

January 16, 2012

Mr. Makhtar Diop
World Bank
Brazil Country Director
SCN Quadra 2, Lote A
Ed. Corporate Financial Center, 7 Andar
Brasilia – DF, Brasil 70712-900

Dear Mr. Diop,

Thank you for your comments on our evaluation of the SEM DPL and the World Bank’s DPL operational policy.¹ We appreciate the further clarification on a number of points, and the additional views on others. Our report underscores the efforts made by the World Bank to use Development Policy Loans to advance significant policy reforms. In several Latin American countries, we have supported these Bank efforts of effective programmatic engagement.

We insist that the evidence available related to the performance of the SEM DPL demonstrates a number of areas in which the operation fell short. While there are some areas related to the actual performance of the SEM DPL where we may agree to disagree, we shall assume that the arguments in our evaluation that were not addressed in your comment are acknowledged and accepted.

Moreover, the challenges faced by the SEM DPL point to the urgent need to update the Bank’s operational policy requirements and complementary guidance to ensure the most effective use of DPLs. Transparency remains one of the central concerns in our view of meeting the Bank’s stated commitment to promoting sustainable development through DPLs. This commitment to the promotion of transparency was emphasized in a recent statement by President Zoellick linking Bank budget support to borrowing country commitments to make budgets transparent and the need to build stronger civil society organizations in order to hold governments accountable.

“We will encourage governments to publish information, enact Freedom of Information Acts, open up their budget and procurement processes, build independent audit functions, and sponsor reforms of justice systems. We will not lend directly to finance budgets in countries that do not publish their budgets, or, in exceptional cases, at least commit to publish their budgets within twelve months.”²

Improved consultation and transparency regarding relevant programmatic budget documents is a widely shared principal of many development actors. However, the Bank’s commitment to

¹ Makhtar Diop, World Bank Director of Brazil Country Office, Nov. 29, 2011 Letter to BIC, “October 2011 BIC Evaluation Report and Bulletin.”

² Statement by Robert Zoellick to the Petersen Institute on April 6, 2011, “The Middle East and North Africa: A New Social Contract for Development,” (<http://goxi.org/profiles/blogs/citizen-empowerment-governance>):

budget transparency, while relevant to DPLs, remains unclear in part due to the emphasis on enacted budgets rather than a full array of revenue and expenditure documents throughout the budget cycle and the absence of specifics on citizen accountability mechanisms.³ In his response to a letter by International Budget Project and Revenue Watch, President Zoellick committed to the concept of a “minimum budget transparency requirement for DPOs.”⁴ However, the suggestion that this criterion for minimal transparency be the disclosure of an “enacted budget” falls short of what is necessary for public executing agents of DPLs in many middle income countries to ensure legitimacy and likely achievement of DPL results.

In line with a full commitment to budget transparency for any country that receives a DPO from the World Bank, the public disclosure of budget expenditures and outcomes by BNDES at a level of disaggregation (operation level) with adequate provisions for citizen engagement would represent a step in the right direction.

The SEM DPL offers an important and timely opportunity to learn. We appreciate the Bank’s constant openness in the exchange of views and propose further that the Bank take this opportunity to elevate the debate about DPL operational policy in a public forum in 2012.

Development Policy Loan Operational Policy 8.60 and the learning from IEG evaluations

1. DPL Volume and Performance Evaluation: The volume of DPL/DPOs as a share of overall World Bank lending and of IBRD/IDA lending has been significant, far more for Latin American borrowers than any other region. The SEM DPL was one of the largest operations ever approved by the World Bank. The central observation is the apparent contradiction between this high level of lending with the dearth of evaluation of DPL/DPO effectiveness.

The 2010 IEG evaluation on Bank safeguard policies underscores the need for a full DPL evaluation:

“Development policy lending is excluded from the analysis because it is not subject to the same environmental and social requirements. Considering the sizable share of development policy lending, the nature and quality of its environmental and social impacts need to be looked at separately from this evaluation.”⁵

An IEG evaluation of the Bank’s Environment and Natural Resource Portfolio in 2008 also suggested that the Bank’s modest levels of environmental lending for this sector are increasingly DPLs, particularly in Latin America.⁶ DPLs as a share of total World Bank ENRM commitments have varied in Latin America, but in 2005 it reached a peak of 25%. In the forest

³ See letter from International Budget Project and Revenue Watch Institute to World Bank President Zoellick in April 2011 that both welcomes the Bank’s commitment to budget transparency as well as offers four concrete action steps to operationalize the Bank’s position.

⁴ President Zoellick letter to IBP and Revenue Watch Institute from (May 11, 2011)

⁵ IEG (2010) “Safeguards and Sustainability Policies in a Changing World,” World Bank, pg. xiv.

⁶ IEG (2008) Environmental Sustainability: An Evaluation of World Bank Group Support,” World Bank

sector alone, between 2002-2010, the World Bank provided \$5.2 billion in DPLs that supported forest reforms, of which \$863 million was directly designated for forest lending.⁷

Yet, the results of these environmental DPOs have not been adequately assessed for their environmental results, but preliminary findings indicated “uneven support for the environment.”⁸

The IEG PRSC evaluation does represent one recent independent assessment of a subset of DPOs. PRSCs were intended to strengthen domestic budget processes. While the PRSC evaluation suggests that these instruments worked better in terms of process, it also reinforces some parts of our critique of the SEM DPL related to adequate accountability for results. In addition to the findings noted in your comment, IEG found that Poverty Reduction Support Credits are unable to ensure pro-poor results or adequately tackle governance issues due to weak results frameworks, the challenges in linking action indicators to tangible results, the deficiencies in monitoring outcomes and the privileging of dialogue with central line ministry authorities over legislative or civil society actors.⁹ The evaluation found that,

“countries lagged in their ability to link budgetary inputs with results and outputs. In most countries the PRSC was not able to make the budget the vehicle for most sector policy interventions, even in pro-poor areas. Large proportions of country sectoral resources are off-budget.”¹⁰

Progress on public financial management and procurement processes was limited to the easiest areas (budget formulation), while budget reporting achievements was constrained by observed weaknesses in budget execution and results frameworks. These mixed indications of effectiveness in the use of PRSC highlight areas of transparency, accountability and participation where DPL operational policy could be strengthened.

Implementation Completion Reports represent another source of evidence for assessing DPL effectiveness. Under the new Access to Information Policy, ICRs are now disclosed. This is a positive step. However, some ICRs lack adequate detail to back up the performance rating – a point which I will address below in reference to the DPL prior action database.

As you note, the 2009 IEG Annual Review of Development Effectiveness (ARDE) focuses on the Bank's performance concerning environmental sustainability. While there are some encouraging signs regarding the use of DPLs for environmental sustainability, this point is overshadowed by evidence presented in the ARDE report that reiterates much of the IEG findings from the previous two decades raising questions about the Bank's overall environmental additionality.¹¹ A major finding is that the centerpiece of the Bank's 2001 Environmental Strategy, 'Mainstreaming,' has largely not worked and has even decreased in some key sectors such as energy, transport, agriculture....¹² The report adds that monitoring and evaluation of

⁷ IEG (Sep 22, 2011) IEG Evaluation of WBG Experience Managing Forest Resources for Sustainable Development, Evaluation Approach Paper, CODE 2011-0051.

⁸ IEG (2008) “Environmental Sustainability: An Evaluation of World Bank Group Support,” World Bank, pg. xxxiii

⁹ IEG (2008) “Poverty Reduction Support Credits,” World Bank.

¹⁰ IEG (2008) PRSC Evaluation, pg. xvii.

¹¹ IEG (2009) “Annual Review Of Development Effectiveness 2009: Achieving Sustainable Development,”

¹² Op cit, pp. xvi-xvii

project results remains weak, thereby reminding that a "culture of [loan] approval" (a term first used in the Wapenhans Report nearly two decades ago...) remains a significant counterweight to effective use of Bank lending.¹³ Our revised performance assessment of the SEM DPL and to a lesser extent the prior Environmental Programmatic Loan in Brazil, which together represent a large share of ENRM DPL lending since 2005, are consistent with these broader findings of the 2009 ARDE report.

The cited 2009 DPL retrospective contains substantive and useful information about DPL performance, including considerable replication of key finding in relevant IEG evaluations. However this retrospective does not constitute an independent evaluation and lacks the methodology to address many important questions about DPL performance.

We might point out that the 2009 DPL retrospective does validate concerns raised in the BIC SEM DPL assessment regarding the rigor and clarity of guidance on environmental and social due diligence for DPLs.¹⁴ However, we disagree that with the recommendation that DPL guidance materials be the only option for strengthening social and environmental due diligence. The Operational Policy for DPLs should also be reviewed to ensure consistency with learning and change in international law regarding social and environmental risk management. We offer more specific suggestions for how the OP 8.60 might be strengthened below.

BIC also participated in the preparation of an important working paper on the performance of environmental DPLs commissioned for the Environment Strategy Review.¹⁵ The terms of reference for this background assessment also underscored the need for independent evaluation of DPL performance.

“Among the regions, the LAC region has supported the greatest number of environmental DPLs; while a few environmental/ NRM/ forestry DPLs are being undertaken or are being developed in Africa, Asia, and Eastern Europe. The flexibility and scope of environmental DPLs allows them to be streamlined and tailored to a specific country context. This trend is evident in the variability across country reforms, sectoral foci, and subsequent policy triggers in the countries that have undertaken such DPLs.

With about 16 environmental DPLs now undertaken, plus additional sectoral DPLs with environment as an important component, the time is opportune to carry out an assessment of this instrument to identify lessons learned, and provide critical input to other countries that are actively seeking similar loans. While some anecdotal reviews and ICRs of a few specific environmental DPLs have been written up, there has been no systematic attempt to highlight enabling conditions, scrutinize environmental mainstreaming in sectors, and assess

¹³ Op cit, p. 27

¹⁴ World Bank Operations Policy and Country Services, “2009 Development Policy Lending Retrospective: Flexibility, Customization, and Results. Oct. 27, 2009

¹⁵ Acharya, Anjali, et al. “The Role of Environmental DPLs in Supporting Environmental Sustainability: Assessing Experience, Learning Lessons,” World Bank Environment Department, Terms of reference, May 2010. Discussion with author in June 2010. **The World Bank has indicated that it will now not disclose any version of this paper.**

effectiveness/ impacts. This background paper aims to fill this gap in learning, and will provide a key input to the issue of mainstreaming environment in the new Environment Strategy 2010.”

We also understand that the original scope of this important paper has been substantially revised and that plans for disclosing the paper have been cancelled. Concerns registered by Bank management regarding attention to acceptable transparency, consultation and accountability standards in the design and implementation of DPLs in the first draft of this background paper resulted in the scaling back of focus on these important areas of DPL effectiveness.

2) New approach to environmental DPLs: We make reference in the evaluation to a number of examples where the Bank fell short in maximizing its options for participation in the design and implementation of the SEM DPL. Perhaps most striking is the reversal of a decision that was piloted by the Bank in an earlier programmatic loan to create a civil society advisory group.

While the new access to information policy improves the transparency of DPLs and the potential for enhanced consultation, there continue to be significant gaps in adequate transparency related to the design and implementation of DPLs. We acknowledge the significance of DPL results frameworks, however we find no answer to our argument that consultation about the design of this framework and space for participation in the monitoring of results indicators are lacking. Our evaluation points to substantive problems with access to DPL information, including frequent borrower objections to simultaneous disclosure, timely access to sectoral and technical documentation related to DPL design, access to evidence behind reported progress and evaluation.

The additional information provided in your response on the principal transparency weakness of the SEM DPL related to lack of evidence of compliance for the second disbursement does not directly contest the evidence we present in the evaluation. We stand by our argument that the Bank has not demonstrated compliance with second tranche conditions related to the application of BNDES social and environmental institutional (SERG) policy.

3. Open OP 8.60 for revision:

Acknowledging the guidance that is provided for DPLs, we should also acknowledge that such guidance is voluntary. What is of greatest concern is the policy. We find the existing criteria that establish requirements for DPLs are inadequate in several areas.

a. DPL amount criteria: We are not disputing whether DPLs are earmarked to directly fund the reform programs. The most pertinent aspect of this issue is the unresolved question regarding the justification of any DPL loan amount and the relationship this decision has with the ambition of the reform agenda. The answer provided in your comment tends to treat the requirements inferred in paragraph 12 of OP 8.60 as self evident. We argue that the application of these criteria to Brazil and the relevant programs is not clear. The SEM DPL includes no such justification for the loan amount of \$1.3 billion. The three criteria listed in paragraph 12 of OP

8.60 suggest vague limits, but do not represent all of the criteria. The reference to “program financing requirements” is unclear in the case of the SEM DPL, unless referring to the Ministry of Environment or the Environmental Area of BNDES? The “costs of the reform” seem to be a relevant factor in the case of SEM DPL, but no detail is provided on reform cost estimates. The reference to “country circumstances” is one example of a loophole that provides excessive discretion. What remains unstated is how these criteria were applied to generate the SEM DPL loan amount. In line with prior stated references to World Bank commitments to budget transparency for DPL receiving countries, we recommend that this explanation become a standard component of any DPL program document, guided by more detailed and tangible criteria.

b. DPL consultation and transparency: The World Bank does more than most other development finance institutions to promote good practices in consultation and transparency. Still, our findings for the SEM DPL evaluation are consistent with the 2009 DPL Retrospective that improvement is needed for ensuring the quality and depth of consultation and greater focus on the outcomes of consultation.¹⁶ As the debate over the necessary transparency commitments for the Bank’s proposed Program for Results instrument has demonstrated, greater effort is needed by both the Bank and its clients to disclose prior to Board approval how they meet objective criteria for minimal institutional capacity to produce results. An assessment of relevant institutions, typically found within a program document, should be disclosed prior to Board approval. We continue to call for disclosure without exceptions of draft Program Documents to enable prior public assessment of proposed policy actions, triggers and performance indicators before Board approval. These limitations in adequate transparency for DPLs have in turn weakened consultation and contributed to flaws in DPL results frameworks, also observed in the Bank’s DPL retrospective.

The critical distinction that we make in our analysis is that between a country’s consultation arrangements for national reforms in policy or strategy, and specific consultation arrangements for translating those national agreements into a results framework for a DPL. We agree that the SEM DPL described the relevant policy consultations that occurred in Brazil. However, the way in which these national consultations translated into several prior actions or triggers in the policy matrix was not clear. The lack of any systematic consultation around the central policy condition of BNDES formulation and application of a new social and environmental policy stands out as the most striking contrast with stated commitments to DPL emphasis on consultation and transparency. As noted above, the Bank declined to continue a practice initiated under the prior Programmatic Environmental Loan of creating a CSO advisory mechanism. We suggest that these flaws in the SEM DPL consultation and disclosure process contributed to at least one indicator (percent of judicially challenged environmental licenses) proving unfeasible to measure and perhaps less meaningful in substance than alternative indicators. This same lack of transparency and consultation resulted in our opinion in the significant underestimation and poor specification of several other performance targets.

As we note in the report, for reasons that were not properly explained, the Bank decided to abandon the original indicator for “improved effectiveness of government agencies in implementing mandated Brazilian environmental and social management procedures (reduction

¹⁶ World Bank OPCS, 2009 DPL Retrospective, pgs viii-x.

in judicially challenged environmental licenses by 20%). The decision to opt for an alternative indicator (increase in EIAs) was not consulted, nor explained beforehand to SEM DPL stakeholders. Neither indicator is the best measure of government effectiveness. With an expected 700% increase in the number of environmental licensing requests over the coming years, the difficulty of monitoring any decline in judicially challenged licenses becomes evident, as well as the need to strengthen the licensing process in general.¹⁷ However the process of clarifying attributed responsibilities at different levels of government and establishing more rigorous standards for the first submission of an EIA to IBAMA – both measures now in debate in the national legislature, are only part of the problem of licensing delays. Through open, formal consultation with experienced practitioners in the area of social and environmental licensing, the World Bank could have avoided the last minute changes to the SEM DPL policy by defining a more appropriate performance target at the outset.

The referenced Development Policy Action Database managed by OPCS since 2009 is a list of short, ambiguous single sentence statements that fail to adequately address the observed substantive weaknesses in performance reporting. For the SEM DPL, the database lists as evidence of completed policy action:

“The Borrower has evidenced in form and substance satisfactory to the Bank that new environmental and social institutional policy, following, inter alia, the provisions of Protocolo Verde (see Section I.A.1(c) of this Schedule), has been approved by BNDES Board of Executive Officers, and is being applied to operations financed directly by BNDES.”

Rather than providing or referencing evidence of effective application and approval of new BNDES policies to operations, this statement like others in the World Bank database exhibits many of the transparency defects that our analysis pointed out in greater detail.

c. DPL assessment of social and environmental risk: While we recognize that the Bank has improved the voluntary good practice guidance in terms of a new compendium of good practice notes for social and environmental analysis, we simply disagree that OP 8.60 provides clear guidance regarding social and environmental risks.¹⁸

First we must be somewhat cautious with the interpretation of data given to suggest low overall social and environmental DPL risk. As stated, the DPL retrospective is not an independent evaluation so the results must be treated with caution. The 2009 DPL Retrospective suggests that less than only 1% of the 1,671 prior DPL actions between FY06-Q4 and FY09-Q3 were identified to have possible negative effects defies believe. Even more surprising is the suggestion that only 6% of those DPLs had potentially positive effects. If this assessment is based on the questionable quality of information conveyed in the DPL prior action database, we can understand why it might underestimate the possible social and environmental risks associated with DPLs. When we consider that the World Bank has funded over \$5 billion in

¹⁷ Paulenir Costancio, “Governo Moderniza licenciamento ambiental em obras de infraestrutura, ASCOM-MMA, 28 Octubre, 2011.

¹⁸ World Bank, (2008) “Assessing the Environmental, Forest, and Other Natural Resource Aspects of Development Policy Lending: A World Bank Toolkit.”

DPLs targeting forest sector reforms alone, it would be curious that such DPLs had neutral effects on forest sector governance. It appears from the Retrospective findings that DPLs are almost pre-determined to have positive impacts on the environment. As we show for the SEM DPL, this is not the case.

Second, we insist on the distinction between voluntary guidance and mandatory policy requirements that remains the source of our primary concern and lies at the root of generalized problems with DPL effectiveness. To take one significant example that we explain in further detail in the paper but is unaddressed in the Bank's reply, the concept of a strategic environmental assessment (SEA) is mentioned in OP 8.60, footnote 8 and throughout the good practice notes as a recommended analytical pre-requisite for specific sector risk analysis. We argue that in practice the World Bank SEM DPL validated a tool referred to as an *Avalacao Ambiental Integrada* (AAI) in the energy sector for the Brazilian hydroelectric investments that falls far short of many of the principles commonly associated with this concept. The report stated:

“World Bank officials stressed that cumulative impact was considered the purview of IBAMA, and acknowledged the disagreement between MMA and MME over the function of the proposed Avalacao Ambiental Integrada (AAI) as a hydroelectric inventory calculator rather than its original intent as a basin-wide impact assessment and siting tool. The Bank observes that MME/EPE’s Integrated Basin Assessment methodology is not the optimal solution, but an acceptable step in the right direction. Unlike the World Bank’s more aggressive lobbying for common standards for EIA terms of reference, the lack of uniformity and even minimum standards for SEAs did not seem to be as pressing a concern for improving environmental governance. A recent lawsuit by the Ministerio Publico Federal (DF) against the arbitrary and ineffective use of AAE as a design tool for hydroelectric investment suggests that complacency regarding misuse of SEAs is not acceptable. See analysis of AAI in policy action #8 below.”¹⁹

The SEM DPL accepted this misuse of the SEA concept, strongly suggesting that extensive voluntary guidance is no replacement for solid, clear mandate in areas of strategic analytical significance central to social and environmental risk analysis. These and other gaps in the OP 8.60 should be revised.

Finally, the central “program” to be assessed by the World Bank prior to and during implementation of the SEM DPL is the BNDES environmental and social risk management system. Again, we might underscore recent debates regarding the lack of adequate guidance for IFC support of Financial Intermediaries and the proposed Program for Results operational policy 9.0 requirements for assessing these same country, program, or firm level systems. The IFC was induced to upgrade its Sustainability Policy, Performance Standards and Access to Information Policies to account for some observed gaps in how FI systems assessments were to be conducted, although not all external recommendations were taken on board.²⁰ The P4R operational policy

¹⁹ See “MPF/DF ajuiza ação para proteger bacias hidrográficas brasileiras,” Aug. 9, 2011, <http://www.prdf.mpf.gov.br/imprensa/acp-mme-epe-ibama.pdf>

²⁰ See IFC Guidance Note – Interpretation of Financial Intermediaries as well as highlighted changes to FI sections in the Sustainability Policy framework, as well as a new web guidance platform designed to advise FIs on ESMS requirements, <http://www.ifc.org/ifcext/sustainability.nsf/Content/FinancialInstitutions>

draft was found roundly insufficient for lacking clear requirements for how program financial, social and environmental, and results systems were to be assessed prior to Board approval.²¹ IEG's evaluation of the PRSC operations found weak evidence of pro-poor achievements – a central social objective of DPLs. The 2009 Retrospective echoes IEG's finding by suggesting that most DPL prior actions are poverty neutral (again with noted reservations about the quality of data from which these conclusions are drawn). Moreover, this management report observes in a footnote that *“there is no definitive criterion for classifying prior actions as likely to have significant poverty and social impacts, which mean that classification, must rely to some degree on subjective judgment.”*²²

Combined, these weaknesses in policy guidance on social and environmental risk lead to a lack of clarity regarding the identification of an affected population for DPLs, which effectively disarm key mechanisms of a safeguard system. While some subjectivity is always involved in risk assessment, far too much discretion is provided for in OP 8.60.

The pattern of substantive concerns raised by stakeholders about the Bank's approach to systems assessment in operational design for Financial Intermediaries and Programmatic Operations point to a lack of consensus regarding how best to define client requirements. Statements in the Bank's response to our SEM DPL evaluation that seem to ignore or minimize gaps in OP 8.60 suggest an underestimation of the Bank's challenges in programming DPLs.

Among the remedies that might be discussed in an update of OP 8.60 is the requirement of an Integrated Safeguards Data Sheet or some equivalent for DPLs that systematizes the relevant analysis that will be necessary for appraisal of an operation. Similarly, such a document would summarize key aspects of OP 8.60 that are triggered and requiring actions. A central revision that would assume greater prominence in a revised OP 8.60 would be draft assessments of relevant country, program, sector institutional capacity to deliver the proposed policy actions and triggers while adequately managing social and environmental risk.

d. Measuring institutional capacity, DPL effectiveness and World Bank additionality

While the Bank has distanced itself from excessively rigid and ideologically driven conditionality that builds instead on country defined strategies and goals, the technical expertise on institutional capacity remains a weaker area of additionality despite its central importance for effective use of DPLs. OP 8.60 should clarify the DPL framework for measuring improvement in institutional capacity. Our evaluation addressed various Bank analytical research investments that suggest options for improving the ability to clarify and improve the definition and evaluation of DPLs in terms strengthening institutional capacity.²³ The various efforts underway to

²¹ BIC, “Program-For-Results System Assessment Criteria: Key Areas Requiring Clarification and Disclosure Prior to World Bank Board Consideration,” Oct. 10, 2011 http://www.p4rcomments.org/uploads/BIC_P4R_Results_Concerns_and_System_Assessment_Criteria_10.10.11.pdf

²² World Bank OPCS (2009) DPL Retrospective, pg. 52, fn 42.

²³ Eltz, Melanie and Urvashi Narain, Alessandro Orfie, and Robert Schneider, “Strengthening Environmental Institutions and Governance: What Should be the Role of the World Bank Group?” Background paper for the 2010 Environment Strategy. The World Bank. (Nov. 3, 2010); A. Acharya, “The Role of Environmental DPLs in Supporting Environmental Sustainability: Assessing Experience, Learning Lessons,” Terms of reference, May 2010.

consolidate the Bank's knowledge systems and update relevant policies or strategies provide a unique opportunity to revise OP 8.60, in which clear references to any measurement framework or adequate guidance are missing. Lacking these more tangible milestones, defining Bank additionality through DPLs will be difficult.

Other Brazil SEM DPL Issues in the BIC Evaluation Contested by the World Bank

1) Origins of the SEM DPL: The SEM DPL was not clearly identified in the in the CPS FY 2008-2011, although some type of support to strengthen social and environmental aspects of BNDES was identified.²⁴ The CPS stated that fewer rapid disbursing DPLs or other operations to the Federal government were anticipated during the first two years of the program. The origins of the financial crisis pre-dated November 2008, as most economic observers now acknowledge in hindsight. Initial drafts of the SEM DPL PID made reference to the financial crisis, macro-economic factors and budget deficits as factors in the design of the SEM DPL. We agree that the SEM DPL finds its origins in the long standing relationship the Bank has sustained with the Brazilian Ministry of Environment. The DPL was evidently motivated by various factors, including the financial crisis.

2) Consultation process: The BIC evaluation lays out in extensive detail the missed opportunities to fully consult on the design and implementation of the SEM DPL, despite repeated efforts to engage the Bank and the government of Brazil on the operation. Not all sectoral and analytic work conducted for the preparation of the SEM DPL, such as the Bank commissioned inputs to the design of BNDES subsector guidelines, were disclosed.²⁵ As observed above, the Bank chose not to replicate the innovative option of convening a civil society advisory group for the SEM DPL. We do not see any reason to change the report's conclusion on consultation.

The simple fact is that the central policy action for the SEM DPL was the approval and application of a new social and environmental institutional policy to all BNDES operations. To date, neither BNDES nor the World Bank has produced evidence regarding the quality of the application of this new policy. BNDES has chosen not to consult systematically on the new policy framework, despite Bank advice in favor of consultation. We might conclude that the mere fact that the Bank advised the government to consult on the BNDES policy framework met the OP 8.60 requirement. However, we would use the same evidence to suggest that OP 8.60 is not rigorous enough to address these exact conditions when the impact on operational performance is high but the Bank's advice on consultation to the client is ignored. We argue that the evidence underscores why paragraph 6 in OP 8.60 should be strengthened to ensure adequate consultation.

²⁴ World Bank Country Partnership Strategy for Brazil, FY2008-2011, annex page 93.

²⁵ For example, "*Estudo sobre Aspectos Sócio-Ambientais de Setores Produtivos e de Infraestrutura para Compôr o Guia de Procedimentos Ambientais do BNDES.*" Prepared by Elabora Assessoria Estratégica em Meio Ambiente, Fevereiro de 2009

The Bank has also chosen not to disclose requested information regarding the application of the new policy. The BIC evaluation highlighted several independently verified instances where the application of the new policy, both in terms of its content and procedural practice, fall far short of the highest international standards, including but not limited to the World Bank's standards. In the face of the evidence presented in the BIC evaluation that went largely uncontested in your comment, the lack of any systematic consultation practice in the design of the BNDES social and environmental policy framework, which was facilitated by the SEM DPL, can only leave doubt as to the integrity of the BNDES policy.

3) Use of DPL funds:

The main point we make in the evaluation is not related to the direct use of DPL funds. The apparent coincidence of the transfer of World Bank DPL funds in December of 2010 at the height of an international debate regarding a high risk BNDES loan to Norte Energia S.A. for initiating construction and contracting supplies for Belo Monte dam is worthy of much greater examination than was provided in the World Bank's assessment of SEM DPL effectiveness. This assessment would have focused on the risk assessment quality of the NESA bridge loan, rather than the financial ties between the SEM DPL and this BNDES loan. Public perceptions aside, we understand that no explicit link exists between the SEM DPL and the BNDES bridge loan to begin Belo Monte. Still, the core question of whether this BNDES bridge loan complied with adequate social and environmental risk assessment measures remains unanswered by both the World Bank and BNDES, despite substantive doubts raised by the Ministerio Publico Federal do Pará, making the second tranche transfer all the more curious.

Your response states that the "*borrower (Norte Energia, S.A.) lost interest in the deal because BNDES's new procedures (motivated by the SEM DPL), the loan agreement included clauses that prevented it from using the proceeds without undertaking significant additional measures concerning social and environmental sustainability.*" We understand that the BNDES bridge loan was delayed due to unclear concerns (since the loan document was never disclosed), but was eventually approved and disbursed in July 2011.²⁶

As you know, the BNDES NESA bridge loan agreement is not public, like all BNDES loans. The suggestion by your comment that BNDES exercised social and environmental conditions on the bridge loan through specific clauses in the loan agreement is a perfect example of the type of information that is missing from the public knowledge of BNDES lending. Suggesting that the World Bank has this information but will not disclose it only compounds the perception that SEM DPL has facilitated a lack of adequate transparency.

Secondly, as DPLs lack any explicit justification of the loan amount, excessive discretion could lead to misuse of the instrument. While the SEM DPL funds may not have been used directly to support BNDES, the timing the second tranche release

²⁶ Agencia Estado, "Norte Energia recebe parte de empréstimo do BNDES," O Estado de Sao Paulo, 25 Julio, 2011, No. 132110.

4) Compliance with SEM DPL Second Tranche conditions for Dec. 2010 disbursement

We appreciate the Bank's position that the technical review prior to second tranche release of SEM DPL met internal standards. However, there is no additional reason to alter our conclusion that public evidence of compliance is lacking.

5) MMA hiring target

While the hiring targets at the MMA were not a second tranche trigger of the SEM DPL, progress toward the stated goals was clearly a part of this loan. What progress was made and why was this acceptable or not? No clarification of this institutional capacity goal was given, particularly during a turbulent period that witnessed the dismissal of two IBAMA chiefs and recurrent budget cuts at the agency. Moreover, the results reporting system anticipated through the ENV TAL operation failed to update progress on these or other SEM DPL performance indicators.

6) Deforestation results

The question we raise in our evaluation is largely about the additionality of the SEM DPL in the impressive deforestation results by Brazil since 2005. The federal macro EEZ would have to have some direct relationship to State EEZs in the Amazon basin for it to have exercised leverage over trends in deforestation. Little explanation of the interplay between the zoning plans and other factors to changes in land use and deforestation was providing in the implementation reports or completion report.

7) Forest Code

The debate regarding revisions to the Forest Code pre-dated the SEM DPL and has continued beyond the operation's close. The suggestion that the legislative phase of the Forest Code revision process beginning in 2011, after the official close of the SEM DPL, would inoculate the SEM DPL from any effect from the outcome of this debate seems inaccurate. The magnitude of the proposed changes to the Forest Code, which are understated in the one sentence that the World Bank devotes to this issue in the ICR, will inevitably have a great impact on future land use choices and deforestation in the Brazilian Amazon. According to analysis of the legislation approved by the Brazilian Senate in November and awaits Presidential approval, Brazilian farmland will now see a reduction in the area that has to be reforested on a scale of about 30 million hectares. World Wildlife Fund estimates that the revised Forest Code will reduce forest cover in Brazil by 76.5 million hectares (295,000 square miles).²⁷ Of course, these are not insignificant risks, although what was missing in the SEM DPL was an adequate assessment.

As the SEM DPL was designed to promote sustainability of investment and strengthened environmental governance, the additionality of the SEM DPL in this debate will only be known in time. Hopefully the Bank will devote greater attention to understanding this and other longer

²⁷ Rhett Butler, "Brazil passes controversial Forest Code reform environmentalists say will be 'a disaster' for the Amazon," *Mongabay*, Dec. 6, 2011, http://news.mongabay.com/2011/1207-forest_code_passed.html

term results of the SEM DPL through an evaluation of the operation after enough time has passed to allow a full and accurate assessment of policy reform effectiveness.

We appreciate the opportunity to provide our views on the subject of the SEM DPL and the prospect for revising OP 8.60. We reiterate our belief that the DPL instrument can be an effective financial instrument for conveying the comparative advantages of World Bank cooperation. These observations and recommendations are offered in the shared interest in making DPLs as effective as possible.

Sincerely,

Vince McElhinny
BICECA Project Manager
Bank Information Center

Cc:

Ms. Hasan Tuluy, Vice-President for Latin America, The World Bank
Mr. Joaquim von Amsberg, Vice-President of Operations and Country Services, The World Bank
Mr. Kyle Peters, Director, Country Services, The World Bank
Mrs. Caroline Heider, Director General Evaluation and Sr. Vice President, IEG, The World Bank
Mr. Rogerio Studart, Executive Director for Brazil, The World Bank
Mr Vishnu Dhanpaul, Alternative Executive Director for Brazil, The World Bank
Mr. Mark Lundell, Sector Leader for Sustainable Development, The World Bank
Mr. Garo Batmanian, Senior Environmental Specialist, The World Bank
Mr. John Garrison, External Relations, The World Bank
Mr. Gustavo Pimentel, Amigos da Terra – Amazonia Brasileira
Mr. Zachary Hurwitz, Policy Director, International Rivers
Mr. Cesar Gamboa, Policy Director, Derecho, Ambiente, Recurso Natural (DAR)
Ms. Margarita Florez, Instituto Latinoamericano de Servicios Legales (ILSA)