

# The Influence of Alternative Development Finance on the World Bank’s Safeguards Regime

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## Abstract

What shapes social-environmental regulations in the World Bank? To date, scholars have emphasized the influence of NGO activism, donor power, and various elements of the Bank’s internal culture and incentive system. This article documents a new and important source of influence: outside financing options for borrower countries. I demonstrate this influence through an in-depth study of the World Bank’s “Safeguards Review and Update,” a four-year policymaking process that concluded in 2016. As alternative sources of finance carrying less stringent safeguards requirements than those of the World Bank proliferated in years preceding the Safeguards Review, borrowers gained negotiating power over Bank policy, enabling them to successfully push for more regulatory autonomy. These findings suggest that understanding the future of social-environmental standards in development finance institutions will require greater attention to new sources of finance and the power shifts they may entail.

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# Introduction

What shapes social-environmental regulations in the World Bank?<sup>1</sup> To date, scholars have emphasized the influence of NGO activism, donor power, and various elements of the Bank’s internal culture and incentive system. Drawing on international relations theories of competition and response among global organizations, this article documents a relatively new and important source of influence on the social-environmental protections that the Bank integrates into its lending: outside financing options for borrower countries, which have empowered borrowers to negotiate more autonomy in how such protection is achieved.

I illustrate the importance and channels of influence of alternative finance through an in-depth study of the World Bank’s “Safeguards Review and Update” (hereafter referred to as the Safeguards Review), a four-year policymaking process, concluded in 2016, which conferred more regulatory autonomy unto borrower countries by permitting the use of borrowers’ own legislative systems and capacities for social-environmental protection, subject to the Bank’s assessment of a borrower’s system. This transition ignited debate among development practitioners given the Bank’s historically imperfect compliance with its own social-environmental policies and many client governments’ lacking regulations and enforcement capabilities. Moreover, it represents a notable ceding of control over the way in which social-environmental protection and mitigation is accomplished in Bank-financed projects.

Drawing on forty-one interviews with those who participated in or were close to the policy process, I show that borrower countries, empowered by relatively new, alternative financing options, in combination with various World Bank institutional logics, drove this policy transition. As alternative sources of development finance carrying less stringent safeguards requirements than the World Bank proliferated in the years leading up to the safeguards overhaul, borrowers gained negotiating power over Bank policy. The Executive Directors representing borrowers leveraged this negotiating power in boardroom debates and interactions with management.

Bank Staff and Management largely aligned with borrowers, driven by a number of distinct incentives and logics. Some aligned with the move toward regulatory autonomy out of worry that losing borrowers would threaten the financial stability of the Bank, and that maintaining an inflexible safeguards regime was increasingly complicating project implementation and imperiling relationships with client governments. Others were more concerned with long-run social-environmental outcomes,

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1. Hereafter, I often refer to the World Bank as “the Bank”.

believing that refusing to concede any safeguards authority would mean (1) that risky development projects would instead get financed by institutions which required fewer protections than the Bank or that (2) the poorest countries most in need of the Bank's concessional finance would not get it because of lacking capacity to comply with strict regulations.

These findings carry important implications for our understanding of what drives regulatory policymaking in the World Bank - an organization whose regulations have for decades served as a model for a wide range of other development financiers. More generally, they suggest that scholars and practitioners may want to more deeply consider the proliferation of new sources of development finance and how the pressures they entail are interacting with the incentive systems and logics embedded in the global organizations that frequently serve as first-movers on regulatory policy.

## The Making of Social-Environmental Standards in the World Bank

The rise of social and environmental standards in the World Bank took place over a period of roughly thirty years, with cascading effects in the development finance community. "Right up to the late 1980s," Robert Wade writes in *Greening the Bank*, "the Bank paid attention to only a few specific aspects of what would later be called environmental problems, and then mainly within rather than beyond the boundaries of specific projects" (Wade 1997, 616). This changed in the late 1980s through the mid-1990s, when the Bank increased its number of environmental specialists from five to approximately 300, it added a vice president for Environmentally Sustainable Development, and "budgetary resources devoted explicitly to environmental work...grew at 90 percent a year" (ibid, 611). The nineties saw a stiffening of the environmental agenda, including establishment of pre-project environmental assessment procedures.

There was roughly parallel growth in the Bank's social safeguards architecture. In 1984, the Bank introduced a set of policies requiring pre-project social impact assessment (Cernea 2016). These were meant to facilitate anticipation of pre-project social risks and to "generate the knowledge and impetus for imprinting into the content of bank projects a proactive orientation to social goals as well, not only goals of an economic growth nature" (ibid, 4). Safeguards amounted to a "game-changer" in the Bank's "thinking and practice," argues Michael Cernea, the World Bank's first sociologist, by "committing the Bank to recognizing the basic socio-cultural variables of development" (ibid, 4).

The Bank’s transformation on social issues had broad effects. Prior to 1984, not a single multilateral agency had social safeguards. Yet after the Bank introduced them, all followed suit. Eventually, every one of the OECD’s twenty-four bilateral aid agencies and all regional development banks began using the World Bank’s framework as a model for their own policies (ibid, 9).

What drove the Bank’s trajectory? This question has been the subject of a considerable body of scholarship. Prior work suggests the answer is multi-factoral, involving a range of internal and external forces. First, scholars appear to agree that NGO activism, prompted largely by Bank-sponsored projects that had devastating impacts on local communities and environments<sup>2</sup>, played a key role. NGOs have directed their efforts at the US government, the Bank’s largest shareholder, which took up their cause and has long led in pushing the institution to adopt stringent social-environmental standards (Gutner 2002, 2005; Park 2014). Internal innovation and leadership by individuals within the Bank have also been important—an example being Michael Cernea’s role in compelling it to adopt an involuntary resettlement policy (Park 2010a). Throughout the Bank’s transformation, proponents have had to overcome a strong culture of favoring operational efficiency above most everything else, including social-environmental risk prevention—a dynamic referred to as the “approval imperative” or “disbursement imperative” (Buntaine 2016; Weaver 2007, 2008). Of all major stakeholder groups, the influence of borrowers, who have long seen the Bank’s social-environmental safeguards as onerous and costly (Six 2009), has been weakest. While borrowers have meaningfully impacted Bank behavior in some areas (George and Sabelli 1994; Gutner 2005; Rich 1994), other actors feature more prominently in the literature on the Bank’s safeguards architecture specifically.

In rest of this paper, I demonstrate the need to add an additional variable to this story: rising alternative finance. Global economic shifts, including increased alternative development finance options, have nudged the balance of power in the World Bank’s board of directors and internal calculus within the Bank, at least with respect to social and environmental matters. While previously documented forces remain strong, borrower power has noticeably increased. In the 2012-2016 Safeguards Review, borrowers pushed the Bank to, for the first time, open the door to use of borrowers’ own legislative systems and capacities for ensuring positive social-environmental outcomes—although NGOs and donor countries ensured borrowers must meet certain requirements before obtaining this autonomy. In the next section,

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2. Two such projects include the Polonoreste project in the Brazilian Amazon and the Narmada Sadar Sarovar dam project in India (Park 2010b; Wade 1997).

I describe the global economic shifts that have underpinned this increase in borrower power.

## An Evolving Development Finance Landscape

Leading up to the Safeguards Review and continuing today, one observes wide variation in the stringency of safeguards requirements across development financiers. The most notable differences have existed between “traditional” western financiers, such as the World Bank, and newer, South-led financiers, of which China is the dominant provider (discussed below). Figure 1 illustrates differences in safeguards requirements between the World Bank, China Development Bank (CDB), Export-Import Bank of China (CHEXIM), and other South-led institutions providing finance to the Latin America-Caribbean region, based on policies in place just before the new World Bank safeguards went into effect. In contrast to the World Bank, neither CDB, nor CHEXIM, nor the Development Bank of Latin America (CAF) required industry-specific social and environmental standards, compliance with international environmental regulations, a grievance mechanism, or independent monitoring and review. CDB, moreover, did not require public consultations with affected communities. The Brazilian Development Bank and Caribbean Development Bank had comparatively relaxed requirements, as well. In a detailed comparison of the World Bank, Inter-American Development Bank, and CAF, Humphrey (2016) reaches findings consistent with the notion that the World Bank’s safeguards, prior to the Safeguards Review<sup>3</sup>, were among the most rigorous out there. He concludes that,

*“In all three of the characteristics analyzed—overall loan processing procedures, environmental and social safeguards, and procurement rules—the World Bank is unquestionably the most willing to impose strict rules above and beyond any national procedures and to enforce those rules in a rigid, legalistic way,”* (p. 159).

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3. His analysis covered policies as they were through 2013 (p. 146).

|  | <b>World Bank</b> | <b>IADB</b> | <b>US EXIM</b> | <b>AFD</b> | <b>KFW</b> | <b>EIB</b> | <b>CAF</b> | <b>CaDB</b> | <b>CHEX</b> | <b>BNDES</b> | <b>CDB</b> |
|--|-------------------|-------------|----------------|------------|------------|------------|------------|-------------|-------------|--------------|------------|
| <b><i>Operational Procedure Requirements</i></b>           |                   |             |                |            |            |            |            |             |             |              |            |
| Ex-ante EIAs   |                   |             |                |            |            |            |            |             |             |              |            |
| Project review of EIAs                                     |                   |             |                |            |            |            |            |             |             |              |            |
| Industry-specific social & env. standards                  |                   |             |                |            |            |            |            |             |             |              |            |
| Required compliance with host country regulations          |                   |             |                |            |            |            |            |             |             |              |            |
| Required compliance with int'l env. regulations            |                   |             |                |            |            |            |            |             |             |              |            |
| Public consultations with affected communities             |                   |             |                |            |            |            |            |             |             |              |            |
| Grievance mechanism  |                   |             |                |            |            |            |            |             |             |              |            |
| Independent monitoring and review during the project cycle |                   |             |                |            |            |            |            |             |             |              |            |
| Establishing covenants linked to compliance                |                   |             |                |            |            |            |            |             |             |              |            |
| Ex-post EIAs   |                   |             |                |            |            |            |            |             |             |              |            |

Figure 1: Operational Procedure Requirements of Environmental and Social Safeguards in the Latin America/Caribbean region, adapted from Gallagher and Yuan (2017).

Leading up to the Safeguards Review, newer South-led financiers were not only offering regulation-lite finance in many cases; much more finance than in previous years was on offer. Rising finance in years preceding the Safeguards Review took several forms. Bilateral Chinese finance, described in more detail below, was one central source. Private financing had also been increasing. The *New York Times* reported in 2018 that private investors now deliver more than \$1 trillion annually to developing countries, “financing every manner of corporate or government investment...more than the \$900 billion the World Bank has doled out in its history.”<sup>4</sup> Third, some emerging powers have begun to globalize their domestic financing bodies and even establish new MDBs. The Asian Infrastructure Investment Bank (AIIB)<sup>5</sup>, led by China, and the New Development Bank, owned equally by the five BRICS countries (Brazil, Russia, India, China, and South Africa), collectively control \$US 200 billion in capital.<sup>6</sup> As of 2017, South-led national and multilateral development banks provided two thirds of the world’s development finance (Gallagher and Kring 2017). Finally, many countries who once relied heavily on external borrowing are now much more capable of self-financing. By 2016, many middle-income countries had a “generally reduced need for external resources” (Humphrey 2016, 144).

Figure 2 provides a partial illustration of the rise of external finance from 2000 through 2014—the middle of the Safeguards Review. Over this period, China stepped up its development finance more than any other developing country by far, strongly surpassing World Bank total commitments in 2009, 2010, and 2013. Though their projects tended to be smaller in terms of dollar value, other South-led financiers also substantially increased their financing over this period, moving from 124 in 2000 to nearly 954 in 2010. What is more, this chart almost certainly understates the rise in regulation-lite development finance over this period, for several reasons. First, the Chinese lending amounts depicted cover only official Chinese finance that AidData has been able to trace through a comprehensive research program; tracking Chinese finance is notoriously difficult. Second, this figure does not capture the rise of finance provided by the private sector—a nontrivial amount, as mentioned above. Third, this

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4. *The New York Times*, January 25, 2018, The Bank is Remaking Itself as a Creature of Wall Street.

5. It is important to note that, in contrast to other China-led financing sources, the AIIB’s safeguards requirements are currently comparable in rigor to those of the World Bank. Thus, while it may be reasonable to expect that the AIIB presents some level of competition for the World Bank and other traditional financiers, borrowers will unlikely opt for its services over of those of the World Bank on the basis of safeguards considerations, only.

6. See AIIB, 2021, “Fact Sheet” (<https://tinyurl.com/4ck5stbv>) and NDB, 2021, “About Us” (<https://tinyurl.com/7c3b8dya>). Accessed September 27, 2021.

figure does not capture the rise of aid recipients' own self-financing capacities.



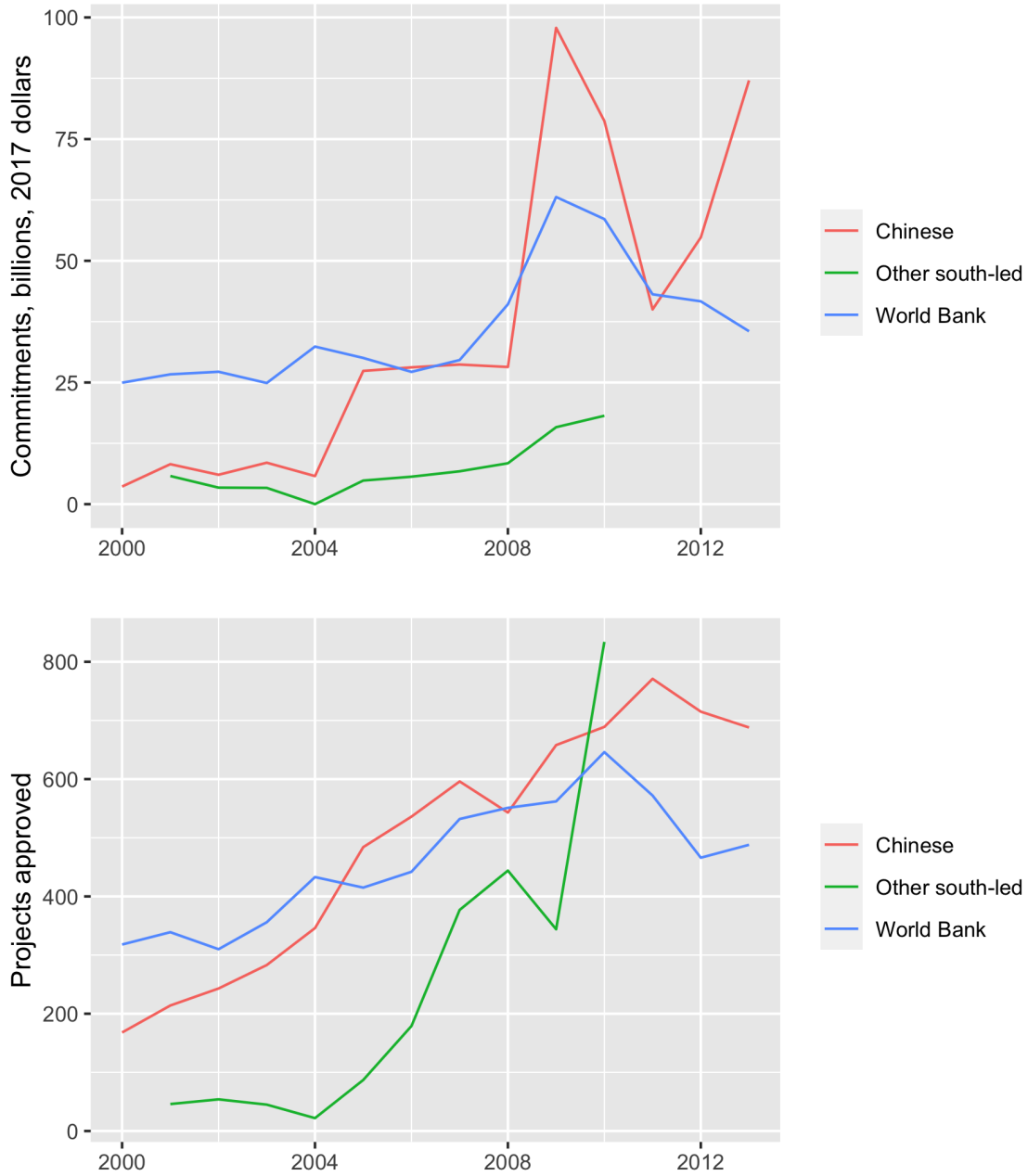


Figure 2: **Finance provided by the World Bank, China (external), and other developing countries (external). Total commitments approved (2017 dollars) and total number of projects approved.** Author’s tabulation using data from Tierney et al. (2011), Dreher et al. (2022), and World Bank (2021b). Data for countries included in the “Other south-led” category only run through 2010.

This context suggests that, in order to understand contemporary World Bank policymaking, it is crucial to consider implications of the rise of new global organizations providing similar services as the World Bank. Next, I outline a theoretical framework for doing so.

## **IO policy change in response to exogenous shocks**

Weaver (2007), Morse and Keohane (2014), and Lipsky (2017) provide three recognized theories of institutional change in international relations which, combined, provide a useful conceptual map of how the global economic shifts described above may affect the World Bank’s social-environmental regulations.

Weaver draws on principal-agent theory to argue that the World Bank’s external authorizing environment is a key determinant of its behavior. In particular, she states that “we should expect international organization (IO) policies and behavior to closely reflect the preferences of the most proximate and powerful member states” as three conditions are increasingly met: 1) “principal preferences are relatively homogeneous” 2) “information asymmetries are small” and 3) “principals are able to overcome their own collective action problems and effectively use their various control mechanisms to shape IO behavior” (Weaver 2007, 497–498). The more disagreement among principal preferences, the greater the information gap between IO bureaucrats and principals. The less effective the coordination among principals, the more autonomy the IO will enjoy.

While Weaver demonstrates the importance of an organization’s authorizing environment, Morse and Keohane home in on a variable that may shift the power balance within authorizing environments: competing organizations. Their theory of contested multilateralism “describes the situation that results from the pursuit of strategies by states, multilateral organizations, and non-state actors to use multilateral institutions, existing or newly created, to challenge the rules, practices, or missions of existing multilateral institutions” (Morse and Keohane 2014, 385). Such situations arise when dissatisfied members threaten to leave the existing institution and either make use of a different one or create a new one better suited to their needs. Usually, Morse and Keohane note, “the sources of dissatisfaction are exogenous,” and dissatisfied coalitions make use of a broad array of alternative institutions to achieve their goals – either as threats or actual alternative means of obtaining the same service. When unhappy coalitions have alternative options, they write, “we should normally expect adaption by the existing institution, since its authority and the scope of its impact will be adversely affected by the establishment of alternative

organizations or practices” (ibid, p. 390). Disagreement over the policies that the existing multilateral organization should pursue is an important driver of contested multilateralism.

In his related theory, Lipsky (2017) focuses in on what may drive actors’ dissatisfaction with an existing institution, not limiting his argument to the influence of other multilateral organizations. He argues that it is the competitiveness of the policy area—the degree to which many institutions perform similar functions—that determines how likely organizations are to influence each other. The greater the number of institutions providing the service, the greater the bargaining power of service demanders, and the more pressure institutions will face to conform with the desires of the service demanders. In his words, “competition disciplines institutions: competitive institutions must adjust frequently and flexibly or risk irrelevance as members move on to more satisfactory arrangements” (ibid, 3-4).

The variables embodied in each of these sets of ideas carry concrete analogues in the context of social-environmental policymaking in the World Bank. As such, they serve as focal points in the analysis and narrative that follows. Weaver’s emphasis on the Bank’s authorizing environment suggests the need to examine the preferences of members of the Bank’s board of directors and the countries and constituencies they represent - especially the most powerful among them. As discussed above, the literature suggests the US government and NGO lobby are critical actors here. Morse and Keohane draw attention to outside shocks to the system, of which the sharp rise in development finance can be considered one, as well as the ways in which organizational members—the Bank’s donors and borrowers—might use the existence and policies of other multilaterals as currency in bargaining for policy changes they would like to see. Lipsky’s emphasis on the competitiveness of the policy arena calls for attention to the wider organizational field, as with Morse and Keohane, but also the specific nature of the services other organizations are providing. Key variables here include the amount of finance provided by other organizations and the stringency of safeguards attached to that finance.

Following a more detailed description of the case at hand and study methodology, I forefront these variables in exploring the consistency of the political economy of the Safeguards Review with the theoretical dynamics described above.

## **The World Bank’s Safeguards Review**

The 2012-2016 Review and Update was the Bank’s most recent iteration of its safeguards policies. After a process involving “nearly four years of analysis and en-

gagement around the world...the most extensive consultation ever conducted by the World Bank,”<sup>7</sup> the Bank’s board of directors approved a new Environmental and Social Framework (ESF) on August 4th, 2016. The ESF became active in October of 2018.

The new ESF<sup>8</sup> encompasses a variety of thematic and procedural changes. Thematic additions included the addition of standards covering “labor and working conditions,” “resource efficiency and pollution prevention and management,” and the health and safety of project-affected communities. Procedurally, the ESF increases the Bank’s involvement throughout a project’s implementation phase; the previous policy focused on upstream regulation (Dann and Riegner 2019).

Legal analyses point to another procedural change as among the most significant: a greater emphasis on use of borrower governments’ own legislative systems and enforcement capacities for safeguards (Dann and Riegner 2019; Passoni, Rosenbaum, and Vermunt 2016). Via the Bank’s Use of Country Systems (UCS) instrument, the new policy gives the Bank leeway to permit a country to use its own system of laws and enforcement capacities, rather than the Bank’s, to avoid and mitigate social-environmental harms, “provided that [the borrower’s system] is likely to address the risks and impacts of the project, and enable the project to achieve objectives materially consistent with [the ESF’s Environmental and Social Standards].”<sup>9</sup> Prior to the ESF’s approval, the UCS tool’s use was restricted to pilot projects, “and thus rarely implemented in practice” (Dann and Riegner 2019). Dann and Riegner highlight this increase in the Bank’s openness to using borrower frameworks as “potentially the most consequential change in the reform” (p. 554).

The Bank’s increased openness to the use of borrower frameworks carries potential upsides and real risks. On one hand, it responds to a growing recognition of the need for borrower ownership and makes it possible to take advantage of effective, efficient borrower country legal systems and enforcement systems, where they exist. In addition, it arguably gives the Bank more opportunity to improve borrowers’ environmental and social protection systems in a more structural way, rather than on a

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7. World Bank (<https://tinyurl.com/4hdwdvp7>). Accessed September 27, 2021.

8. The policy is comprised of multiple documents; these are available at: <https://tinyurl.com/6ry7buay>. Last accessed September 27, 2021.

9. World Bank (2017, 2021a) outline a standard, if vague, procedure for how the Bank will determine whether or not to approve use of parts or all of a borrower’s framework. The policy is processed-focused. It describes, in broad strokes, what kinds of materials the Bank will use to make its assessments and states that assessments will involve stakeholder consultations. It does not specify what kind of evidence will signify “material consistency” with the Environmental and Social Standards.

project-by-project basis. However, the delegation of safeguards authority also raises the risk of poor social and environmental outcomes. Dann and Riegner note that this risk “depends on how generously [Bank] management interprets the criterion of material consistency regarding country systems” (p. 554). If the Bank (inadvertently or deliberately) misjudges consistency, project-affected people and environments could end up subject to weaker protections across all ten of the thematic areas covered by the ESF’s Environmental and Social Standards.

Throughout the Safeguards Review, critical scholars and NGOs expressed deep concern over a possible transition toward borrower frameworks, citing an absence of strong regulations and enforcement in many borrower countries and arguing that the language of ESF gives the World Bank too much discretion over when and how borrower frameworks are used (Bugalski 2016; Cernea and Maldonado 2018). Some went as far as arguing that the transition represents a “watering down” of the safeguards policies, potentially indicative of a “race to the bottom” in the standards of development finance institutions.<sup>10</sup> The Independent Evaluation Department of the Asian Development Bank (ADB) additionally criticized an early draft of the ESF, warning that a “more flexible approach to its safeguard policy...could dilute the strength of [the World Bank’s] social and environmental protections.”<sup>11</sup>

Because the new policy only became active in October of 2018, the extent to which the World Bank makes use of borrower frameworks in practice, and the outcomes of this, remain to be seen. As of the time of writing, no systematic research has examined this issue, to the best of my knowledge. In addition, it is important to emphasize that the ESF’s increased emphasis on borrower frameworks is far from a complete devolution of safeguards authority to borrowers. As described above, countries must convince the Bank that their legal systems are “materially consistent” with the Environmental and Social Standards before the Bank can approve a country systems approach, and the new ESF contains new thematic requirements to boot.

Nevertheless, the Bank’s openness to regulatory autonomy is new and represents at least the beginning of a structural break with the institution’s control-heavy safeguards procedures. In the next section, I briefly describe the study methodology

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10. For instance, see: Bretton Woods Project, February 10, 2016, *World Bank Safeguards Review: Human Rights-Free Zone*. See: <https://tinyurl.com/3w6d25zj>. Last accessed September 27, 2021; Earthrights International, August 17, 2016, *World Bank’s New Environmental and Social Framework is a Huge Step Backward for Human Rights*. See: <https://tinyurl.com/p6wfx9bk>. Last accessed September 27, 2021.

11. ADB Independent Evaluation Department, November 11, 2014. See: <https://tinyurl.com/4hj2n7br>. Last accessed September 27, 2021.

before presenting an analytical narrative answering the core question of this article: what drove this outcome of the Safeguards Review?

## Research Methods

Understanding what drove the World Bank to shift toward reliance on borrower frameworks required probing the perspectives of a broad range of actors who took part in the policymaking process and triangulating findings with key documents. All told, the Safeguards Review involved World Bank officials; donor, borrower, and NGO representatives; and other stakeholders; from more than sixty countries<sup>12</sup>. To trace key perspectives on a global level, I interviewed five types of individuals, forty-one in total.

The first category consisted of individuals directly involved in administering the Safeguards Review and negotiating its final outcome. These included World Bank Executive Directors, their staff, and staff and managers from the World Bank. The second category included Bank officials who did not directly participate in the Safeguards Review but work on safeguards-related issues and thus may have influenced the process through informal channels. The third category consisted of NGO workers who lobby the Bank on social-environmental issues and engaged in the Safeguards Review through meetings with Bank officials and written submissions. Comprising the fourth category were individuals who did not participate in the Safeguards Review, but given current or prior roles, are familiar with several its key drivers. These included staff from other MDBs and retired Bank officials. Fifth, as a means of thoroughly understanding the role of borrower countries in the policymaking process, I conducted a set of interviews focused on Mexican actors during a brief fieldwork period. There, I interviewed individuals who participated in the official Safeguards Review consultation hosted by the Bank in Mexico City in December of 2015. Interviews typically lasted between 60-90 minutes. I recorded and transcribed conversations with the permission of informants and took detailed notes when interviewees preferred not to record.

Three types of documents informed this research. First, I considered those that I determined to be most representative of the Bank's official rationale for undertaking the Safeguards Review and producing the Environmental and Social Framework (ESF). These are "World Bank's Safeguard Policies Proposed Review and Update: Approach Paper" and "Review and Update of the World Bank's Safeguards Policies:

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12. World Bank (<https://tinyurl.com/4hdwv7>). Accessed September 27, 2021.

Proposed Environmental and Social Framework” (World Bank 2012, 2016). While the first document outlines the Bank’s ex-ante rationale for undertaking the Safeguards Review, the second document is that which Bank management submitted to the Board in seeking approval of the third draft of the ESF, which became final. The latter contains comments from Bank Management on the policy review process. Second, I considered other World Bank publications which provide further explanation of policies, concepts, and events mentioned in the most representative documents. Finally, I considered a range of materials produced by other actors and organizations. These include official submissions to the Safeguards Review from World Bank member governments, NGOs, think tanks, universities, activist groups, and other organizations; grey literature produced by NGOs, think tanks, and other research institutes; newspaper articles; and speeches.

I supplement this interview and archival material with brief descriptive analysis of Chinese and World Bank finance data.

## The Political Economy of the World Bank’s Safeguards Review

### *Borrowers*

Interview evidence suggests that while borrower countries had long lamented the “red tape” and increased investment costs that they say safeguards entail, their new abilities to leave the World Bank for other development financiers finally allowed them to begin reducing the safeguards burden. Client-country interviewees who engaged most directly in the Safeguards Review said that the reduction of transaction costs was their primary objective in the negotiations. Though all expressed support for the sustainability principles safeguards aim to uphold, they provided detailed accounts of the ways in which such costs can render business with the Bank unviable. “Safeguards are clearly helpful and important and have created much better conditions for countries in terms of doing better projects,” said a former World Bank Executive Director from Mexico. “But when you go too far, they start to create huge problems. The investment costs increase quite a lot.”<sup>13</sup> Rogerio Studart, another former World Bank Executive Director for the Latin America-Caribbean region added, “If you look at the safeguards, they’re all good. They’re all well-intended. But there are many.

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13. Author’s interview with former Executive Director, World Bank, October 2017.

And when you put them together and try to implement them... it becomes a huge, huge transaction cost.”<sup>14</sup> <sup>15</sup>

The rise of condition-lite finance has had predictable effects: as developing countries have become increasingly capable of bypassing condition-heavy loans for less-regulated finance, they have done so. The Mexican case is telling. According to a former management official in the Mexican finance ministry, MDBs today finance roughly twenty percent of the Mexican government’s external debt—about five percent of its overall debt. Eight years ago, MDBs like the World Bank and the IDB were financing the majority of it.<sup>16</sup> The official added that instances in which Mexico “has not been able to work with a multilateral because of safeguards... happen a lot.” They “just don’t present [the] projects” that they know will be difficult for the Bank, turning to other financiers instead. He listed Mexico’s national development banks, commercial banks, and private investors as backup options, in that order.<sup>17</sup>

It is not only Mexico that has transitioned away from the Bank and other traditional financiers. A former World Bank Executive Director from Mexico recalled some of his South American colleagues, including from Peru, Brazil, and Colombia, saying that “they were not using the World Bank investment loans as much because they thought [the loans] were too complicated.”<sup>18</sup> In the years during which the Safeguards Review took place, he pointed out, many Latin American countries had been seeking funds from the Development Bank of Latin America (CAF) “because safeguards there are a bit less complicated.” The former Executive Director and his team would highlight this in boardroom discussions during the Safeguards Review, cautioning pro-safeguards representatives that, “if you keep on pushing [safeguards], the World Bank might become irrelevant.” “My voicing this wasn’t a threat,” he added. “It was a reality. It was something we were seeing.”<sup>19</sup>

Others with a firsthand perspective noted similar patterns. “Sometimes the borrowers do not need the Bank,” said Studart. “The larger middle-income countries—even those that have high environmental standards, such as Brazil—would not dare

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14. Author’s interview with Rogerio Studart, April 2017.

15. A 2010 assessment from the Bank’s Independent Evaluation Group supports these claims from borrowers (World Bank IEG 2010, 73–80). It estimates that, on average, safeguards increase a project’s cost by roughly USD \$14 million, with borrowers assuming 99.6 percent of that cost. Furthermore, this figure only reflects the direct costs of producing risk prevention and mitigation plans. It does not capture the delay costs borrowers frequently lament.

16. Author’s interview with former management official, Mexican finance ministry, August 2017.

17. Ibid.

18. Author’s interview with former Executive Director, World Bank, October 2017.

19. Ibid.



to approach the Bank” for infrastructure projects. “The transaction cost just to have the discussion is too high.”<sup>20</sup> He drew a connection between middle-income countries’ increased financial capacity, their distaste for conditionality, and the creation of alternative financial institutions, such as the AIIB and New Development Bank. “Emerging market countries like China and Brazil are getting big enough to say, ‘OK, this is not our bank. It does not represent our interests. . . so we need to do something else,’” he said.<sup>21</sup> In Studart’s view, such ultimatums came to a tipping point during the Safeguards Review. “Stronger safeguards,” he opined, would have “completely [impeded the Bank’s] ability to operate in developing countries.”<sup>22</sup>

Officials from other western-led MDBs described similar borrower behavior at their institutions. One safeguards official spoke of client countries threatening to decrease their borrowing from his institution in the presence of rising finance with less stringent safeguards requirements.

*“Some of the emerging economies were gaining confidence. Sometimes when their economy was doing very good, they said ‘Look, World Bank and [second western-led MDB], if you keep making us adhere to these very strict requirements, we can borrow from other sources.’ So when their economies were really doing good they were trying to negotiate with us, saying, ‘if your products are not competitive we can go to other places like bilaterals or get good terms from commercial borrowing.’”<sup>23</sup>*

He went on, describing the frequency with which borrowers lobby his institution’s management on safeguards matters and suggesting rising alternative financing was beginning to make this lobbying consequential:

*“Whenever our management meets with high government officials. . . the things that they [government officials] always seem to be lobbying against are the procurement rules and the safeguards. These are two key areas where they feel that they really need to do extra-national requirements to get the loan moving or to get the projects running. . . in Asia there is some emerging, brewing competition amongst the development banks, so management feels that there is constant pressure to make our products*

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20. Studart interview.

21. Ibid.

22. Ibid.

23. Author’s interview with staff member, major multilateral development bank, October 2017.

*more competitive and you know sort of adaptable to the moving trends or moving framework.”*<sup>24</sup>

An official from another western-led MDB detailed the many sources of alternative finance available to Brazil, noting the competition they presented for other traditional, western-led development banks:

*“If you rewind back to the 80s and 90s, the World Bank was the major player in development finance around the world. Nowadays, you have Chinese financiers and just have a lot more sources of financing. And I think governments are becoming more creative with how to finance. For instance, up until the crisis there, Brazil relied almost exclusively on BNDES, which was like an endless spigot because it received capitalizations every year from the treasury. Then they were also leveraging public pension funds. . . So they had a nice well-oiled machine in Brazil. But then, in addition to that, there are things now like climate bonds and green bonds, where especially in the private sector, you don’t even need to rely on international finance. On the public sector side, they can look to international pension funds. They can raise money, or get money from CalPERS in California or the Norwegian pension fund. It’s such a creative financial landscape now. The World Bank, [second Western-led MDB], other development banks—the reality is we compete with many more players now.”*<sup>25</sup>

Lending data are consistent with the idea that some borrowers were switching away from World Bank financing, toward financing with less stringent safeguards, prior to the Safeguards Review. Figure 3 plots annual approval of World Bank and Chinese external projects over time globally, for the Latin America-Caribbean (LAC) region, and for Brazil. China overtook the Bank on all three levels, with the switch in financing dominance particularly strong in the LAC region and Brazil. While the moment of eclipse happened for the LAC region in 2010, just before the Safeguards Review, the eclipse happened for Brazil during the Safeguards Review.

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24. Ibid.

25. Author’s interview with staff member, major multilateral development bank, July 2017.

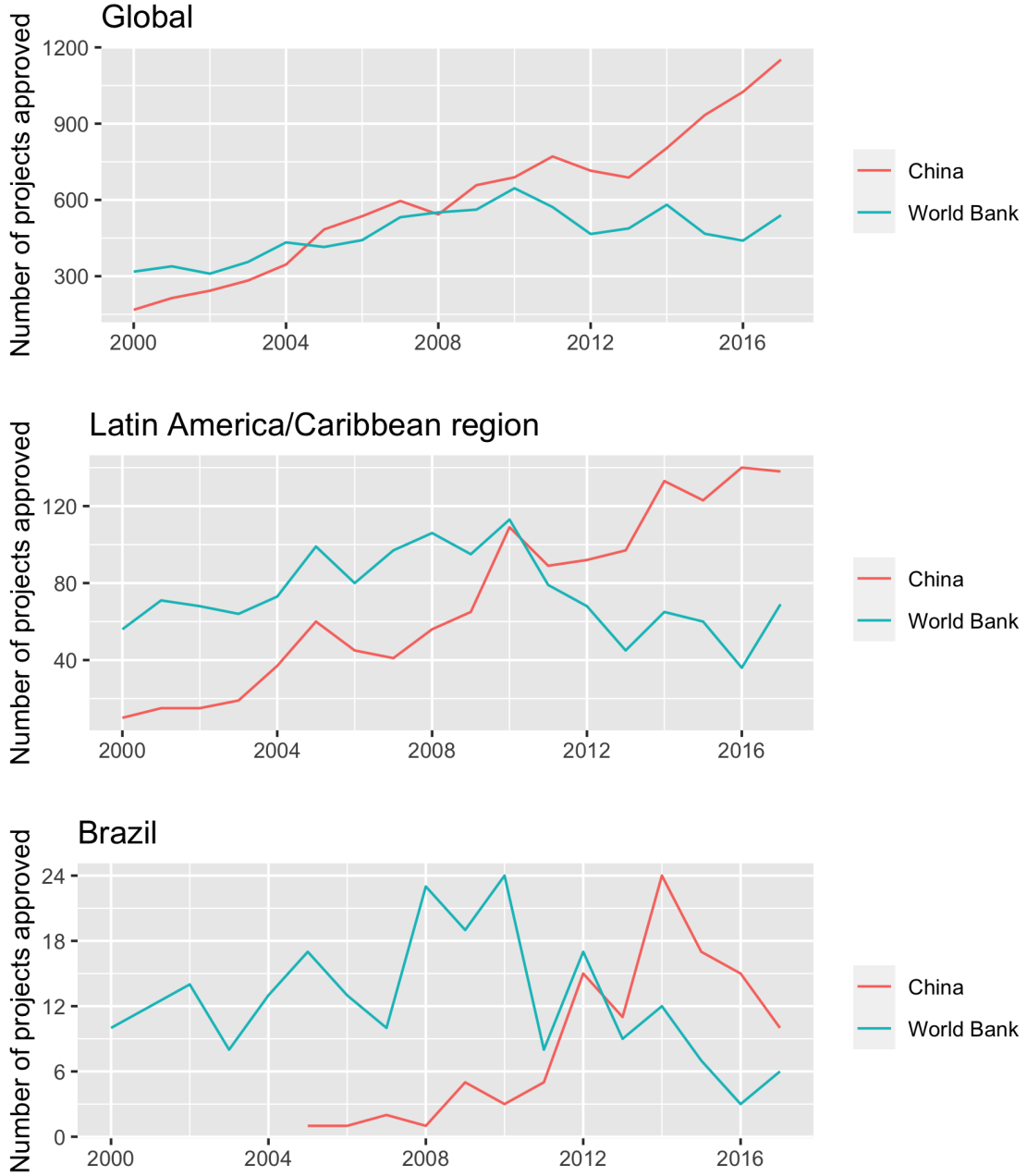


Figure 3: **Chinese external projects and World Bank projects approved during 2000-2017 period.** Author's compilation using data from Dreher et al. (2022) and World Bank (2021b).

Figure 4 digs slightly deeper, showing the same data as Figure 3 but separated into hard infrastructure versus other project types using the AidData methodology (Dreher et al. 2022). Here, World Bank trends in the LAC region and Brazil—places with particularly high levels of Chinese finance during this period—are the key things to notice. Just after Chinese infrastructure financing began to take off in the LAC region (around 2008), one observes more of the World Bank portfolio starting to go into non-infrastructure projects. The World Bank’s switched emphasis to non-infrastructure projects at this time was even stronger in Brazil specifically. When Chinese infrastructure financing took off in Brazil around 2011, World Bank infrastructure financing decreased drastically, with only a brief recovery in 2012. In both the LAC region and Brazil—again, areas with particularly high level of Chinese finance—World Bank infrastructure financing took a bigger hit than World Bank non-infrastructure financing as Chinese finance increased. These trends are consistent with the idea that safeguards stringency factored into client countries’ borrowing decisions during this period. Increasing availability of financing with less stringent safeguards requirements roughly paralleled a notable decline in World Bank financing for infrastructure projects, which typically entail more involved safeguards processes (Humphrey 2016).

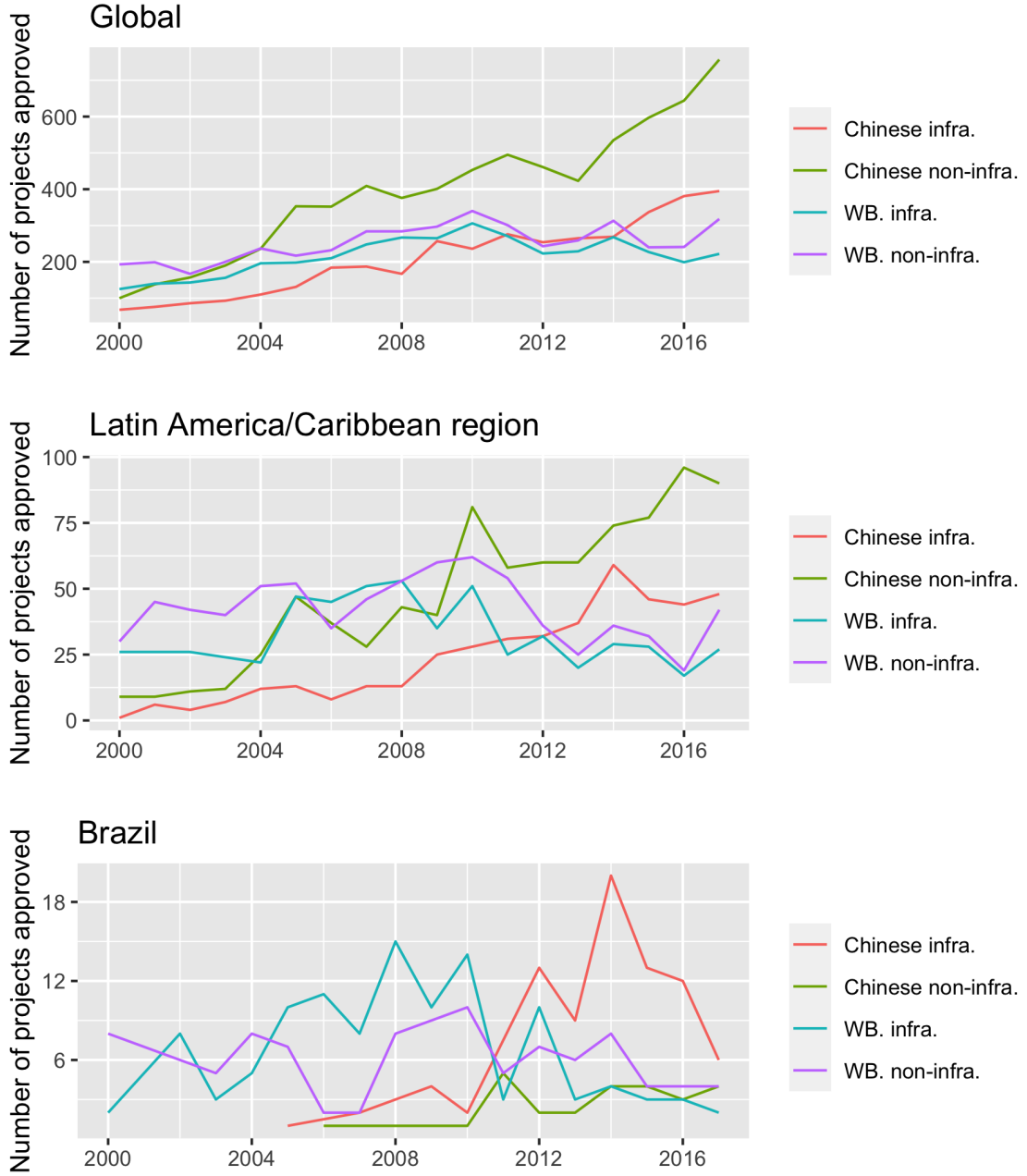


Figure 4: Chinese external projects and World Bank projects approved during 2000-2017 period, split into hard infrastructure vs. other project types using the AidData methodology (Dreher et al. 2022). Author's compilation using data from Dreher et al. (2022) and World Bank (2021b).

## *Donors*

In contrast to borrowers' collective enthusiasm for a transition toward borrower frameworks, donors were split on the matter. Some donor governments, such as Norway, were ready to move forward with the transition. The Nordic-Baltic constituency viewed new emphasis on borrower frameworks as part of a larger project aimed at building the safeguards capacities of client countries, which would ultimately enable borrowers to uphold strong sustainability standards without the assistance of the Bank.<sup>26</sup> For us," said the Nordic-Baltic representative, "the transition to borrower frameworks was obviously positive."<sup>27</sup> The US delegation had a different view. Concerned about the risks a more flexible safeguards framework might entail, they aligned with the NGOs and advocacy groups who tend to view use of borrower frameworks as, "an end-run around safeguards standards," and the US was "leading the charge" to "dampen down" the transition.<sup>28</sup>

The US constituency did not categorically reject the idea of transitioning toward borrower frameworks, but rather sought modifications which it believed would reduce the risks associated with it. These centered on how the Bank would decide whether to approve the use of parts (or all) of a particular borrower's framework. First, the US sought to ensure that the final decision rest with the Bank's Chief Environmental and Social Standards Officer (CESSO), not the Bank's director for the country in question, as was the original plan. The US argued that the Country Director would have incentives to approve their country to use its own system, even if inadequate, and the CESSO would be more objective. Second, the US delegation advocated for development of a rigorous analytical framework for assessing whether a country's legislative system and enforcement capacities could uphold accountability standards equivalent to those of the Bank.<sup>29</sup> "The science is actually not very well-developed," said a US Treasury official. "There's a lot of rhetoric and political support behind borrower systems, but the real sort of roll-your-sleeves-up, technical work has only just started."<sup>30</sup> Both requests were partly rooted in a concern related to the Bank's plan for improving borrower systems where they were lacking—in particular, on the question of who would fund the "capacity building" programs that could make up for such gaps. "The reality is. . . there's nothing remotely close to the resources to fund

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26. Author's interview with World Bank Nordic-Baltic constituency representative, October 2017; Author's interview with former management official, The World Bank, August 2017.

27. Author's interview with World Bank Nordic-Baltic constituency representative, October 2017.

28. Author's interview with US Treasury official 1, August 2017.

29. Author's interview with US Treasury official 2, August 2017.

30. US Treasury interview 1, August 2017.

the type of capacity-building that I think would have been needed to meet initial expectations,” said a Treasury official.<sup>31</sup>

The US prevailed in at least two respects. First, the ESF requires that the Chief Environmental and Social Safeguards Officer be the one to decide whether the Bank uses parts or all of a borrower’s framework in a given project – not the World Bank Country Director of the country in question (World Bank 2021a). Second, as described above, the ESF does indeed outline a standard, if vague, procedure for how the Bank will determine whether or not to approve use of parts or all of a borrowers’ framework. “The only choice was to dampen down expectations and kind of walk things back...Expectations got wildly out of line initially for the pro-borrower system,” said a US Treasury official.<sup>32</sup>

### *Internal dynamics*

While contrasting viewpoints characterized Board debates, interview and archival evidence suggests that, internally, there was general agreement that a transition toward borrower frameworks was necessary. However, a number of distinct logics underpinned this consensus. Some Bank staff and management were primarily concerned with the financial condition of the Bank. Studart, who claims to have spent much of his Executive Directorship trying to improve “the business of the Bank,” fleshed out this perspective.<sup>33</sup> In short, middle-income countries’ declining demand had begun threatening the financial stability of the Bank because the Bank relies on middle-income countries for a significant portion of its income. Middle-income countries pay higher interest rates on the loans they get from the World Bank, subsidizing low-income countries’ interest payments. Such cross-subsidies were especially critical prior to and in the early stages of the Safeguards Review, according to Studart, because the Bank had “exhausted its capacity to leverage” after expending many of its resources to assist countries in the aftermath of the 2007 financial crisis, after which “there was never a significant capitalization.” In this context, safeguards had created a “business nightmare,” he added. “Management would come to us with their own agenda, which was very much in alliance with those of the borrowing countries, for a single reason: the Bank is a bank.”

Safeguards were putting increasing pressure on staff responsible for managing relationships and facilitating projects, as well. Dr. Natalie Bugalski, a legal scholar

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31. Ibid.

32. US Treasury interview 1, August 2017.

33. Studart interview

and founder of an NGO that frequently challenges the Bank on human rights issues, stated that in one case Bank staff's efforts to support communities negatively impacted a project had created tensions with the client country government with whom they were working.<sup>34</sup> Meanwhile, because their professional advancement depends on it, staff had remained under intense pressure to complete projects, and safeguards had increasingly come in the way of their efforts to get projects approved and implement them without problems. Studart confirmed these views, noting that "safeguards became so overwhelming that nobody at the Bank had any desire to do infrastructure projects. . . simply because it would take a lot of time and a lot of discussions."<sup>35</sup>

Other Bank staff pushed for more borrower-friendly safeguards as a way to avoid selection issues that might threaten the Bank's overall development impact. On one hand, some Bank staff worried that maintaining rigorous safeguards would mean losing environmentally risky projects to financiers less concerned with sustainability. For instance, when her advocacy organization had pressed the Bank to comply with its safeguards policies in years leading up to the Safeguards Review, Bugalski said that Bank officials often responded by highlighting the risk that heavy-handed safeguards would result in the client country cancelling agreements with the Bank and instead seeking assistance from Chinese financial institutions, which do not emphasize safeguards.<sup>36</sup> In this view, stronger safeguards might ultimately mean less environmental and social protection. Several others, including current and former Bank staff, described a more general selection concern: that strong safeguards might increasingly preclude the countries most need in need of development finance. "When it comes to safeguards," one former official said, "there's a tension between raising the bar, but not raising it so high that. . . the poor countries, with less institutional capacity and resources, are no longer able to meet the criteria, and only the wealthier countries are able to. That would be sort of counter-productive in terms of poverty reduction."<sup>37</sup> In both scenarios, Bank staff believed the Bank would be able to do more good by remaining involved in risky projects rather than allowing sustainability concerns to preclude its involvement.

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34. Author's interview with Natalie Bugalski, Co-founder and Legal Director, Inclusive Development International, November 2016.

35. Studart interview.

36. Bugalski interview.

37. Author's interview with former management official, The World Bank, August 2017.



### *The Role of the 2010 IEG Safeguards Evaluation*

In 2010, the World Bank's Independent Evaluation Group (IEG) published a detailed (192-page) performance evaluation of the Bank's safeguards regime (World Bank IEG 2010), which helped motivate the Safeguards Review. Many Bank staff interviewed were familiar with the report. Due to its comprehensive nature and Bank employees' familiarity with it, one would expect that the report played an important role in driving the ESF's emphasis borrower frameworks.

However, this does not appear to be the case. If anything, the report's recommendations caution the Bank against conferring regulatory autonomy in the near term, pointing to ongoing difficulties the Bank had been having in monitoring and implementing safeguards and the failure of multiple "Use of Country Systems" (UCS) pilots, which had taken place between 2004 and the time of the report's writing. While IEG the report does stress a need to "enhance" client "responsibility and ownership" over safeguards, it frames this as a long-term project that should come after a concerted effort to strengthen client countries' safeguards systems (23–25). At times, the IEG report's comments on the UCS pilots strongly caution against a transition to borrower frameworks. For instance, it notes that "of the regional safeguards advisors and the environment and social development sector managers interviewed by IEG, three-quarters maintain that the right approach is not being followed, and not one believes that the UCS approach in its present form can be scaled up" (ibid, p. 138). It highlights that "a progress report to the Board state[d] that the UCS approach has not worked for social safeguards in any country" (ibid, p. 86).

If this interpretation of IEG's recommendations is correct, it bolsters the notion that competitive forces (and their interaction with institutional logics) played a decisive role in the ESF's new emphasis on borrower frameworks. It implies that pressure from competing financial institutions not only put borrower frameworks on the agenda and partially moved the idea from theory to practice; it did so in opposition to the Bank's own Independent Evaluation Group.

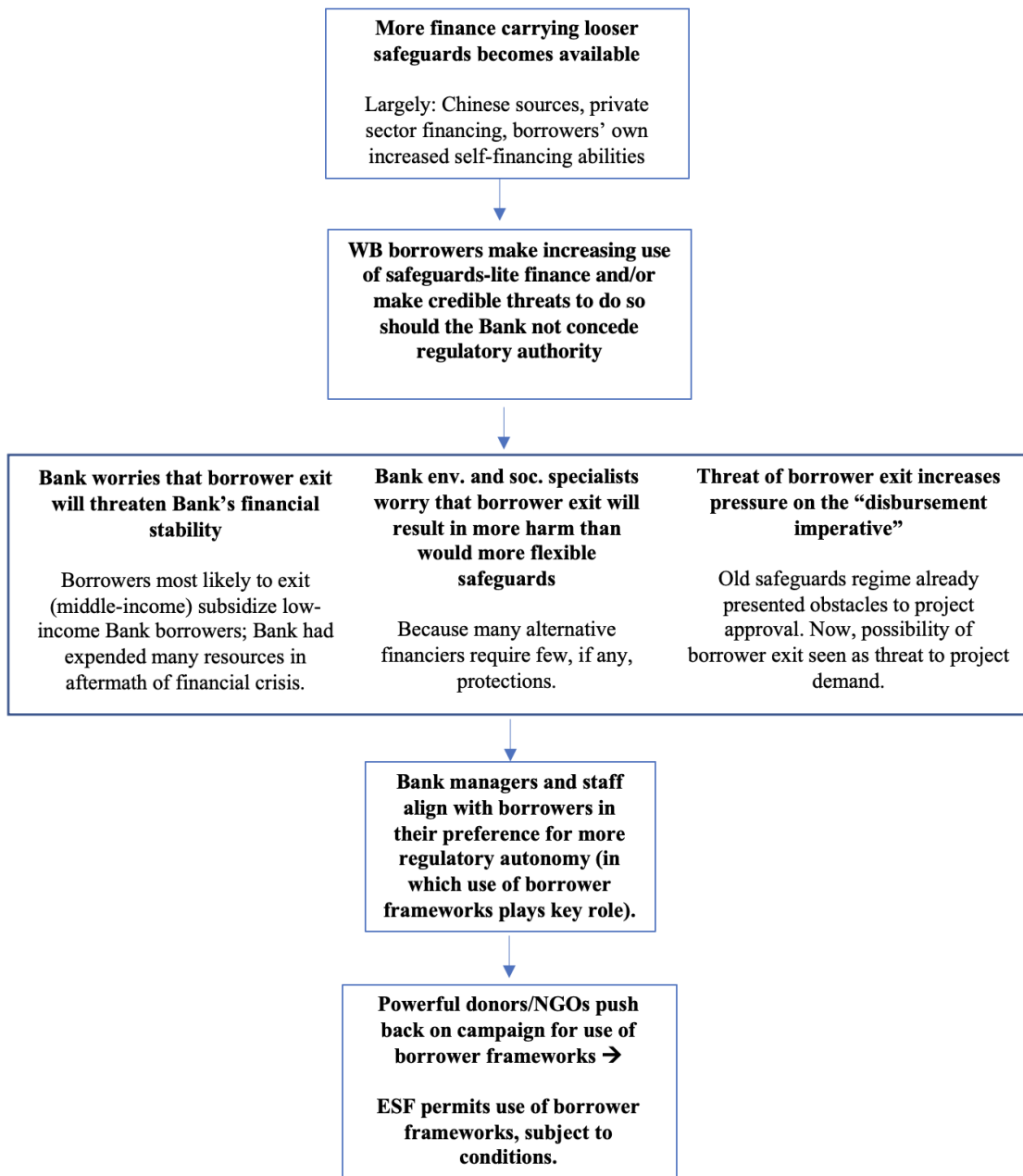


Figure 5: How competing finance affected policymaking dynamics in the Safeguards Review.

## Discussion

The case study presented in this paper suggests that borrower countries, historically understood as some of the least powerful actors in World Bank social-environmental policymaking processes, are now playing a significant role. In the Safeguards Review, they succeeded in pushing the Bank to adopt a safeguards regime entailing the beginning of a transition toward use of borrowers' own legislative systems and capacities for preventing and mitigating risks associated with Bank-sponsored development projects.

The heightened borrower influence described here emerges from changes in the global economy. Borrowers have gained negotiating power as a direct result of the proliferation of alternative sources of development finance, which have allowed them to partially disengage from the World Bank or make credible threats to do so.

The power shift observed in the Safeguards Review was not total, however. At the same time that borrowers achieved assurance that the Bank would at least consider granting them regulatory autonomy, NGOs and donors added new thematic requirements to the safeguards standards. They also ensured that borrowers would not be approved to use their own systems without the Bank's determination that they are "materially consistent" with the safeguards standards. Still, the possibility of regulatory autonomy marks a major step forward in client ownership - something borrowers have sought for decades.

What this means for the people and environments potentially threatened by future Bank-financed projects remains up for debate (and observation). While some see the possibility of regulatory autonomy as an important opportunity for the Bank to help borrowers strengthen their risk prevention and mitigation capacities, others see it as a major liability, given the Bank's record of non-compliance with its own social and environmental policies and lacking capacity or political will for social-environmental protection in many client countries.

These findings complement those of studies which have examined similar issues in the context of other aid organizations and regulatory areas. For instance, Kurlantzick (2006) illustrates similar aid shopping to that discussed here, outlining several instances in which developing countries have foregone western sources of finance, including from the World Bank and IMF, in favor of Chinese government finance, largely on the basis of Chinese finance coming with fewer conditions. Hernandez (2017) goes a step further by demonstrating how aid shopping has affected the World Bank's application of loan conditions in Africa. Examining lending to fifty-four African countries between 1930 and 2013, he finds that the Bank "delivers 15 percent fewer conditions for every percentage-point increase in Chinese aid" (p. 529).

Humphrey and Michaelowa (2013) identify increasing borrower-influence in development finance institutions through a statistical analysis covering lending from the World Bank, Development Bank of Latin America, and Inter-American Development Bank.

In a world that is every day becoming richer and more globalized, it is difficult to imagine a future in which the policymaking dynamics observed here do not play out with greater frequency. Scholars and practitioners interested in these trends may find it especially fruitful to examine the unfolding of the two newest multilateral development banks, the AIIB and the NDB. Both are led by developing countries and largely viewed as explicit alternatives to the Bank's condition-heavy services. China, an opponent of stringent social-environmental safeguards in the World Bank, holds majority voting power in the AIIB and equal voting power as the four other countries involved in the NDB. The US, a strong proponent of stringent social-environmental standards in development finance, is not officially involved in either the AIIB or NDB. To what extent will the World Bank continue to serve as a model of accountability for development finance institutions? Should we be looking eastward, instead?

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