

Effective Financing of Environmentally Sustainable Development

Ismail Serageldin
Alfredo Sfeir-Younis
Editors



*Proceedings
of the Third Annual World Bank Conference
on Environmentally Sustainable Development*

*sponsored by the World Bank
and held at the National Academy of Sciences
and the World Bank
Washington, D.C.
October 4–6, 1995*



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Cover photo by Curt Carnemark. Members of a village venture-capital and collective-saving association in Pakistan bank the proceeds of their work, using passbooks to their collective account. They are part of the Aga Khan Rural Support Programme (AKRSP), which was launched in 1982 by the Aga Khan Foundation and Pakistani villagers and received additional funding from ODA, CEC, CIDA, the government of the Netherlands, and the World Bank.

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Contents

Preface ix

Acknowledgments xii

PART ONE PLENARY SESSIONS

Opening Plenary

Inaugural Session

Welcoming Address	<i>Bruce Alberts</i>	3
The Role of International Cooperation	<i>Boutros Boutros-Ghali</i>	5
Partnerships in Governance and Implications for Conduct	<i>Maurice F. Strong</i>	6
Effective Financing of Environmentally Sustainable Development	<i>Ismail Serageldin</i>	9

The Potential Costs of Inaction

Introduction	<i>Kathryn Fuller</i>	13
Panelist Remarks	<i>Henry W. Kendall</i>	14
	<i>Edward O. Wilson</i>	17
	<i>Robert T. Watson</i>	21
	<i>José Israel Vargas</i>	26

Changing Public Attitudes: Government, Media, and Education

Keynote Address	<i>Al Gore</i>	29
-----------------	----------------	----

Private Sector Leadership for Solutions

Introduction	<i>Keith A. Bezanson</i>	34
Panelist Remarks	<i>Lester Brown</i>	35
	<i>Whitney MacMillan</i>	37
	<i>Rose Mazula</i>	39
	<i>Nancy Barry</i>	41
	<i>Roberto F. de Ocampo</i>	46
	<i>Muhammad Yunus</i>	47

Effective Financing of Environmentally Sustainable Development and New Forms of Partnerships

Speaker Remarks	<i>Jessica Matthews</i>	49
	<i>Claude Martin</i>	51

How Governments Can Lead Environmentally Sustainable Development

Introduction	Henrique B. Cavalcanti	53
Panelist Remarks	Ralph Willis	54
	Ana R. Ordoñez de Molina	56
	Kwesi Botchwey	59

Closing Plenary

Effective Financing of Environmentally Sustainable Development in Developing Countries: New Directions

Keynote Address	Ibrahim Boubacar Keita	61
-----------------	------------------------	----

Effective Financing: The Global Environment

Introduction	Sven Sandström	64
Panelist Remarks	Mohammed T. El-Ashry	65
	Elizabeth T. Dowdeswell	67
	Alfredo Phillips	69
	James Gustave Speth	73
	David McDowell	75

Beyond the Conference: The Need for Action

The Value of the Individual in Environmentally Sustainable Development	Nafis F. Sadik	80
--	----------------	----

Support for a New Policy Framework and the Institutional Dimensions

Introduction	James D. Wolfensohn	83
Panelist Remarks	Enrique V. Iglesias	84
	Mitsuo Sato	86
	J. Brian Atwood	88
	Huguette Labelle	91
	Fawzi H. Al-Sultan	93

Closing Remarks

A New Spirit of Partnership	James D. Wolfensohn	96
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PART TWO THEMATIC AND REGIONAL ROUNDTABLES

Thematic Roundtables

<i>Environment, Health, and Sustainable Development</i>	101
<i>Effective Financing of Global Environmental Programs</i>	104
<i>Effective Financing of Environmentally Sustainable Development through Private Sector Development</i>	107
<i>Effective Financing of Environmentally Sustainable Development: Conservation, Science, and Policy</i>	109

Regional Roundtables

<i>Effective Financing of Environmentally Sustainable Development in Latin America and the Caribbean</i>	112
<i>Effective Financing of Environmentally Sustainable Development in Sub-Saharan Africa</i>	115

<i>Effective Financing of Environmentally Sustainable Development in Asia and the Pacific</i>	117
<i>Effective Financing of Environmentally Sustainable Development in Europe and Central Asia and the Middle East and North Africa</i>	119

PART THREE BACKGROUND PAPERS FOR ROUNDTABLES

Thematic Roundtables

Environment, Health, and Sustainable Development

Environment and Health: Key Links	<i>David Tejada de Rivero</i>	125
Environmental Health and Sustainable Development	<i>Anthony J. McMichael</i>	128
Water Pollution: Sustaining Improvement	<i>Letitia A. Obeng</i>	132
The Two Tasks of an Environmental Agency:		
An Illustration from Air Pollution Control in Santiago	<i>Gunnar S. Eskeland</i>	135
Industrial Safety in Large Corporations	<i>Usha Wright</i>	138
Innovative Environmental Biotechnologies in Small-Scale Enterprise for Sustainable Development	<i>Purushottam Khanna</i>	141
The Two-Century Debate: Population, Environment, and Development	<i>Saad Eddin Ibrahim</i>	145

Effective Financing of Global Environmental Programs

Global Environmental Markets: The Case for an International Bank for Environmental Settlements	<i>Graciela Chichilniski</i>	148
Valuing Biodiversity for Use in Pharmaceutical Research	<i>R. David Simpson, Roger A. Sedjo, and John W. Reid</i>	151
Taxing Variable Cost: Environmental Regulation as Industrial Policy	<i>R. David Simpson and Robert L. Bradford, III</i>	155

Effective Financing of Environmentally Sustainable Development through Private Sector Development

Energy for Development	<i>Peter Kassler</i>	158
Policy Choices for Governments	<i>Gretta Goldenman</i>	161
Getting beyond the Environmental Liability Conundrum in Central Europe's Privatization Programs	<i>Thomas Kolaja</i>	164
How Privatization Can Help the Environment:		
The Case of the Odra Cement Plant	<i>Vivek Talvadkar and Gavin Wilson</i>	167
The Case of Mining in Bolivia	<i>Craig B. Andrews</i>	170
Internalizing Environmental Cost: The Case of Emissions Trading	<i>John B. Henry, II</i>	173
Emissions Trading in Santiago: An Overview	<i>Raul O'Ryan</i>	176

Effective Financing of Environmentally Sustainable Development: Conservation, Science, and Policy

Beyond the Tropical Forest Action Program:		
Financing Forest Development and Conservation	<i>Markku Simula</i>	179
Proposal for the Establishment of a Regional Fund for Agricultural Technology	<i>Nancy Birdsall</i>	183
Agricultural Research Funding in Latin America	<i>Martin Piñeiro</i>	186
Introducing Environmental Costs in National Accounts in the Service of Sustainable Development	<i>Jean-Pierre Brard</i>	189

A Nongovernmental Organization Perspective on Effective Financing of Environmentally Sustainable Development: Measurement Issues and Indicators	<i>Gerald O. Barney</i>	192
The International Perspective	<i>Joke H. Waller-Hunter</i>	196

Regional Roundtables

Effective Financing of Environmentally Sustainable Development in Latin America and the Caribbean

Effective Financing through the Private Sector	<i>Teodosio Brea</i>	199
Macroeconomic Policies and Environmental Sustainability in Latin America	<i>Ramón López</i>	202
Private-Public Sector Partnerships: Conditions and Opportunities	<i>J. Hugh Faulkner</i>	205
Effective Financing: The Role of Communities and Nongovernmental Organizations	<i>Yolanda Kakabadse</i>	208
Debt Swaps and Sustainable Development in Costa Rica	<i>Alvaro Umaña</i>	211
Effective Financing of Environmentally Sustainable Development in Latin America and the Caribbean	<i>William L. Partridge</i>	214
Development, Debt, and Financial Mechanisms for Environmental Protection	<i>Juan Pablo Ruiz Soto</i>	218
Natural Resource Degradation Effects of Poverty and Population Growth Are Largely Policy Induced: The Case of Colombia	<i>John Heath and Hans P. Binswanger</i>	220

Effective Financing of Environmentally Sustainable Development in Sub-Saharan Africa

Effective Private Sector Financing of Environmentally Sustainable Development in Sub-Saharan Africa	<i>Udayan Waglé</i>	223
AGETIP's Experience in Community Participation and Resource Mobilization	<i>Magatte Wade</i>	226
Financing of Environmentally Sustainable Development in Rural Areas: The Case of Madagascar	<i>Francis Lethem</i>	229
Transboundary Programs: From Ecology to Policy	<i>Mersie Ejigu</i>	232
Political and Policymaking Tasks That Lie Ahead for Effective Financing of Environmentally Sustainable Development: The Case of Zambia	<i>William Harrington</i>	235
Effective Financing of the Debt Burden in Sub-Saharan Africa	<i>Kingsley Y. Amoako</i>	237

Effective Financing of Environmentally Sustainable Development in Asia and the Pacific

Grow Now, Clean up Later? The Case of Japan	<i>Kazu Kato</i>	240
Securing Funds from Capital Markets to Finance Infrastructure	<i>Frank Soriano</i>	243

Effective Financing of Environmentally Sustainable Development in Europe and Central Asia and the Middle East and North Africa

The Post-Communist Transition and Environmental Health in Central and Eastern Europe	<i>Gordon Hughes</i>	246
Pollution and Health: Environmental Health Action Plan for Europe	<i>J. E. Asvall</i>	250
Health and the Environment: Lessons from Central and Eastern Europe	<i>Clyde Hertzman</i>	254
Effective Financing of Environmentally Sustainable Development in Eastern Europe and Central Asia	<i>Theodore Panayotou</i>	258
Effective Environmental Financing in the Transition Economies of Central and Eastern Europe	<i>Tomasz Zylicz</i>	261
World Bank Environmental Lending in Central and Eastern Europe: Lessons from Experience	<i>Kristalina Georgieva</i>	265

Environmental Funds and Other Mechanisms of Financing Environmental Investments in Central and Eastern Europe and the Former Soviet Union	<i>Grzegorz Peszko</i>	268
Effective Financing of Environmentally Sustainable Development in Europe and Central Asia	<i>Timothy Murphy</i>	271
Averting a Water Crisis in the Middle East and North Africa	<i>John A. Hayward</i>	274
Water Problems in Jordan	<i>Munther J. Haddadin</i>	277
The International Incidence of Carbon Taxes	<i>John Whalley and Randall Wigle</i>	280
The Czech Oil Refining Industry: A Case Study of Environmental Issues in Privatization	<i>Daniel J. Arbess</i>	283
Appendixes		
A. Program		285
B. Presenters		295

Preface

The Third Annual World Bank Conference on Environmentally Sustainable Development was convened by the World Bank in October 1995 to focus on effective financing of environmentally sustainable development. The choice of the word *effective* indicated the thrust of the conference.

The broad consensus forged at the 1992 Earth Summit in Rio de Janeiro is at risk. The implementation of the many valuable recommendations embodied in Agenda 21 is stymied by the shortage of public funds at a time when almost all governments are cutting back on investments, and official development assistance flows are at an all-time low. Continued reliance on public funding from the governments of either the North or the South is bound to limit the implementation of many necessary actions.

This conference was designed around five premises:

1. Public expenditures can be handled better, even within the same budget envelopes. Deployed differently, both in terms of revenue collection and expenditure patterns, public funds can have a much greater impact in implementing the objectives of Agenda 21.
2. The role of the private sector, whose financial flows to developing countries are more than three times greater than those from official development assistance, needs to be redefined so that these flows can be channeled to promote environmentally friendly and socially responsible investments.
3. The right incentive frameworks can greatly influence the role of the private sector, both domestically and internationally. Market-based instruments, not just regulations, are key to success in this area.
4. The civil society has much to contribute to make these development patterns a reality.
5. A new partnership needs to be instituted among national and local governments, national and international private sectors, civil society, and international financiers. It is not enough to get the prices right. We must also get the roles right if the desirable goal of environmentally sustainable development is to become a reality.

To explore these ideas, the World Bank assembled distinguished practitioners from these domains to exchange experiences, highlight their common ground, and distill the lessons that each could take back to his or her own domain.

During the conference the organizing premises were all proven correct, and the results were a very rich, multifaceted dialogue. More than 1,400 people attended the sessions and heard these discussions.

The presenters came from international organizations, national governments, and state and local bodies. They came from nongovernmental organizations, universities, small community organizations, and the media. Heads of states, ministers and leading government officials, corporate leaders, heads of nongovernmental organizations, distinguished academics, and a variety of experts assembled from every corner of the world to discuss the world's future.

These participants came to discuss the vital question of how to finance environmentally sustainable development in an era of declining support for public initiatives, rapid development in some parts of the world, and enormous challenges in others—during a period of biodiversity loss and incipient climate change. The participants compared their experiences in

financing environmentally sustainable development through public and private means, partnerships involving both, and other innovative mechanisms. They discussed the need for better financing methods for sustainable development and the risks of failure in that quest.

The participants concluded that

- Above all, the cost of inaction may be catastrophic.
- In this age of downsized government and shrinking public resources, efforts to promote sustainable development no longer can depend on governments alone or on resources from traditional donors.
- Partnerships among government, the private sector, and local stakeholders appear to be the best way to leverage scarce resources.
- Nongovernmental organizations can provide a vitally important complement to both the public and private sectors.
- While we should seek win-win situations wherever possible, we must also be realistic and acknowledge that much environmental reform has occurred only in response to government regulation and has caused a loss for some economic actors. However, efforts to protect the environment can be accomplished in ways that internalize the full costs and bring out real benefits, thus creating necessary support for their implementation.
- Stress on the environment is generally proportional to population growth.
- Educating women is probably the leading factor in stemming population growth.
- Damage to the environment is generally proportional to consumption.
- Market-based systems for trading pollution credits hold considerable promise as a way to reduce net pollution.
- Microenterprise appears to be an important mechanism to accelerate the upward mobility of the poor.

Held at the National Academy of Sciences and at the World Bank in Washington, D.C., the conference and its many Associated Events advanced the debate from how to finance sustainable development amidst ever-increasing claims on public funds to the practical realm of how to use available resources more effectively.

The World Bank has decided to assist its

member states in taking concrete steps to promote effective financing of sustainable development. These include the reaffirmation of its own post-Rio fourfold agenda to

1. Assist borrowing countries in promoting environmental stewardship through policy dialogue, studies, lending, and technical assistance
2. Perform systematic environmental impact assessments for all World Bank-financed projects to ensure that they do no harm
3. Promote win-win strategies by investing in people, particularly women, and promoting efficient use of natural resources
4. Address global and regional challenges as well as national ones, primarily through its work with the Global Environment Facility and the Montreal Protocol Fund (addressing ozone depletion).

Beyond this agenda the World Bank is now committed to what has been aptly called the *new environmentalism*. It is a *people-centered* environmentalism that seeks to provide all people with clean air, clean water, and fertile soils and that considers the needs of future generations without undermining the pursuit of better livelihoods today.

The ten hallmarks of the new environmentalism are:

1. Set priorities carefully.
2. Go for win-win options first.
3. Promote cost-effectiveness.
4. Use market incentives where feasible.
5. Economize on administrative and regulatory capacity.
6. Set realistic standards and enforce them.
7. Work with the private sector.
8. Recognize that public involvement is crucial.
9. Build constituencies for change.
10. Incorporate environmental concerns from the outset.¹

The World Bank is also very active in the conceptual and methodological work that undergirds the current development paradigm. Thus, during the past two years the Bank has been promoting change in the “greening” of national income accounts and environmental measurements. The Bank is also developing new conceptual structures that measure wealth (stocks), not just income (flows). It is looking for better

measures of four forms of capital: produced assets and natural, human, and social capital.

This philosophy was reaffirmed and enriched by the discussions at the conference and its Associated Events. This volume contains the edited texts and testimony provided by the 183 presenters. Given the large increase in the number of presenters from the previous Environmentally Sustainable Development Conferences, presentations have been substantially edited to keep the volume to a reasonable length, to present arguments and themes in the clearest manner, and to balance the views expressed at the conference. All of the plenary speakers are represented, through either papers that they submitted or edited transcripts of their remarks. The summations of each of the four thematic roundtables and four regional

roundtables in Part Two give the sense of the wide-ranging discussions at the break-out sessions. Finally, all of the papers presented in the roundtables have been edited and are included in Part Three. Full versions are available by contacting the authors as listed in appendix B.

Besides capturing in one place the extraordinary range and depth of viewpoints presented at this conference, this volume also serves as a valuable record of an important aspect of this stage in the world's pursuit of sustainable development.

Note

1. For a full explanation of the ten hallmarks see *Mainstreaming the Environment: The World Bank Group and the Environment since the Rio Earth Summit, Fiscal 1995* (Washington, D.C.: World Bank, 1995), 10–11.

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Effective Financing of Environmentally Sustainable Development

Ismail Serageldin

Never before has there been a greater need to invest wisely in environmental protection. Never have public funds been more scarce. Today, environmental problems abound in the North as well as in the South. Although the citizens of the North are infinitely better off environmentally than those in the South, there are still problems. In the United States one of every four households lives within four miles of a toxic waste dump. On a global level U.S. carbon emissions, running at twenty-four times the per capita average of India's emissions, raise questions about the contribution of the United States and other countries of the Organisation for Economic Co-operation and Development (OECD) to the problem of climate change. The sustainability of the global ecosystem requires that we question the current patterns of consumption and waste in the North.

But the problems of the South, the clients of the World Bank, are of an unprecedented magnitude. The current situation in the developing countries is more serious than any faced by any society in history. In the next generation they will experience:

- *Unprecedented population growth.* Some 2 to 3 billion people will be added to the planet, 95 percent of them in developing countries. This represents an annual increase larger than the population of Germany.
- *Unheard of densities.* Bangladesh already has 120 million people in an area the size of the state of Arkansas, whose population is 2.5 million.
- *Urbanization at an unprecedented rate.* Urban population will triple in the developing countries over the next generation. India's urban population will grow to more than twice the total populations of the Germany,

France, and the United Kingdom. The incremental urban population of Asia will equal half its current population.

- *Shortages of water.* Already a severe problem in the Middle East, northern China, and southern India water shortages will cause groundwater levels to drop almost everywhere.

Failure by the developing countries to promote environmentally sustainable development would lead to a disastrous decline in their socioeconomic well-being.

But our clients are players on the global stage as well. The roles of China and India in global warming and of Brazil and Indonesia in sustaining biodiversity are such that their actions will have a major impact on all of humanity.

The stakes have never been higher for all of us—the developing countries as well as the industrial countries, the international agencies and the nongovernmental organizations, the private sector and civil society. We must all collaborate on a solution and forge new activist partnerships to promote environmentally sustainable development worldwide.

The Road from Rio

The Earth Summit in Rio de Janeiro in 1992 changed our perceptions about the environment and raised our awareness of its importance. Under Maurice F. Strong's skillful guidance Rio created a unique spirit that intensified our political commitment and international solidarity concerning the global environment. Vice President Al Gore captured the mood at the Earth Summit when he said: "All of us at Rio seemed to share a deeper understanding—a recognition that we are all part of something

much larger than ourselves, a family related only distantly by blood but intimately by a commitment to each other's common future."

The Rio Earth Summit captured the spirit of a new environmentalism in which pragmatism was in full harmony with idealism. The new environmentalism recognizes economic development and the environment as partners, not as adversaries. It recognizes that if we are to address fundamental environmental challenges, we must address fundamental human challenges of poverty and inequality. It recognizes that solutions will require productive partnerships, involving the private sector, civil society, the scientific community, national and local governments, and the international community.

The new environmentalism did not develop easily. Today, however, it is acknowledged and accepted by men and women of wisdom and understanding everywhere. So why do we have these problems today? The answer is that we have continued to rely on public funds for financing desirable activities. For the developing countries this has largely meant official development assistance flows. We have also tried to regulate, rather than channel and catalyze, the flows of private capital out of fear of what they might do in terms of environmental damage. These approaches to financing must change.

By an unfortunate irony while confidence in the importance of environmental aspects as an integral part of development has been strongly affirmed, the development enterprise itself—a vital and indispensable endeavor in global terms—is under attack. The very idea of developmental cooperation between the North and the South is assailed. The triumph of the market economy has produced a false euphoria that revels in today's economic possibilities even if they may cause a bleak tomorrow.

While we can be justifiably proud of what we have achieved in conceptual and operational terms, we must redouble our efforts in the face of diminished development assistance budgets. We must not allow the failure of politicized aid that was labeled as development assistance or the occasional failed project of the past to overshadow the success stories achieved by so many developing countries. We must join forces with friends and allies to roll back the tide of doubt

that threatens the world's development enterprise. If we fail, the worst-hit victims will be the weakest in human society—the poor, the hungry, the unemployed, the marginalized, and, worst of all, the future generations that will inherit polluted waters, unhealthy air, parched fields, and eroded soils.

The World Bank's Response

Responding to these challenges, the World Bank has pursued a deliberate policy of folding environmental action into its projects. In so doing, the Bank has developed into a major force in the battle against environmental degradation. Since Rio the Bank has adopted a fourfold agenda, which can be summarized as follows:

1. *Assisting our borrowing countries in promoting environmental stewardship.* The Bank has become by far the largest external financier of environmental investments in the developing world. The current portfolio of loans targeted to reduce pollution; protect soils, forests, and parks; and strengthen environmental policies and institutions exceeds \$10 billion, up from \$2 billion just six years ago. It supports 137 projects in sixty-two countries.
2. *Screening all World Bank-financed projects to "do no environmental harm."* The Bank now insists that every operation that it funds, not just the few billion dollars invested in environmental projects, be reviewed to ensure that environmental dimensions are properly addressed. This covers the World Bank's entire lending program, representing new commitments of more than \$20 billion annually.
3. *Promoting win-win strategies.* There are two basic parts to this item of our agenda: *investing in people*, especially empowering women, and *promoting the efficient use of resources*. Although not targeted specifically at improving environmental conditions, both tenets have powerful pro-environmental impacts.
4. *Addressing global and regional challenges.* Some environmental damage traverses national borders and is regional or global in impact. The World Bank now coordinates external assistance and financing in a number of regional sea and river programs and is, along with United Nations Environmental Programme and the

United Nations Development Programme, an implementing agency to the Global Environment Facility and the Montreal Protocol Fund.

Beyond the fourfold agenda the World Bank is very active in the conceptual and methodological work that undergirds the current development paradigm and the very tools of economic analysis. Over the past two years the World Bank has been actively promoting change in the areas of greening national income accounts and environmental measurement. This work, done collaboratively with others, is leading to improved methodologies for environmental assessment, benefit-cost analysis, and financing mechanisms. This work is now proceeding apace at both the micro- and macro-levels.

Greening the Portfolio

Beyond supporting individual environmental projects, the World Bank is working toward greening the entire portfolio, which would make our \$20 billion a year of new lending become supportive of environmentally sustainable development. Just think: \$200 billion of World Bank funding over the next ten to fifteen years—considered together with domestic resources and cofinancing that would represent \$500 billion of total project cost.

Yet as large as that sum may sound, that is the amount traded by the international capital markets in just twelve hours. The private sector invests that amount in developing countries in thirty months—\$180 billion a year. If these funds could be properly directed, the amount of investment that would be promoting sustainable development would be multiplied many times over. That is why we must all begin to think in new ways. The World Bank alone cannot overcome these challenges. We all need to act together.

The Challenge of Effective Financing

Let me turn now to the theme of this year's conference—the effective financing of environmentally sustainable development. The three elements in this phrase have been carefully chosen. The conference is about finance. But it must be finance of the right kinds of investments—those that pro-

mote environmentally sustainable development. To help guide our discussions, let me suggest that there are three elements we need to consider.

First, we need to increase the level of finance. If we were to move from present patterns of development to more sustainable patterns, the developing world alone would need additional investments of about \$140 billion a year. Where would this extra investment come from? One source should be additional foreign assistance. Unfortunately, the present climate does not encourage this avenue of finance.

Much more important will be the mobilization of domestic savings to finance sustainable development and the promotion of better macroeconomic management, less distorted markets, and a more efficient domestic financial system. This may not sound exciting, but without these improvements we should not expect households and businesses to increase their savings and investments.

We also need to reach the poorest, especially women, and empower them to create their own future by extending their access to credit. The shining example of Grameen Bank and its visionary founder, Muhammad Yunus, has encouraged many to believe in microfinance as an effective way to reach the poorest. The Consultative Group to Assist the Poorest (CGAP) was launched last June to channel \$200 million to the poorest groups. The World Bank is proud to be associated with CGAP. Without such partnerships and outreach we will not be able to lay the foundations for a sustainable future.

Second, we need to change the pattern of existing finance. The \$140 billion in extra finance for more sustainable patterns of development is important. Its impact on sustainable development, however, will be much less important than what happens to the \$1.5 trillion that is already invested each year throughout the developing world. All financing needs to be reshaped, not just the incremental portions.

In this regard we need to change the way ministers of finance think about taxation. The purpose of taxes should be to change behavior, not just to raise more revenue. Individuals and enterprises should be encouraged to act more responsibly toward the environment through clear tax signals.

This shift in the incentives facing investors can happen at the industrial level as well. There is evidence that leading businesses are beginning to find that good environmental behavior can pay off over the long term, and they are putting pressure on laggards. This incentive shift can be helped by institutions such as the World Bank and funds such as the Global Environment Facility. Consider the proposals that we and the International Financial Corporation are currently exploring for a venture capital fund for biodiversity protection and another for renewable energy. Through the use of small amounts of concessional funding, it seems to be possible to reshape the calculus facing private investors. The environment department's work in partnership with Norway on Joint Implementation of the Climate Change Convention, and the Bank's new Solar Initiative also fall into this category.

Third, we need to reduce the need for additional finance. Many of the resources that have been invested in environmental concerns have been unnecessary. This is because until recently policymakers in this area paid inadequate attention to cost-effectiveness. We must pay greater attention to reducing the costs of solutions. There are some remarkably encouraging signs. Countries as diverse as China, the Czech Republic, and Mexico are using cost-effectiveness analysis to set policies and decide on environmental investments.

Reducing the need for finance must involve permitting the private sector—households, farmers, and corporations—to decide how best to reduce environmental damage. This is the purpose of so-called market-based instruments. There are lots of such instruments, ranging from tradable permits to deposit refund schemes to performance bonds and effluent charges. The good news is that almost all of these ideas are being tried out somewhere. The bad news is that they are not being tried in enough places.

The three approaches—increasing the level of finance, paying greater attention to what we finance, and reducing the need for additional finance—will all be needed. In the course of this conference we will need to explore these three approaches in detail. It is extremely important

that we get the message out to change the hearts and minds of policymakers, citizens, and international agencies.

The Role of the Conference

The various strands come together in this Third Annual World Bank Conference on environmentally sustainable development, with its focus on effective financing. Our conviction that partnerships are vital if we are to achieve our goals has led us to draw together a very broad spectrum of organizations, perspectives, and individuals. This conference, therefore, represents a first effort in examining how the individual actions of different stakeholders in the development community can be brought together so that the whole is greater than the sum of the parts.

Conclusion

We live in a world of plenty, of dazzling scientific advances and technological breakthroughs. The Cold War has ended and with that has come the hope of global stability. Adventures in cyberspace are at hand. Yet our times are marred by conflict, violence, debilitating economic uncertainties, and tragic poverty. And now so many of the rich want to turn their backs on the poor.

I know, perhaps better than most, that these are exceptionally difficult times for financing international programs. The needed resources will not come from foreign aid in traditional terms. They will come from a redeployment of resources toward implementing policies whose ultimate goal is to sustain the groups of this earth.

The question we face is simple: Will we accept environmental degradation that aggravates human suffering as inevitable? Or will we strive to help—in Franz Fanon's evocative phrase—“The Wretched of the Earth?”¹ Throughout this conference let us think of the unborn, remember the forgotten, give hope to the forlorn, and reach out to the unreached and by wise actions today lay the foundation for a better tomorrow.

Note

1. Franz Fanon, *The Wretched of the Earth* (New York: Grove Press, 1963, 1968).

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