in major confrontation and loss.

A typical example reviewed by the Task Force was a dam financed by the Bank and constructed and commissioned without new water withdrawal rights having been agreed. To comply with existing water rights, the power authority would have to reduce generation dramatically with a direct loss of $20 million annually in revenue and an indirect loss to the economy estimated at $200 million. Moreover, unique animal and plant species will now require costly measures to ensure survival now that the project is operating. Risks to the borrower are high given its commitments under the Convention on Biological Diversity and to the Bank and its commitment in the Natural Habitats policy to help preserve critical ecosystems. An early assessment of the risks and potential impacts would have included options for different sites. A little money spent early in the project cycle would have saved millions of dollars later.

III. Client Consultation Phase[5]

55. Following informal discussions with the Board, client consultations were organized in 10 select countries identified by the Regions. Country Offices played a major role in setting-up these consultations. Country participants ranged from 20-50 and typically included three groups of officials: those who worked directly with Bank-financed projects, others in the national regulatory agencies and those who are designated Bank counterpart ministries/agencies. Typically, the format involved an introduction by the CD/Country manager and a plenary discussion of the key initial findings of the internal work, a plenary or more often, small group discussions of fiduciary and safeguard policies, a report back to the plenary followed by discussions of the way forward.

56. In general, all the borrowers felt that their relationship with the Bank has had a significantly positive impact on their countries' development experience. In relation to the overall relationship, clients who participated went out of their way to emphasize:

(i) their appreciation for the Banks' effort to bring to bear a simultaneous depth in terms of country context and breadth in terms of the relevant cross-country sectoral knowledge;
(ii) the value they attach to the perceived objectivity of the Bank's advice;
(iii) the importance they attach to continuity and sustained association with the Bank achieved over the period of implementing projects; and
(iv) the concern they feel that the Bank's increased emphasis on supporting adjustment and budget support operations will come at the cost of sustained association at the sectoral level.

57. In relation to the Bank fiduciary and safeguard policies, as emerged in the internal phase, the Bank's relationship with its borrowers is complex and often combines appreciation and frustration at the same time. The overall feedback from the consultations with ten borrowers reflects this mix. The primary messages from these client consultations are:

(a) Overall, the Bank's fiduciary and safeguard policies are judged to be of considerable and demonstrated value, fully consistent with national goals and objectives and commitment to them is universal. The Bank's policies have generally helped raise standards and ensured adequate attention to the protection of the biophysical and social environment and to transparent public procurement and financial management. There appears to be a clear commitment among borrowers, regardless of their level of income

[5] Consultations held during April-May 2001 in Argentina, Brazil, China, India, Mozambique, Philippines, Romania, Russia, Tanzania and Yemen.

or state of institutional development, to work toward adoption of international good practice in application of these policies.

Box 4: Client Examples of Positive Outcomes of Policy Implementation

Procurement

Philippines. Bank's insistence on ICB process resulted in a 60% reduction in cost and higher quality of books.

Argentina. In the absence of harmonization among provinces and at the national level, Bank's policies provide a much needed common operating framework which contributes to transparency, reduced conflicts and faster decision making; and a price advantage of 10-20% due to Bank procedures and assured financing.

China. Numerous examples of Bank procedures leading to significant cost savings (50-60%) over traditional methods.

India. Bank procurement guidelines have often saved money, estimated to be about 10% in some specific cases.

Tanzania. Processes developed for IDA financed projects voluntarily extended to apply to entire sector, resulting in lower cost and avoidance of later delays due to post-award conflicts.

Financial Management

Yemen. In the absence of a national financial management system, the Bank's LACI framework provides a much-needed standard approach across all sectors for a transparent and reliable system.

Argentina. Practices of the Bank and support under the CFAA have favorably impacted the national approach to financial management, given a lack of full harmonization of provincial and national systems.

Romania. The Bank's CFAA exercise is expected to help the government renew and strengthen institutional capacity in a difficult but critical area.

Tanzania. The Bank's capacity building effort with the Auditor General towards a single institutional audit process will provide a high quality assurance to all donors.

Brazil. Despite its rigidity and limitations, LACI is being harmonized with Brazil's own SIAFI system, because both support goals of transparency and efficiency.

Social & Environment Safeguards

Argentina. Institutional capacity developed through Bank financed projects successfully transferred to entire sectors. Public consultation under the EA process helped gain ownership of the community and reduce cost of implementation of the roads program.

Brazil. In the PNMA I project: application of Bank policy led to a 50% cost reduction by avoiding a change in the course of the river and instead constructing an "alleviation" channel.

India. The national highway authority has adopted the Bank's approach to re-settlement in its entire national program, even though it is not financed by the Bank.

Tanzania. EAs and beneficiary assessment done for the water sector operation have helped develop better design standards and better tariff policies, more in tune with beneficiaries' ability to pay.

Philippines. For the first time in its history, the Philippines has provided for a special treatment of indigenous people, because of Bank policies, in the Subic Bay project.

(b) Clients recognize and wish to reduce the increased administrative costs to them associated with these policies, but are much more concerned about the cost of delays associated with the way the Bank does business in these policy areas. During the consultation process, some borrowers provided data to support their view that the estimates by the task force of client cost (See Para 26) underestimated the real client costs of these policies. Moreover, all borrowers indicated that the most significant cost of doing business with the Bank—cost of delay in launching and implementing projects had never been explicitly estimated. Examples were cited of the loss of an entire construction season because the Bank could not decide on policy interpretations. Procurement delays were mentioned consistently—IT equipment that was obsolete on arrival and multiple reviews at various stages of small consulting contracts. Most borrowers said they shared part of the responsibilities for delay and they were willing to bear the reasonable incremental costs of these policies where they clearly improved the cost-effectiveness of a project. However, they sought action to reduce the costs of avoidable delay resulting from the Bank's inefficiency in making decisions and higher level of risk-aversion. Clients believe there is scope for reducing the costs of these policies through a sharper focus on fundamental goals, more timely and consistent policy interpretation and greater consistency in policy application with national standards and among donors. There is also room for enhancing the benefits of these policies by building national capacity and shifting the focus of application of these policies, over time, from individual projects to entire sectors and sub-regions. (See Section (h) below)

Box 5: Time is Money

The Bank's work with the private sector shows an appreciation of the value of time. The private sector is willing to spend money up-front to save time and reduce costs in ways the public sector--and often the Bank--are not. The private sponsors of the **Bolivia-Brazil** Gas Pipeline Project invested significant resources up-stream in environmental and social assessments to help build a constituency for the project, ensure good project design and lower the chances of implementation delays. In **India**, the Infrastructure Lending and Financial Services Project built into the project a mechanism to help sub-borrowers carry out environmental and social assessments and mitigation plans for their investments. The sub-borrowers accept the value of doing the right thing at the outset rather than facing serious problems later that could affect future revenue streams. They are willing to pay attention to, and pay for, safeguard processes and mitigation strategies upfront.

By contrast, the Bank's work with the public sector often seems indifferent to the time value of money. One project included funds to purchase computer hardware and software at an estimated cost of $1 million. The initial bidding resulted in no acceptable bids. The specifications were subsequently found to have been unacceptable and, after some delay, were revised. A second round of bidding was initiated. The cost estimate had increased to $1.5 million. The lowest evaluated bidder was selected. However, the Bank under a prior review requirement found a mistake in the process. Although was not expected to have an impact on the outcome of the bidding, the Bank insisted on a third round of bidding. The borrower refused and found other sources of funds. Result elapsed time: four years and significant borrower costs.

In a second case, during the preparation phase of an urban transport project the social scientist on the task team took the view that the indigenous people's policy should not be applied given that the affected minorities by the project had migrated to urban areas and the project does not make them vulnerable to group-specific impacts. However, the Legal Department noted that since the affected minorities are indigenous peoples as defined in and for the intent of the OD 4.20, irrespective of their place of residence, the OD applies. Although the task team broadened resettlement related consultation and social assessment, the internal debate continued even after the negotiations. The Bank took over six months to build consensus between legal, social scientists, operations staff and management to reach a decision that the affected people are identified as "indigenous peoples" but they are not the intended target of OD4.20 in light of the changed economic and cultural pattern of their living.

In a third case, a power transmission project in a country facing an acute energy crisis, was held up almost a year over disagreement on compensation approach – whether cash payments or restoration of incomes for resettlement. In the absence of an effective process to ensure timely decision on issues, the clients felt that ends were becoming sub-ordinate to the means.

(c) **These policies have not affected the overall volume of Bank/IDA lending but may be impacting sectoral composition.** This is partly because of recent policy to emphasize new sectors such as human development. Country-specific situations such as exposure limits, portfolio quality, availability of IDA and other factors are more important to overall borrowing. However, there is evidence especially among IBRD clients, that the composition of lending has been impacted. In some traditional sectors, such as energy, transportation and water resources, the Bank is seen by our clients to be a less preferred source of financing. Turning from the Bank for funding of infrastructure, is at least partly due to the desire to avoid the complexities of resettlement, indigenous peoples, environmental assessment and other safeguard policies. The same participants indicated that these questions get less attention in the Bank's absence (and are also less costly and time consuming). The Bank may be genuinely becoming a lender of last resort, but for perhaps the wrong reasons. (See Para 35 also)

Stated Order of Lender Preference for Insfrastructure	
IDA Eligible Clients	**IBRD Clients**
No Preference indicated	Commercial Sources Bilateral Donors Other MDBs IBRD

(d) **Most clients sense that the Bank is loosing its ability to make balanced, context-specific judgments in favor of a risk-averse, rule-book approach to avoid criticism.** Many clients noted the changes within the Bank, that has manifested themselves in many different forms including: (i) multiple channels (team leaders, policy enforcers and legal staff) communicating directly with borrowers, (ii) inconsistent and sometimes conflicting application of policies, (iii) delays in decision-making and multiple clearances. The participants noted that differing country circumstances and capacities were less and less respected, with a tendency for seeking "perfection" on every aspect of a project, regardless of reality or cost. They also felt a reduced managerial engagement in promoting balanced decision-making among competing goals. They sensed that there is a new internal culture or standard where pursuit of best practice in every dimension has become the minimum requirement, and the quality of an operation is measured by its "compliance" with QAG, OED or Inspection Panel assessments rather than its sustainability on the ground in actual client conditions.

(e) **Clients' major concerns were more about procurement and financial management, since these affect all operations**. Procurement issues were more prominent than during the internal Bank review phase, while environment was less prominent.

(i) Procurement. Procurement was the single-most hotly discussed issue. Perhaps it was because procurement occurs in almost all projects and is inherently time-consuming and expensive. It is a continuous process unlike audits (an annual event) or environmental assessment (a single event). However, there were many examples where the bank's Guidelines for Procurement were said to be inappropriate or their interpretation by the Bank to be extremely rigid, leading to neither efficiency nor effectiveness in procuring goods and services. Principal concerns were: inflexibility in applying the official guidelines, low value-added multiple reviews and "no-objections" for procuring technical assistance, TL "encroachment" below the agreed ex-ante thresholds, inappropriate requirements for procuring IT hardware and software, and the failure to treat more successful and experienced institutions with a lighter hand.

(ii) Financial Management. While clients support the basic goals of financial management policies and the concepts behind the LACI program, their views about the infeasibility of the PMR-based disbursement process were fairly uniform and loud. However in countries at the two extremes of institutional development (i.e. having no national FM systems and having good national FM systems) implementation was more relatively successful. Clients all agreed that reducing multiplicity of project audits and harmonizing audit and financial reporting requirements among national authorities, other donors and the Bank would achieve considerable savings without reducing the quality of fiduciary assurance.

(iii) Safeguards. Bank safeguard policy objectives were applauded and were said to conform to most country requirements in principle. Several had been adopted on a national basis. The principal disagreements came over **involuntary resettlement**, primarily the treatment of "squatters," the levels of compensation and multiplicity of compensation regimes, and the Bank's reluctance to accept cash compensation instead of income restoration measures. **Indigenous Peoples** policy concerns were primarily about the definition of the target groups and applicability of the policy in urban settings. **Dam Safety** was mentioned in one country (raising concerns about its link to the World Commission on Dams recommendations) and **Physical Cultural Resources** in another (urging the Bank's full attention to this question in its risk analysis). **Environmental policies** came in for least commentary, reflecting perhaps the internalization of environmental assessments and less "normative" content of the Bank policy than in some social safeguards.

(f) "Harmonization" should be pursued primarily at the country level, especially the convergence among national and sub-national policies with those of the MDBs. The major conflict between donors and borrowers comes when national laws, regulations and standards differ from external funder requirements. Implementation will be faster and less costly and sustainable impact will be greater when these differences disappear, and national standards conform to good international practice. The three principal messages from the consultations:

(i) In countries with *federal structures,* there is as much of a challenge to help harmonize policies and standards among states and provinces as between national and international standards;
(ii) Harmonization of MDB requirements at the country level and managed by the country itself seems to have yielded considerable success, because differences are fewer; and,
(iii) The Bank should focus its efforts increasingly on helping individual countries enhance their overall capacity to apply these policies to all development activity.

(g) A new Bank commitment to building national capacity was sought. There was a strong consensus that the ultimate safeguard is to have borrowers with the determination and capacity to apply these policies in all their development endeavors, not just on Bank-financed projects. In lieu of traditional TA and Bank studies, borrowers want the Bank and development partners to progressively rely more on strengthened national and sub-national institutions to apply these policies or aspects thereof, based on their demonstrated capacity. Borrowers urged the Bank to move beyond the PIU model supported by costly TA, and to engage systematically in building mainline national institutional capacity and progressively devolve responsibility and accountability to those who demonstrate their ability to apply the policies effectively. This would involve a systematic assessment of current capacity, efforts to build competence over time, and evaluation of experience leading to increasing delegation of authority for various aspects of policy implementation. Borrowers were aware that CPARs/CFAA's instruments are being increasingly deployed in fiduciary areas to assess capacity, but did not yet see support for capacity building nor increased delegation to their institutions as foreseen in these instruments. Similar instruments and efforts in the safeguard area were not known.

(h) Clients support further innovation in policy implementation to increase their value and reduce the costs. In the internal phase of this work, many examples were highlighted of team leaders creatively extending the impact of the current policies by working at the sector-wide level, by strengthening national institutions and by delegating aspects of policy implementation to them (See Box 10). Clients in the 10 country sample were not always aware of these innovations. Borrowers argued that the Bank's medium term strategy should be to refocus the efforts on safeguards and fiduciary management so that borrowers exercise principal responsibility for implementation of due diligence and compliance, while the Bank focuses on the sharing of knowledge about effective practices among clients and monitoring the achievement of policy goals. The current safeguard policy framework, built on the "ring-fenced" investment project model, was not seen as designed for these type of sector-wide programmatic lending activities. There was a sense that continued innovation to meet these emerging activities needs to be accelerated. Over the medium term, a strengthened policy framework would need to codify the role of the Bank, to (i) help build country capacity, (ii) more clearly define, and differentiate, the Bank's due diligence responsibilities and the Borrower's implementation responsibilities; and (iii) harmonize national and donor standards over time to agreed international good practice.

IV. The Way Forward

A. Respond to Client Feedback

58. Most clients took the consultation process very seriously, and many have continued to be engaged following the process with additional details and ideas. Management is also taking this feedback seriously, keeping in mind its commitment to full compliance with current policies and to being cost effective. Some Sector Boards had started taking action as early as the first internal phase of the work, others have become more engaged since the client feedback. The Safeguard Sector Boards had launched a strengthening of the internal system to ensure consistency and faster decision making. They are equally committed to take up the recent client feedback. (See Box 6 below)

Box 6: Response from the Safeguards Sector Boards

(a). Resettlement Policy Issue of "squatters": Assistance to squatters relates to protection of vulnerable groups (in this case, those without legal rights to affected land). A policy that does not protect an extremely vulnerable section of the affected population would further impoverish such groups, apart from posing a substantial reputational risk to the Bank. The revised resettlement policy does, however, clarify that those without legal claims to affected land do not need to be "compensated", but would need to be provided with "resettlement assistance" to help them at least restore their standards of living. This is expected to resolve a procedural constraint faced by many borrowers, who found themselves unable to "compensate" those without legal rights, as required by the existing policy. (See Table 5 also)

(b). Definition of indigenous peoples to whom the Bank's Indigenous Peoples policy applies is highly context specific and is difficult to address within a generic policy statement applicable to all regions. However, the revised policy draft (OP/BP 4.10) does provide a process by which a determination regarding the application of the policy is made.

(c). Harmonization of donor policies. Efforts are underway among the multilateral development Banks, although it is likely to be a complex and long drawn process. While harmonization of donor and country policy is critical for a long term solution to the high transaction costs associated with processing the safeguards requirements of projects, this effort requires very high level and institutional commitment in order to be successful. ESSD expects to identify and initiate a few country policy harmonization pilots during FY02.

(d). Building client capacity for safeguard policies continues to be a high priority. In collaboration with WBI, an outreach program involving borrower country policy makers and implementers is currently being designed for delivery in FY02. Several regions, notably AFR and MNA have initiated capacity building pilots. Recent developments in AFR include the assistance to the launching of the Southern Africa EIA Institute as well as of the CLEIA (Capacity Development and Linkages in EIA in Africa) with a small secretariat based in Accra - Ghana. Based on borrower's request for building the capacity of national and sub-national institutions and empowering them to play an enhanced role, a suitable capacity building program is currently being developed in collaboration with WBI for implementation in FY02.

(e). **Strengthening country/sector policy frameworks** would be an effective way to break away from the current, "ring-fenced" approach to safeguards. This would also help promote sector-wide and programmatic lending activities.

Table 5: Resettlement Policy Issues Raised During Client Consultations

Issue Raised	Is the issue related to the policy statement or its application in specific cases?	Range of successful approaches used in WB-financed projects to address the issue.	How does WB policy and practice compare with the approaches of other MDBs?	How is the issue handled in Part I Countries?
1. Compensation of "squatters".	Policy issue. Clearly stated in the policy.	Wide range in actual practice. Pragmatic solutions are found based on specific circumstances. Good practices have been documented.	Similar treatment of squatters in most MDB *policies*. Lack of comprehensive information on the range of *practice* in other MDBs.	Much better protection of and much less pressure on public lands. Therefore, rarely an issue. However, if squatting takes place, practice related to providing assistance is variable.
2. Different compensation regimes in same geographical area (i.e., between WB, Borrower, and other MDB financed projects).	Policy issue. Bank requires compensation at replacement cost. Others may calculate the compensation payable in different ways.	Replacement cost is determined based on valuation carried out by responsible government agencies. Independent valuators not used.	Similar to the World Bank's requirement on replacement cost.	Compensation is calculated at the replacement cost of affected asset, which is usually negotiated and calculated by professional valuators.
3. Requirement to go beyond cash compensation to restoration of incomes.	Policy issue. This has been a key objective of the policy for the past eleven years.	Wide range depending on the specific circumstances. In countries where markets are functioning well (e.g. Korea, Thailand), cash compensation by itself helps achieve the objective of income restoration.	MDB policies also require income restoration. Wide range in actual practice, depending on the specific circumstances.	Due to efficient markets, payment of compensation at replacement value results in income restoration. Implicit assumption about income restoration in the compensation regime.

59. The Financial Management Sector Board, in addition to actions on reforming LACI, is actively engaged in reviewing the audit system for options available to enhance the level of fiduciary assurance while at the same time reducing its cost. (See Paras 40-41)

60. The Procurement Sector Board has developed a set of proposed actions to respond to client concerns, noting that it is not in a position to follow through on all dimensions without significant support from RVPs. The support of RVPs is critically needed in the area of developing and implementing models of cost-effective delegation of functions and authority in the area of procurement to Country Offices. The procurement Board has also analyzed the key differences among MDBs that may be contributing to increased client costs (Attachment III). These will form the basis of further work on harmonization.

Box 7: Procurement Sector Board Response to Client Feedback

General response: The Board agreed that most of the concerns and issues raised by clients were valid and identified the following actions to be taken:

(1). <u>Revising ex-ante thresholds</u>: Thresholds, based on country conditions (CPAR, if available) and the capacity assessment of the implementing agency, are set during the project design phase and are incorporated into legal agreement. *Proposed actions*: Review regional guidelines on thresholds to determine if they are in need of updating; (ii) Develop process with LEGOP to review thresholds during implementation based on performance, management reports and ex-post review.

(2). <u>Adherence to delegation implied in ex-ante limits</u>: Requests to review documents below the established thresholds for prior review come from the task team manager or from the clients. *Proposed actions*: With LEGOP, clarify policy to TTLs and provide advice on how to treat procurement documents from clients, that are below the established thresholds.

(3). <u>Reduce multiple "no objections" on procurement of TA (consulting services)</u>: The prior review process and the mandated thresholds are stated in the Guidelines. *Proposed actions:* Examine the prior review procedure to determine if the process can be simplified without sacrificing goals of the policy.

(4). <u>Increased delegation to Country Offices</u>: Delegation of fiduciary responsibilities to Country Offices requires the office to have qualified accredited staff. *Proposed actions:* Take fresh stock of decentralization plans and promote cost effective ways of providing access to qualified procurement staff. (e.g. Hub concept of SAR and AFR).

(5). <u>Slow pace of IT hardware and software procurement</u>: *Proposed actions for FY02*: (i)Issue new standard bidding documents, developed with input from the industry; (ii) Issue technical guidance notes and provide staff training.

(6).<u>Harmonization at the country level</u>: *Proposed actions in FY02*: (i) Identify countries and run pilots with multi-donor sector programs using CPAR as a tool; (ii) Expand work with OECD, donors and client countries to develop flexible standards and benchmarks for public procurement systems.

61. Regions have welcomed the systematic feedback from their clients as part of a Bank-wide process. They have made particular note of;

(i) The sharper articulation of client concerns regarding procurement and the call for greater decentralization;
(ii) The clearer messages from IBRD clients regarding the impact of application of safeguard policies on the PSI sector; and
(iii) Client views of the high cost of delays when combined with perceptions of increased risk aversion.

In addition to strengthening pipeline risk assessments and targeted upstream support (See Para 50 also), regions plan to enhance managerial support to team leaders to make balanced judgements, review regional processes to ensure timely attention to complex cases, and to enhance recognition to those staff who transparently manage risk and help clients produce high impacts. Regions strongly endorse a more vigorous implementation of the concept of building capacity by building on client capacity, and gradually delegating aspects of policy implementation to those client institutions that demonstrate capacity. This needs to be done systematically, as an orderly process based on progress made under agreed action programs. Regions plan to intensify these programs as much as possible and support them, as appropriate, through sector/country wide operations. Regions also take seriously the feedback on increased rule book mentality among staff, and beyond managerial support, they believe that role of institutional signals generated for example through internal audits and evaluations needs to be re-assessed.

B. Build Client Capacity by Building on Capacity to Enhance Benefits

62. All ten borrowers interviewed during the consultation process endorsed the principles and objectives of the Bank's safeguard and fiduciary policies. They felt strongly that ultimately, the commitment and capacity of borrowers to implement these policies will determine their effectiveness. Borrowers conceded that their capacity to apply these policies effectively was often quite limited and had grown more slowly than the demands of the policies. For example, many lack the requisite information systems to implement LACI or the PMR-based disbursement mechanisms. As of February 2001, only 22 projects were using PMR-based disbursement mechanism, or 5 percent of all projects approved since LACI was introduced, compared to a target of 60 percent of all projects.

63. Many borrowers have limited capacity to undertake environmental, social or poverty assessments (and typically entrust the task to foreign consultants to satisfy the Bank's requirements). Even in cases where borrower institutions have built capacity and applied safeguard processes along the lines of Bank policies, a number of consultation participants noted a continuing reluctance by the Bank to delegate any responsibility to, or in some cases even to engage, national institutions and, consequently, to reduce costs to clients.

64. Bank Group lending for training to build local capacity has remained constant at about $675 million per year, primarily to support specific project-related institutions. A few IDA credits for TA to environmental institutions are also under implementation. The Bank's experience in technical assistance lending has been disappointing. Countries are increasingly reluctant to borrow for capacity building. The principal reasons for failure are lack of borrower commitment, inadequate time allowed to bring about changes, inadequate professional expertise guiding the process and lack of perseverance. There has been some support to strengthen sector-wide or country-wide training for procurement management and financial management, such as in the Philippines, but client capacity building support in safeguard areas has been very modest. The Bank has also provided grant funding through the Institutional Development Fund (IDF), but overall such support has been inadequate both in volume and in scope. Over the last 7 years, the IDF has financed $22 million mainly for strengthening fiduciary systems. World Bank Institute (WBI) conducts almost no training of member country specialists in safeguard policies in environment and social development or financial management.

65. Further innovations, under current policies, are possible. It is time to consider alternative approaches to capacity building. Rather than building technical assistance primarily into investment projects alone, capacity building for fiduciary and safeguard management needs to become a program fully driven by and integrated into country assistance strategies. The Bank would collaborate with other donors to carry out country assessments, and design and delivery of capacity building program. The capacity building program would be phased in time and in scope. The Bank in turn would increase its focus on monitoring the ex-post results and achievements of policy goals with the explicit purpose of delegating responsibility for policy implementation increasingly to client agencies that meet the requisite standards. The process of delegation would consist of four principal elements:

- **Country capacity assessment**—expanding current assessments for procurement (CPARs) and financial management (CFAAs), and initiating similar assessments of safeguard capacity;
- **Capacity building**—initiating a pilot program for capacity building based on the assessments;

Box 8: Capacity Building by Building on Capacity

The Case of USAID in Financial Management

High quality and timely audits play a critical role in assuring sound financial management. Development institutions often find themselves trying to achieve a balance between assuring high quality audits on projects financed by them and on building capacity of national institutions to scale-up the impact of their assistance.

The Bank, through its CFAA process, has recently evaluated the structure and capacity of a number of SAIs, and has found that they generally lack sufficient expertise (or independence) to adequately fulfill their fiduciary mandates. The Bank has developed program of assistance with some SAIs, often funded through IDF to help improve their performance.

As a leader in this field, USAID approach has some interesting features. It has not pre-qualified any of the SAIs to undertake audit work in the countries where USAID operates due to quality concerns. It has, however, signed Memoranda of Understanding with 17 SAIs that allow those institutions to conduct audits on USAID financed projects subject to the supervision by USAID, while pursuing agreed-upon developmental reforms. This approach allows USAID to simultaneously assist SAIs in their development, building on capacity that exists and developing the capacity further by working with them, while still ensuring that competent project audits are conducted and high international standards are maintained.

Source: FM Sector Board

- **Delegation**—Entrusting greater responsibility and accountability over time to client agencies for specific aspects of policy implementation, based on demonstrated competence, under gradually diminishing Bank supervision; and
- **Monitoring and evaluation**—Monitoring the actual achievement of policy goals and client performance periodically against the agreed standards.

Box 9: Alternative Approach to Capacity Building

The ultimate objective of development is to ensure countries have the capacity to manage their own development agenda effectively and efficiently. And yet the Bank's experience with capacity building has not been encouraging. Its high reliance on technical assistance and "ring-fenced" project units has not been replicable. The Task Force found several examples of Bank interventions which have taken a different approach and been more successful in helping clients build strong institutional capacity on safeguards and fiduciary management.

In **Poland**, for example, the Bank's ten-year involvement with other donors has helped create a national environmental agency that is capable of helping the country meet standards for accession to the European Union. In **India**, the Bank has worked systematically at the national, state and local level to help develop capacity for managing involuntary resettlement and finding local solutions to complex problems. It is increasingly relying on these institutions for policy implementation.

In **West Africa**, the Bank is participating in a multi-year, multi-donor effort to reform and harmonize public procurement practices in the eight countries of the West African Economic and Monetary Union. In **Indonesia**, the Cirata Hydroelectric Power Project is the latest in a series of projects where the Bank has helped the power utility build a first-rate environmental management function capable of independent oversight and control, which the Bank increasingly relies upon.

To move from a project-specific orientation to sector-wide approaches to safeguard and fiduciary management, would produce major benefits. Such a process would assess a country's capacity in key sectors to carry out public procurement, financial reporting or environmental protection, in accordance with Bank agreed goals and standards. Borrowers would increasingly use their own national systems rather than Bank-specified requirements where they had demonstrated full capacity. Newer operations (such as Eritrea for environmental protection) are carrying the concept further.

C. Scale-up Development Impact of Current Policies Through Continued Innovation

66. Several borrowers urged the Bank to strengthen a process that would systematically help raise the overall national standards commensurate with their own capacity and financial means. This ultimately would result in the broader application of good safeguard and fiduciary practices, and significantly increase their benefits. The major challenge is to increase the development impact and cost-effectiveness of these policies by moving beyond safeguarding the expenditures associated with Bank financing, to supporting systemic improvements in Borrowers' institutions. Some current Bank policies, such as procurement and environment, recognize this potential. The EA policy promotes the use of strategic sector wide environmental assessments, and the procurement policy calls for review of ex-ante review limits based on client demonstrated capacity and assessment through CPARs which enhance the impact and thus the benefit/cost relationship of these policies. Under current policies, many innovations have taken place (See Box 10 below).

Box 10: The Importance of Being Macro: A Country/Sector Focus Works Better

Case studies provide evidence of the value of moving beyond "ring-fenced" implementation of safeguard and fiduciary policies to a country or sector level, to achieve a wider and more durable impact.

The India Infrastructure Lending and Financial Services Project adopted an umbrella policy framework consistent with Bank requirements and created capacity to design and monitor safeguard activities within the project. This minimized the need for Bank involvement in every investment financed by the project. The Bank no longer carries out ex-ante reviews of EAPs and RAPs but relies on ex-post audits. The impact of Bank support is enhanced since the framework now applies to all activities in the sub-sector. In **UP Transport Project**, the Government has adopted a resettlement policy that not only applies to the Bank financed project but extends it to all road sector activities in the state enhancing the impact of Bank assistance.

Bolivia: Education Reform Project. Bolivia CDF programs faced difficult issues in the procurement area with little enthusiasm initially for the rigor of Bank's procurement policies. However, serious work to examine the national requirements against the benefits of applying Bank policies, led to the development of a customized solution meeting the needs of the Bank and the client. The decentralized procurement support system has proven useful, capacity building is taking place and counterparts find value in using the agreed harmonized processes. The effort is expensive in terms of staff time and takes time and patience but is considered by the CDF team to be of value because of its sector wide impact.

Bogota Urban Transport Project faced an initial resistance to the Bank's resettlement policy, but the Bogota Municipality was able to use the framework of the 1995 National Law which permitted compensation for land acquisition at commercial rates to harmonize with the Bank's policies. Thereafter implementation proceeded smoothly and led the client to establish a systematic process and build capacity to manage resettlement issues for all future infrastructure work in the municipality, significantly enhancing the development impact of Bank's support. The effort took time and patience but then had a significant multiplier effect.

In AFR, the Bank is supporting a number of sector investment programs, with donors supporting the Governments' overall sector expenditure program. Assurance on the use of all donor funds comes from the review of overall procurement and financial management arrangements in these programs. The Bank's current policies do not allow full Bank participation in such arrangements, though the Bank is supporting the overall sector-wide or national systems.

The CASs of the clients consulted include nearly15-40% of future lending in the form of operations which are sector or state wide. In addition to the implementation challenges posed when working sector wide, these operations also face a special challenge to effectively meet the Bank's fiduciary and safeguard requirements developed for ring-fenced operations. At the same time, these new styles operations also offer an opportunity to enhance the benefit/cost relationships of these policies. By engaging core national fiduciary and safeguard institutions and working with mainline sector institutions and national processes, the Bank can significantly help scale up the impact of these policies. However, not all cases of such sector-wide operations are suited for or need to carry the additional burden of scaling-up safeguard impacts. A judicious choice must be made.

67. The Bank should continue to innovate as it has done so far on assisting countries to apply key principles and good practices in their overall development program. As innovation continues, the current policies developed for ring-fenced projects which are not ideal for sector-wide operations, would need to be modified to reflect the scaled-up vision, by emphasizing the following:

(i) **an integrated approach**, creating an umbrella safeguard process where the environmental and social impacts are considered together rather than as separate policies and processes;

(ii) **partnership,** where lending agencies and borrowers consider new policy development in a harmonized fashion, consistent with good international and national practice;

(iii) a **focus on goals, principles and processes,** where the policies would articulate fundamental goals and general principles to be honored and key processes for ensuring their application and support;

(iv) a **countrywide or sectoral approach,** where the emphasis will be on capacity building for an entire country/sector; and

(v) **an approach focused on upstream assessment and downstream monitoring,** where early assessment of risks and mitigation options and vigorous monitoring of implementation activities complements well-engineered mitigation plans.

D. Adopt a Two-Pronged Approach to Policy Harmonization

68. The consultation process generated two new perspectives and recommendations on effective policy harmonization. First, there were several examples where harmonization among donors had been very successful at the country or provincial level. The state of Kerala in India indicated that it had taken the initiative and achieved a measure of success to have all major donors—bilateral and multilateral—agree to common reporting and auditing requirements for co-financed operations. In Brazil, where the national and provincial systems are well harmonized, the national government has identified the three areas where their procurement practices of the Bank and IDB differ.[6] They believe that working together at the country level to resolve these differences would be clearly easier to harmonize between two MDBs in a specific country than among five MDBs globally. It does not suggest a dilution of goals or proliferation of policies, as it would allow application of specific requirements to differing circumstances, as currently permitted under most policies (such as the Procurement Guidelines). The view from the clients was that while harmonization at the global level should continue, the process of finding common ground should be intensified at the country level.

69. Secondly, most borrowers felt that ultimately the most effective harmonization will be to align national policies with good international practice. The major conflict today between borrowers and lenders takes place where national laws and regulations are different than those required by the Banks. Borrowers accept the higher standards on individual projects in order to obtain financial support, and this may lead to higher national standards over time. But it often means the borrowers revert to a different standard once the loan is fully disbursed and face extra costs and effort applying different processes.

70. Harmonizing policies and procedures among donor agencies represents an opportunity to establish agreed standards among lenders and borrowers and to save borrowers significant money in the application of the policies. The Development Committee in April 2001 highlighted the need to accelerate the process of MDB harmonization on

[6] These are: acceptance of Portuguese as a language, use of law 8666 for NCB, and somewhat different thresholds for ex-ante clearance of TA contracts.

procurement, financial management and reporting, and environmental assessment taking into account national policies. In the past few years, progress has been made on developing standardized bidding documents. Environmental assessment processes are also broadly comparable. However, progress has often been rather slow. Not all donors have equally seen the value of harmonization of policies, particularly as it is sometimes perceived as meaning "do it in the Bank's way." But it is also fair to say that circumstances in the countries served by different MDBs and/or bilaterals are often very different, and finding common ground among all five institutions is inherently difficult.

71. A two pronged approach to policy harmonization would (i) continue the ongoing inter-MDB/DAC effort; and (ii) would add an additional country-up dimension linked to the same overall process. Up to four specific client countries may be invited to volunteer in the first year; they could identify with the MDBs/bilaterals one of the four policies to the attention of managements of the institutions concerned for resolution they wish to work on. The Bank and the concerned MDBs would start a bottom-up process, anchored in their Country programs. Key differences in policy goals and major process essential to achieve the goals which remain after staff level efforts would be brought to the attention of the managements of both institutions for resolution. Agreed good practices or country specific processes would be developed by the client for its own use, and shared with the MDBs/bilaterals, to implement agreed policy.

V. Summary of Recommendations

72. To summarize, the principal recommendations of the Cost of Doing Business task force, and current status of their implementation, are:

- **Continue Reforming Current Policies and Procedures.** (i) implement the simplification and rationalization of the LACI financial reporting and disbursement systems; (ii) introduce risk-based and single audit approach in order to strengthen the quality of fiduciary assurance while reducing fragmentation, duplication and delay; (iii) complete the conversion of the safeguard policies on resettlement, indigenous peoples and physical cultural resources to remove ambiguities and permit case specific solutions to achieve policy goals; (iv) revisit Bank's procurement practices, especially related to procurement of IT and review of consultant contract "no objection" procedures and (v) pursue enhanced delegation of authority to strengthen field offices. (See Para 38-48)

(The OPC has reviewed proposals from the FM Board to streamline LACI which is to be rolled out starting FY02; the FM Board is reviewing the current audit system to identify ways in which it may be possible to eliminate fragmentation and duplication, reduce cost, and improve the overall level of assurance received by the Bank on the use of its funds. CODE has reviewed the proposed clarification in social policies and steps are underway to complete external consultations and codify changes in FY02; the procurement board has developed an action plan to review and develop suitable responses to client concerns; and institutionally led effort is underway to develop by January 2002 the next step of functional decentralization. Further progress will continue to be monitored).

- **Strengthen Internal Processes.** Clarify accountability for high risk operations, providing one-stop authoritative policy interpretations, clarify decision process for making judgments in application of policy requirements; and integrate all safeguard policy applications into a single risk assessment process under the umbrella of the environmental assessment. (See Para 49)

(A Bank wide safeguard process harmonization effort has been underway since July 2000; it includes pipeline risk assessments, joint RVP/NVP accountability for high risk tasks, structural harmonization across regions for safeguard functions; a one stop shop for authoritative policy interpretations and a helpdesk. The safeguard system is now being reviewed by IAD to further adjust and strengthen, as needed).

- **Enhance Bank Capacity to Ensure Continuing Compliance.** Provide adequate budgets for lending and supervision tasks to ensure the Bank can carry out its due diligence functions fully, including full cost of all policy revisions and intensify program of staff training and client capacity building in fiduciary and safeguards systems. (See Para 50-53)

(The FY02 budget aims to increase overall lending and supervision coefficients by 9% and 4% respectively, provides special resources for increased capacity building and staff training and funds sector boards/legal department to provide high quality timely support in policy interpretation. Actual delivery of these resources to fiduciary and safeguard work for high risk tasks, is through a process of pipeline risk assessment. This aspect will be monitored closely)

- **Reduce delays by Moving Safeguard Assessments "Upstream."** Initiate assessments of environmental and social impacts at the earliest possible time in project processing; provide funds for upstream safeguard work for high risk operations, especially in the PSI sector. (See Para 54)

(Initial FY02 budget allocations in the Regions indicate a continued adherence to pipeline risk assessments combined with "off-the-top" incremental allocations for "up- stream" safeguard work on high risk operations. The regional process for pipeline fiduciary and safeguard risk assessments needs to be harmonized into a Bank-wide process in FY02. Further work on reducing factors contributing to delays is needed).

- **Help Build Client Capacity to Manage Policy Implementation.** Launch a pilot program to help build borrower capacity for progressively managing specific aspects of safeguard and fiduciary responsibilities—Bank to help assess current capacity, help strengthen capacity by delegating specific aspects to national agencies with demonstrated competence, and monitor policy outcomes. (See Para 62-65)

(The fiduciary Sector Boards are encouraging an increase in the numbers of CPARs and CFAAs to assess capacity and as justified to raise thresholds for prior review. The safeguard Boards are developing a customized capacity building pilot program with WBI, with the objective to help clients who demonstrate capacity to undertake more policy implementation work under Bank supervision. During the client consultation phase, some countries came forward to work on these ideas with the Bank.)

- **Scale-up development impact of these policies through continued innovation, and codify such practices into future policy.** Further encourage and support on-going innovation; move systematically from ring-fenced project-based compliance to support systematic improvements in borrower's institutions, while maintaining agreed policy goals. (See Para 66-67)

(Concerned Sector Boards need to take stock of these innovations and to promote these concepts through their quality support functions and training programs; lessons of experience need to be studied with a view to develop a process to codify the more successful practices into future policy statements.)

- **Deepen the Process of Policy Harmonization.** (i) Intensify the on-going effort to develop common policies and standards, at the level of international good practice, among MDBs at the "macro" (global) level for procurement, financial reporting and environmental assessment; and (ii) launch pilot efforts for "micro" harmonization among MDBs and with national policies at the country level, one policy at a time. (See Para 68-71)

(During the client consultation phase, a number of countries volunteered to be included among the early pilots for a "bottom-up" harmonization effort. These countries are being considered for inclusion in a pilot effort led by the relevant Sector Boards, to complement the ongoing "macro" policy harmonization effort.)

73. While many elements of the proposed agenda are moving forward as indicated above, the overall direction of change is complex, including the way the Bank relates to its borrowers in these areas. Specifically, it calls upon the Bank's managers to (i) encourage balanced judgments, (ii) reward high impact activities where risks have been carefully assessed and managed, (iii) invest explicitly and early in risk assessments, public participation and consideration of design alternatives, and (iv) make timely decisions that will maximize development impact. Both clients and Bank staff endorse the concept of building capacity and delegating aspects of policy implementation to borrowers that demonstrate capacity. The challenge is to move systematically with specific programs that help build permanent capacity. It is an agenda that will only be realized with perseverance, flexible instruments and resources. But it is the only way forward if the Bank's fiduciary and safeguard policies are to become what borrowers expect them to be—instruments of sustainable and effective development.

ATTACHMENT I

List of Case Studies

	Project
Environment	Ethiopia: Gilgel Gibe Power (Energy II) *Lesotho: Highland Water* Indonesia: Water Resources SAL Indonesia: Cirata II Hydro Power Indonesia: West Java and Jakarta Poland: Hard Coal SECAL Turkey: Water Supply Brazil: Gas Sector Dev. Mexico: Disaster Management Djibouti: International Rd Corridor Tunisia: Education WBG: Solid Waste & Env. Mgmt Bhutan: Rural Access Road India: IL & FS Infras. Financing
Social Development	Senegal: Transport II China: Qinba Mts. Pverty Red. China: Chongqing Urban Environment Vietnam: Agricultural Diversification Indonesia: Cirata II Hydro Power Brazil: Gas Sector Dev. Columbia: Bogata Transport Jordan: Amman Ring Road Lebanon: Beirut Urban Transport Tunisia: ASIL II India: IL & FS Infras. Financing India: Coal Sector Env. & Social Mit. Pakistan: Gazi-Barotha Hydropower
Financial Management	Chad: Public Works & Cap Building Lesotho: Highland Water Senegal: Integr. Health S. Dev Cambodia: Forestry Concession Mgmt Indonesia: Cirata II Hydro Power Romania: Fin. Systems Modernization Slovenia: LACI Requirements Tajikistan: Farm & Privatization Supp. Argentina: Integr. Drug Preven. Pilot Guyana "El Nino" Algeria: Emergency Reconstruction Pakistan: Social Action Program II
Procurement	Chad: Public Works & Cap Building Lesotho: Highland Water Senegal: Integr. Health S. Dev Indonesia: Cirata II Hydro Power Moldovia: PSD I Russia: Highway Rehab & Main. Argentina: Provincial Health Sec. Dev. Bolivia: Education Reform Brazil: Salvador Urban Transport Djibouti: International Rd Corridor Pakistan: Family Health II Pakistan: Social Action Program II

SUMMARY OF COUNTRY CONSULTATIONS

Country	General Conclusions	Safeguard Policies	Fiduciary Policies		Policy	The Way Forward
			Procurement & FM	LACI	Harmonization	
Philippines	• Goals and principles endorsed. • Recognize uniqueness in every country and apply policies appropriately. • Implementation a serious problem—policies poorly understood, rigidly enforced, some unrealistic. • Building national capacity would enhance compliance. • Volume of lending affected by portfolio issues, not policies.	• Resettlement norms problematic (i) should allow cash compensation, (ii) "rewarding" squatters violates national laws, (iii) compensation levels too high, (iv) interpretation unyielding and rigid. • Environmental assessment process well understood and generally applied. • Subic Bay project: 1st time special treatment of Indigenous people due to Bank policies	• Procurement guidelines have resulted in savings when applied flexibly. (60% in case procurement of books) • Bank providing training on procurement.	• LACI objectives and structures applauded, but rules very problematic and unlikely to lead to PMR based disbursements .	• Joint portfolio reviews with JBIC and ADB working effectively. • Harmonization works better when country driven.	• Restore common sense and judgment to policy application. • Examine positive experience in sector-wide training in fiduciary policies as model for "certification". • Adopt integrated, early safeguard risk assessments.
India	• Goals and principles endorsed. • Lending not affected by these policies but may affect composition. • Implementation often problematic. • Need harmonization between states and federal level.	• Some ministries (national highways) adopting Bank approaches sector-wide. • Policies have strengthened national capacity on resettlement. • Implementation often too rigid, risk-averse, conflicts with	• Procurement guidelines applauded (have saved money). • Need to respect national competence—raise thresholds, reduce reviews. • Review experience requirements for bidders to	• LACI principles okay but reporting requirements rigid. • PMR-based disbursement s too complex in federal system.	• World Bank policies are de facto harmonized with other donors because they mostly adopt WB standard. • There has been harmonization on procurement with ADB, but still very different from GOI.	• Integrate more with national approaches and standards. • Awareness raising: organize workshops for PIUs and oversight agencies. • Integrated and early risk assessments valuable.

Country	General Conclusions	Safeguard Policies	Fiduciary Policies		Policy	The Way Forward
			Procurement & FM	LACI	Harmonization	
	• Bank in danger of exclusion from certain sectors if policies too rigid, including power, water resources, transport.	national laws. • Pollution Handbook treated as law rather than guideline.	reduce discrimination against local firms and NGOs.		• Good harmonization experience in Kerala suggests value of borrower-driven processes.	• Make LACI voluntary • Experiment with sector wide capacity building and certification over time.
China	• Goals and principles endorsed • Application often problematic • Bank now too risk averse • Bank financial costs are high and delays are an issue. • Bank risks exclusion from important sectors. • Should respect local capacity more.	• Chinese standards often stricter. • Key problem is implementation. • Resettlement compensation system is troublesome. • Squatters provisions violate national law. • WCD recommendations not feasible.	• Procurement dominated discussions. • Four generic issues: (i) lowest bidder often incapable (ii) guidelines not suitable for IT/software (iii) excessive use of foreign consultants • (iv) delays are costly. • Bank process involves 50-60% gain over traditional processes	• LACI rejected but alternative reporting system agreed, closely aligned to national system	• Should harmonize first with national standards. • Hierarchy of preference—local funds, JBIC, ADB and World Bank as last resort.	• Bank should review its overall policies in new era—human rights, role of government, minority vs. majority rights. • Focus on development first, not the means. • Regain balance and courage to do right thing. • Developing borrower capacity best safeguard.

Country	General Conclusions	Safeguard Policies	Fiduciary Policies		Policy	The Way Forward
			Procurement & FM	LACI	Harmonization	
Russia	• Principles endorsed. • Bank projects often the difference between good practice and no applications. • Unilateral changes in policies cause of strain.	• Environment standards strict but not applied. • No other safeguards mentioned. • Bank process preserves EA standards in absence of EPA.	• Guidelines useful but Bank should analyze real cost savings. • Guidelines not suited to new age products—IT/software. • Selection process for consultants also outdated-neglects value of relationships. • Use annual audit for all review, such as ex-post procurement reviews.	• LACI principles applauded, but application too rigid.	• Harmonization should be with national policies based on analysis of current standards, Bank requirements and good international practice.	• Harmonize national/Bank/EU standards. • Review procurement guidelines in some areas. • Integrate all audit requirements into single process. • Revisit policy against financing taxes. • Think more strategically where knowledge is the asset and comparative advantage.
Romania	• Goals and principles endorsed and benefits perceived. • No major controversies or conflicts. • Issues are more in the application and interpretation. • GOR staff seek access to greater opportunities for training.	• Limited experience with social and environmental safeguards. No major issues. • GOR staff request early identification of safeguards in project cycle.	• GOR staff perceive less flexibility in application of procurement guidelines than guidelines actually allow. • Bank procurement staff turnover and processing delays are issues.	• LACI gets a mixed review.	• Not a major issue in Romania.	• Capacity development is a clear priority for GOR. • Specific training on fiduciary and safeguards requested. • CFAA and CPAR seen as opening up prospects for system-wide approaches by the Bank, which are welcome.

Country	General Conclusions	Safeguard Policies	Fiduciary Policies		Policy	The Way Forward
			Procurement & FM	LACI	Harmonization	
Yemen	• Goals and principles endorsed. • Policies have raised local standards. • Bank should raise awareness at senior political level. • As IDA-only country, benefits of Bank relationship clearly outweigh perceived costs.	• Only country raising concern that Bank should implement physical and cultural resources policy systematically.	• Guidelines commended. • Request for quicker processing of consultant selection.	• LACI applauded and applied on eight projects, the most in the world (no existing reporting systems which needed to be altered).	• Endorsed stronger harmonization among multiple donors, especially on reporting	• Continue to apply fiduciary and safeguard policies. • Ensure adoption of cultural resources OP. • Safeguard risk assessments should be carried out early and as an integrated process. • Raise awareness of policy value with political level.
Mozambique	• Fundamental goals supported; increasing transparency, added competition assuring that resources are spent as intended, efficiently and effectively. • Bank's rigor helps establish and raise national norms • Bank faces a serious internal challenge due to risk aversion and in improving the implementation. • Ensure increased continuity and timely access to Team Leaders. • Need fuller delegation to the Country Office.	• No personal experience of any social development policy. • Believe that (i) EA (and beneficiary assessments) favorably impact project design if applied early in the cycle; (ii) that sector wide EAs can be useful.	• Strong concerns over (i) rigidity in process steps: (ii) slow pace of pre-contract work due to multiple clearances; (iii) inadequate application of judgements re non-price factors and small size of the local market.	• Policies impose high costs of special skills and experts to be deployed. • LACI requirements on the other hand are too rigid, complex and need a review.	• Goals are similar, though Bank demands are most rigorous. • Concerned that harmonization among donors, without first harmonizing with national policies could lead to greater rigidity.	• Ensure that sector-wide lending operations are ready for the requirements of these policies. • Bank needs to make special sector-wide arrangements to achieve a high level of fiduciary assurance. • Mutual growth process is needed: Bank helps build the capacity on a sector wide basis and increases reliance on national institutions to undertake policy

Country	General Conclusions	Safeguard Policies	Fiduciary Policies		Policy	The Way Forward
			Procurement & FM	LACI	Harmonization	
						implementation.
Tanzania	• The goals are laudable and consistent with national goals and policy objectives. • Processes developed under Bank financed activities are voluntarily being extended to overall. operations of Government. • By its high standards of policy implementation Bank contributes to overall improved development environment. • While policy implementation has its frustrations, the Bank is considered a most valuable development partner. • Many of the costs are in the form of delays. • Real limit to how much costs of doing business with the Bank can be reduced. • There is scope to multiply the impact of the Bank's policies and its effective implementation.	• Safeguard policies are seen to have helped improve design of specific operations when applied early in the project cycle (Water Sector). • Compensation requirements which far exceed normal government policy/capacity. • Set of impacted people receives the high level of compensation demanded by Bank policy than most others.	• The major gain is better use of development resources through competitive and thus lower prices and increased transparency • Concern expressed (i) Credit Agreements do not offer the same flexibility as the guidelines. (ii) Bank gets involved in procurement decisions below agreed thresholds (iii) Multiple clearances needed at all stages of procurement (iv) Failure to differentiate those institutions with higher capacity; (v) Rigidity about certain rules which do not contribute to goals (vi) Slow pace of overall procurement of TA and IT equipment.	• Rigid and not too useful LACI requirements • Only one project has so far accepted LACI for disbursements • Why cannot the Bank accept PMRs generated through clients own systems? • Why should the Bank aim to apply PMR to commercial institutions which have sound financial management.	• Harmonization would help reduce cost and enhance impact. • Increased decentralization to MDB's country offices would help. • Bank is supporting a capacity building effort with the Auditor General • Undertaking a single institutional audit process would reduce cost not quality.	• The Bank's role and that of the Government be more distinctly defined. • Sector wide and programmatic operations need fiduciary and safeguard framework on a sectoral or national basis. • New approach would involve (i) stocktaking of national policies and systems (ii) Integrating national and Bank policies (iii) Tanzania specific processes and procedures which best achieve goals. (iv) Delegation of policy implemen-tation to sectors institutions who build the necessary capacity. (v) Bank support capacity building and monitor achievement of goals.

Country	General Conclusions	Safeguard Policies	Fiduciary Policies		Policy	The Way Forward
			Procurement & FM	LACI	Harmonization	
Argentina	• The Bank's overall program brings considerable value. • The demand for the Bank's support is strong and far exceeds available program resources. • The primary concern is the need to sustain the collaborative effort over time. • An enhanced tendency to risk-aversion and rules-orientation by Bank staff. • The fundamental goals of these policies seen to be fully in line with Argentina's objectives. • There are special needs of the federal-provincial structures. • Bank lending is impacted in its composition but not in overall volume by these policies.	• Clear and demonstrated gain from Bank policies, whose goals are consistent with national objectives. • Problems emerge when done late in the project cycle if actions are seen as an "imposition" of the Bank. • Resettlement policy has been mixed; while goals are consistent with national objectives, actual implementation has suffered from (i) changes in compensation policy; (ii) treatment of squatters; (iii) presence of multiple compensation regimes; (iv) Bank's approach to bypassing national governments in public consultations.	• Bank's procurement policies and procedures provide a much needed operating framework. • Price advantages from Bank procedures were quoted in the above 10-20% range. • CFAA has favorably impacted national system.	• Bank policies are consistent with national goals and policies. • Cost of audit function can be reduced yet quality maintained by eliminating multiple project audits. • No project in Argentina has adopted LACI. LACI judged to be largely inapplicable.	• Lack of internal harmonization with Bank policies and procedures leads to longer decision time. • There is a need to reduce the need for multiple no-objections at different stages. • Harmonization with MDBs would inevitably lead to reduced cost. • Better harmonization of national, provincial and Bank processes is needed. • IDB needs to catch up with the Bank's effort on audit system. • Bank is more demanding in up-front requirements and more persistent in application of its policies.	• Focus at the up-stream stage of operation. • More flexibility in the process/procedures aspects of implementation of policies is necessary. • Bank should pay more attention to results and outcomes. • Increasing focus to sector-wide assessments, with special attention to harmonization of provincial and national approaches. • Progressive capacity building is needed. • Bank should delegate more of the policy implementation to well trained units, while monitoring and holding them accountable for achieving the fundamental goals.

Country	General Conclusions	Safeguard Policies	Fiduciary Policies		Policy Harmonization	The Way Forward
			Procurement & FM	LACI		
Brazil	• Brazil values development partnership for its impact on strategy, and quality of program execution. • Overall borrowing level is not impacted, but composition is impacted. • Bank is the less-preferred lender in infrastructure and natural resources development due to these policies. • Risk-aversion and rule book mentality among team leaders is more evident. • Team Leader continuity and decentralization of authority to Country Office most desirable.	• National policies and goals are fully consistent with the Bank. • There are real examples of benefits despite high costs of participation provisions. (PNMA-I project had 50% cost reduction). • There is 'pain everywhere' due to rigidity in application, irrespective of size of impact or nature of operation. • Most issues concern resettlement, on account of different compensation regimes and the Bank's insistence that income restoration be done a in project framework despite better opportunities elsewhere. • Bank is ahead of others in implementation of safeguard requirements.	• National goals are consistent with Bank policies and goals. • Costs of policy implementation can be reduced. • Key cost drivers are (i) low limits and multiple clearance for TA projects, (ii) rigid procurement planning even for TA & LILs. • Delays are due to inadequate decentralization to Country Office. • Bank is more costly to client than IDB.	• National goals and objectives are consistent with Bank. • Benefits are transparency, better cost control and improved project monitoring. • LACI has rigidities and needs more skilled people. • SIAFI system needs to be harmonized with LACI. • PMR based disbursements into special accounts in foreign currency cause special problems due to exchange rate risks.	• Concept is strongly supported. • LACI harmonization with SIAFI to be in coordination with IDB. • Bank documents for works and goods form a good basis to pursue harmonization. • IDB is more harmonized with national systems: (i) IDB accepts Brazil's Law 8666 for national procurement; (ii) IDB accepts Portuguese language for ICB/RFPs; (iii) IDB/Bank have different limits for TA. • IDB is more decentralized in procurement decision making.	• Bank should focus more on goals and monitoring the results. • Bank/Client should work `together to learn and ensure that policies are applied cost effectively in given local reality. • Bank should support client capacity building and rely on strong national institutions to handle policy implementation. • Achieve full harmonization of national/state/IDB policies and procedures for Brazil.

ATTACHMENT III

ANALYSIS OF COST DRIVERS IN PROCUREMENT POLICIES AND PRACTICES: COMPARISON AMONG MDBs AND TWO COUNTRIES

A cost driver is defined as (i) an issue which significantly affects MDB administrative costs or (ii) an issue whose different treatment among MDBs significantly affects clients administrative costs.

Cost Driver	IBRD/IDA	Other RDBs	Brazil	India
Mandatory use of standard documentation for ICB (e.g. pre-qualification, standard bidding documents, and standard request for proposals for consultants selection)	Mandatory use	Each MDB specifies the use of its own standard bidding documents (SBDs). However, in practice IBRD has the most complete suite of SBDs, which is generally seen as an advantage for Borrowers. Recently, MDBs have agreed on harmonized standard bidding documents for goods and are working on documents for civil works (pre-qualification) and consultants (request for proposals).	In this aspect IBRD has an advantage, as it has a more complete set of SBDs than IDB. We also have an Standard document agreed with the Government for NCB for (goods, and works), and for local selection of consultants. This also reduces time and cost. Harmonization among the two MDBs should be pursued.	IBRD has an advantage, as it has a more complete set of SBDs than ADB. IBRD has agreed on SBDs for NCB for all Bank financed projects. Further Government of India uses Bank style documents for its own procurement.
Language of bidding documents	English, French, or Spanish. Contracts with local firms may be in local languages	Each MDB has differing requirements. AfDB permits English and French. AsDB requires English. EBRD and IDB permit only their own 4 working languages although EBRD may allow client to choose to use a local language.	IDB: bidding documents for ICB and NCB are issued in Portuguese which is an official language of IDB, and bidders have to bid in Portuguese. Although this is seem as favorable by the borrower, it is not favored by foreign bidders, and therefore is detrimental to international competition under ICB. IBRD: Portuguese is mandatory for NCB, but is not allowed for ICB. The Bank has allowed the Borrower to issue a translation in Portuguese of the bidding	This not a problem in India as English is used for all ICBs. Even in NCBs by and large borrowers are using English.

Cost Driver	IBRD/IDA	Other RDBs	Brazil	India
			documents issued in English, and local bidders are permitted to submit their bid in Portuguese. The Borrower still has to prepare the Bid evaluation report in English.	
Threshold between ICB and NCB	No fixed thresholds specified in guidelines. Established in Legal Agreement on case-by-case basis according to given guidelines criteria.	Most MDBs determine this threshold on a case-by-case basis. However, there is scope to standardize the criteria used to establish this threshold in order to ensure that staff exercise this discretion consistently across MDBs – especially in co-financed operations. In addition, EBRD and IDB specify *monetary* thresholds above which ICB is mandatory.	Co-ordination with IDB on co-financed projects is necessary to adopt the same thresholds.	Co-ordination with ADB on co-financed projects is necessary to adopt the same thresholds.
MDB acceptance of local procurement systems in NCB	Bank must determine if local procurement system and procedures are acceptable, and may require specific waivers from non-acceptable provisions.	All MDBs require that they approve ex-ante the local procurement system if NCB is to be used. However, there is scope to standardize the criteria used to evaluate and approve these systems across MDBs.	IBRD does not accept all provisions of the local regulations for NCB, which the IDB does. However, agencies complain that applying the local law takes more time than under IBRD required waivers to the local regulations. Harmonization among the two MDBs should be pursued actively to reach agreement on the applicability (or requirement for waiver) of local regulations for NCB.	Not a problem in India. IBRD requests waivers from national procedures for provisions which it considers unacceptable (such as negotiating contract prices and provisions subsequent to competitive bidding). ADB has similar requirements and full harmonization should be achieved.
Requirement of 'prior review' of procurement process by MDBs	Mandatory for contracts above specified dollar thresholds for advertising, pre-qualification, bid documents,	All MDBs have 'prior review' requirements. However, there is scope to standardize the process of these reviews across MDBs, including the setting of thresholds – especially in co-financed operations – to ensure that these reviews are conducted consistently across MDBs.	IDB and IBRD should harmonize their thresholds when dealing with the same executing agencies	ADB and IBRD should systematically harmonize their thresholds when dealing with the same executing agencies. MOH requested that the threshold for prior review be increased to

Cost Driver	IBRD/IDA	Other RDBs	Brazil	India
	bid evaluation, draft contract (for consultants only), and modifications over 15% of contract price			reduce delays in procurement. Threshold for prior review do reflect the capability of the implementing agency. The cause for delays is not the prior review in itself, but rather that the prior review shows inadequacies in the bidding documents or bid evaluations, which leads to revisions by the borrower. If such prior reviews were eliminated, the inadequacies would be caught during post reviews with a higher cost to the borrower. Thresholds may have to be modified upwards or downwards during implementation, based on proven capacity of Executing Agencies. This is a policy issue to be tackled. Executing agencies with strong capacity (i.e. NTPC) are subject to very little prior reviews
Decentralized procurement review process	Relatively centralized process. Regional procurement advisers located in Washington HQ. Delegation of fiduciary responsibility to Country Offices is possible subject to certain condition, especially	IDB in particular has a distinct advantage in relying on country offices to make procurement (and more generally project supervision) decisions at the local level.	IDB has fully decentralized its supervision work to field offices, which is seen as a considerable advantage by the Borrower for IDB over the IBRD, which is far less decentralized. Although IBRD has delegated fiduciary responsibility for procurement reviews and no-objections below RPA thresholds to procurement specialists in the Country Office, as most Task Leader are not based in the field, interaction with them still requires additional time over that of the IDB processes.	IBRD has its strongest country office in India, and is in an ideal position to provide the best possible service to the executing agencies. Monitoring of turn around time will be actively pursued.

Cost Driver	IBRD/IDA	Other RDBs	Brazil	India
	adequate staffing of the CO.			
Margins of preference (e.g. domestic preferences, regional preferences) for goods, works and consultants	Domestic Goods: 15% Domestic Contractors: 7.5% for recipients below a specified GDP	Preference levels vary across RDBs – some higher and some lower than IBRD/IDA Some RDBs have preferences for *regional* work and *regional* goods also Only EBRD does not maintain any preferences This issue is politically sensitive and will require resolution at the level of the Board	IBRD accepts domestic preference, not regional preference, whereas IDB accepts regional preferences. This is a POLICY issue that only the Boards of the two institutions can address.	Not an issue in India.
Eligibility criteria for nationality of bidders, suppliers, contractors, consultants, and for origin of goods and services, restricted to member or eligible countries.	Restricted to member countries though in practice this is not an issue given the almost global membership of IBRD/IDA (183 member countries).	Most RDBs have more limited membership than IBRD; only EBRD has no member country eligibility requirements	IBRD has an advantage over the IDB since nearly all countries are IBRD members, whereas IDB membership is more limited. This is a POLICY issue that only the Boards of the two institutions can address.	Same as for Brazil
Selection of consultants: Advert for Expression of Interest Pre-qualification of consulting firms Basis for evaluation (Price and quality, Quality only, other types of selection)	Required for contracts - $200,000 Not permitted Cost- and quality-based selection most commonly used. Other methods are prescribed or allowed in specific circumstances.	Most RDBs required advertisement Most MDBs require some form of pre-qualification and use different criteria to evaluate eligibility. There is scope to harmonize these criteria. The bases on which evaluations of proposals are conducted differ across MDBs and there is scope to harmonize these in order to ensure that consultants are evaluated consistently.	The IDB uses pre-qualification whereas IBRD does not. The IDB process is similar to that dictated by the Brazilian law, which facilitates their procedures. On the other hand, IBRD allows the use of price in the selection process, which is compatible with the Brazilian law, while the IDB is moving to this system only now.	Executing agencies like the Bank method wherein cost is also given adequate weight age in evaluation. ADB is also moving to this system.