Report No. 26373

Extractive Industries and Sustainable Development:

An Evaluation of World Bank Group Experience

(Four Volumes)

Volume I: Overview

July 29, 2003

Operations Evaluation Department (IBRD/IDA)
Operations Evaluation Group (IFC)
Operations Evaluation Unit (MIGA)

Abbreviations and Acronyms

ASM artisanal and small-scale mining
CAS Country Assistance Strategy (World Bank Group)
EA Environmental Assessment
EI extractive industries (oil, gas and mining)
EIR Extractive Industries Review
FY fiscal year (July 1 to June 30)
IBRD International Bank for Reconstruction and Development
IDA International Development Association
IFC International Finance Corporation
IMF International Monetary Fund
MIGA Multilateral Investment Guarantee Agency
NGO nongovernmental organization
OED Operations Evaluation Department (World Bank)
OEG Operations Evaluation Group (IFC)
OEU Operations Evaluation Unit (MIGA)
TA technical assistance
WBG World Bank Group

Definitions

Extractive industries for this review include oil, gas, and mining of minerals and metals. Mining for construction materials, including cement production and quarries, is not included, nor are indirect investments through financial intermediaries.

Sustainable development meets the needs of the present without compromising the ability of future generations to meet their own needs. This requires sound environmental and social performance and economic efficiency. Given that fiscal revenues constitute a major source of net benefits (beyond those for the project sponsors) obtained from the extraction of mineral resources, the interests of future generations can be protected through the efficient utilization of these revenues for people in the host country.

Revenue management refers to the collection, distribution, and utilization of government revenues.

The World Bank Group includes IDA, IBRD, IFC, and MIGA. In this report, the combination of IDA and IBRD is referred to as the World Bank or "the Bank." The evaluation units of the WBG are the Operations Evaluation Department (OED) of the Bank, the Operations Evaluation Group (OEG) of IFC, and the Operations Evaluation Unit (OEU) of MIGA. These units are independent of WBG management and report to the WBG's Board through the Director-General, Operations Evaluation.

Resource-rich, and *EI-dependent* are used interchangeably in this report to refer to developing countries whose average annual export value of oil, gas, or mineral products exceeds 15 percent of total exports. This standard has been chosen with reference to the WBG's Poverty Reduction Sourcebook, which states: "A country's mining sector can play an important role in poverty reduction strategies if the approximate share of the mining sector is…greater than 10–25 percent of export earnings…" For a list of countries meeting this criterion, see Volume II, Annex B.

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Preface

The extractive industries — oil, gas, and mining — produce essential inputs (energy, metals, and minerals) for the global economy. Demand for these inputs is likely to increase, especially in developing countries, as people seek to improve their living standards.

The World Bank Group (WBG) finances only a small fraction of the investment in the sector, but its reach — through its access to stakeholders, and the influence of its environmental and social policies, guidelines and procedures, and the demonstration effects of its projects — is potentially greater. However, the WBG's involvement in the extractive industries has come under increased scrutiny in recent years from several sections of civil society. At the Annual Meetings in 2000, some nongovernmental organizations (NGOs) presented the WBG with a request to stop supporting the extractive industries because, in their view, the adverse environmental, social, and governance impacts outweigh whatever economic and social benefits may accrue to the domestic economy and the poor from the extractive industries. Climate change resulting from the use of fossil fuels is also an important concern.[1]

Following the 2000 Annual Meetings, WBG management launched the Extractive Industries Review (EIR) to take an in-depth look at the potential future role of the WBG in extractive industries. The EIR, headed by Prof. Emil Salim, former Minister of Environment for Indonesia, focuses on consultations with concerned stakeholders.[2] Its findings and recommendations will be presented to WBG management in December 2003.

Conducted in parallel with the EIR, this study by the independent evaluation units of the World Bank, International Finance Corporation (IFC), and Multilateral Investment Guarantee Agency (MIGA), assesses how effective the WBG has been in enhancing the contribution of extractive industries to sustainable development. The purpose is to provide an objective assessment of the results within the context of the WBG's overall mission of poverty reduction and the promotion of sustainable development. Its findings and recommendations provide guidance for the WBG's future strategy in the sector.[3]

The methodology of this evaluation is outlined in the Approach Paper.[4] This Overview (Volume I) highlights the main conclusions and recommendations, drawing from the experience of three agencies of the WBG — World Bank (Volume II), IFC (Volume III), and MIGA (Volume IV). They are based on a review of the portfolio of EI projects and EI-related advisory services; thematic reviews on revenue management, safeguards compliance, and governance; field

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1. Climate change has been covered in other WBG publications and evaluations. See www.worldbank.org/climate change and www.ifc.org/test/sustainability/docs/Climate_Change_IFC.pdf. The WBG's environmental strategy for the energy sector — *Fuel for Thought* (www.worldbank.org/html/fpd/energy/eee/FuelforThought.htm) — aims to mitigate the effects of and vulnerability to climate change. See Volume II, para. 2.13 and Box 2.2 and Volume III, paras. 27, 33, 52, and Box 4.

2. For more information on the EIR see www.eireview.org.

3. Concurrently, the Compliance Advisor/Ombudsman (CAO) has been examining the extent to which IFC and MIGA have addressed sustainability concerns in recent extractive industries projects. See www.cao-ombudsman.org.

4. The Approach Paper and other supporting documents for this evaluation study are available on the Internet (www.ifc.org/oeg/EIEvaluation/eievaluation.html).

missions to evaluate selected projects and prepare country case studies; and surveys of stakeholders and WBG staff. The other three volumes contain specific conclusions and recommendations for the respective agencies of the WBG.

Acknowledgments

Special thanks are due to the members of our advisory panel, who provided unique perspectives and advice:

- James Cooney, General Manager, Strategic Issues, Placer Dome Inc.
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- Arvind Ganesan, Director, Business and Human Rights, Human Rights Watch
- Michael Rae, Program Leader — Resource Conservation, WWF, Australia (formerly World Wildlife Fund, now World Wide Fund for Nature)
- David Rice, Group Policy Adviser, Development Issues, BP

Many thanks to all the people we met in the field and in Washington who shared their views about the sector, in particular to those who told us about the impacts that oil, gas, and mining projects had on them personally.

The authors would also like to thank World Bank Group (WBG) staff involved with the evaluated projects — either at appraisal or currently — who took time to respond to our many requests for information and generously shared their knowledge and perspective with us. In particular we thank Clive Armstrong of the joint World Bank/IFC Global Product Group for Oil, Gas, Mining, and Chemicals, who coordinated the responses from different parts of the WBG. Contributors to the specific reports on the World Bank, IFC, and MIGA are separately acknowledged in Volumes II–IV. We also thank William Hurlbut, who provided editorial and document production support on all four volumes.

Summary

How effectively has the World Bank Group assisted its clients in enhancing the contribution of the extractive industries (EI) to sustainable development?

On the one hand, with its global mandate and experience, comprehensive country development focus, and overarching mission to fight poverty, the WBG is well positioned to help countries overcome the policy, institutional, and technical challenges that prevent them from transforming resource endowments into sustainable benefits. Furthermore, the WBG's achievements are many. On the whole, its EI projects have produced positive economic and financial results, though compliance with its environmental and social safeguards remains a challenge. Its research has broadened and deepened understanding of the causes for the disappointing performance of resource-rich countries. Its guidelines for the mitigation of adverse environmental and social impacts have been widely used and appreciated. More recently, it has begun to address the challenge of country governance with a variety of instruments.

On the other hand, the WBG can do much to improve its performance in enhancing the EI sector's contribution to sustainable development and poverty reduction. There are three main areas for improvement.

Formulate an integrated strategy: The WBG has not devoted enough attention to the developmental needs of the poorly performing resource-abundant countries, many of which experienced negative growth during the 1990s. To address this gap, the WBG needs to formulate and implement integrated strategies at the sector and country levels for transforming resource endowments into sustainable development. These strategies should start with the presumption that successful EI projects — whether financed by the WBG or not — should not only provide adequate returns to investors but also provide revenues to governments, mitigate negative environmental and social effects, and benefit local communities. The strategies will also need to address governance squarely and help to ensure that EI revenues are effectively used to support development priorities. They will require, in addition, much better cooperation across the WBG and with other stakeholders.

Strengthen project implementation: The WBG needs to strengthen the implementation of its existing policy framework. Given the potential environmental and social impacts of resource extraction and the controversy surrounding the sector, rigorous implementation of safeguard policies is a minimum requirement for it to operate in a world concerned with sustainable development. The safeguard policies and guidelines also need to be adapted in line with evolving good practice, especially where they are inconsistent or incomplete. In addition, in light of growing concerns about the sustainability of EI development, the WBG needs to more systematically define, monitor, document, and report on the economic, social, and environmental impacts of its projects. Specifically, the distribution of benefits, identified as an important issue for the sector by many stakeholders, needs to be explicitly monitored and evaluated.

Engage the stakeholders: Often in collaboration with other organizations, the WBG has brought together diverse stakeholders in extractive industries to address issues at the local, national, regional, and global levels. The WBG's convening role has been actively sought and has been significant because of its access to all stakeholders, its private and public

development experience, and its ongoing involvement with project investment and technical assistance in the sector. But the WBG has inadequately addressed some areas — notably governance and revenue management. The WBG's performance in these areas can be enhanced through improved consultation with stakeholders, including local communities, and by systematically and transparently reporting on key sustainability indicators. The WBG should also vigorously pursue country- and industry-wide disclosure of government revenues from extractive industries. Such an approach is also likely to raise standards and practices for the sector as a whole

Background and Objective

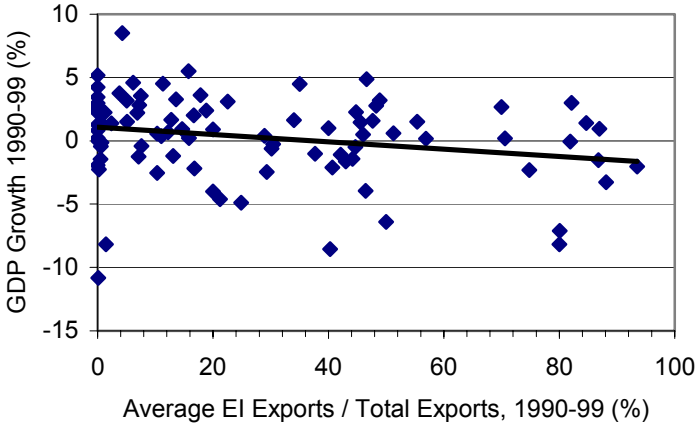
Objective of the Study

1. The objective of this study is to evaluate how effectively the WBG has assisted its clients in enhancing the contribution of extractive industries to sustainable development.[1] The WBG's activities in EI have come under increased scrutiny and criticism from several sections of civil society. Some NGO groups have asked the WBG to stop supporting the extractive industries because, in their view, the adverse environmental, social, and governance impacts outweigh whatever economic and social benefits might accrue to the domestic economy and the poor. Others have been concerned with issues of poor governance and the failure to effectively use resource rents in support of sustained economic development. This study responds to these concerns by evaluating the WBG's relevant experience and making recommendations to inform decisions about the WBG's strategy in the sector.

Main Issues for the Sector

2. Extractive industries can be important contributors to a country's economic development and often offer the first opportunities for foreign investment and private sector development. They generate government revenues, foreign exchange earnings, and employment, often in depressed and remote areas. However, they also can aggravate or cause serious environmental, health, and social problems, including conflict and war. They provide scope for rent seeking and opportunities for distorting public expenditure policies. Many resource-rich countries perform worse than resource-poor countries in key aspects of development, including economic, social, and governance.[2] The relationship[3] between EI-dependence and economic growth for all WBG borrower countries is shown in Figure 1.[4]

Figure 1: Slower Economic Growth with Greater EI-Dependence



1. This evaluation focuses on the impacts of extractive industries on developing countries. It does not address issues of downstream consumption, including important global impacts such as climate change, except for climate change impacts related to production, such as gas flaring.

2. This phenomenon — resource-rich countries falling far short of their developmental potential, and even being worse off than resource-poor countries — has been termed "the paradox of plenty."

3. This relationship, which is statistically significant at the 95 percent confidence level (t-statistic = -2.39), illustrates a conclusion that is widely accepted in the literature. No claim is made that EI dependence is the sole determinant of a country's economic growth.

4. "Borrower" includes all countries eligible for borrowing from the WBG with a population greater than 1 million as of 2000, for which data is available. When non-borrower countries are included, the slope is also statistically significant (t-statistic = -2.82), and steeper (-0.038 vs. –0.032).

3. Much research, at the WBG and elsewhere, has been done to better understand and address this paradox.[5] The emerging consensus is that the underperformance of resource-rich developing countries is not inevitable, because most of the factors that explain it result from institutional and policy failure.[6] Overall, while the technical requirements for managing volatile and exhaustible revenue flows and investing them for sustainable development are well understood, they are difficult to implement because of poor governance. Thus, creating good governance is at the heart of the institutional and policy changes needed to sustain sound fiscal management and maximize the benefits from the extraction of mineral resources.

The WBG's Changing Role in the Extractive Industries

4. The WBG provides only a very small share of the financing for the sector, but its reach—through its access to all stakeholders, the influence of its environmental and social policies, guidelines, and procedures, and the demonstration effects of its projects — is potentially much greater. The WBG's advice on the enabling environment for extractive industries also has a broader effect on the sector than the financing volume would indicate.

5. *The World Bank*: The Bank's role has evolved from mainly supporting exploration and production activities (1960s to the early 1980s), to sector policy reform and commercialization of state-owned enterprises (1980s), to a greater emphasis on capacity building and private sector development (1990s). Also in the 1990s, the Bank began to help transition economies to maintain production levels, rehabilitate or close uneconomic facilities, and attract foreign investment. Since the mid-1990s, the Bank's approach has evolved toward greater collaboration with civil society, local governments, and private companies. The share of extractive industries in the Bank's overall lending declined from 4 percent in the 1980s to under 2 percent in the 1990s.

6. *The International Finance Corporation*: IFC has focused on countries where its value added — as a catalytic agent and neutral third party between governments and private investors — was greatest. Since 1992, investments in oil and gas (but not mining) exploration were discontinued, mainly because of poor results and difficulties associated with assessing exploration risks. The share of EI investment in IFC's total lending portfolio has decreased substantially from 15 percent in 1990 to 6 percent today. Since the mid- to late-1990s, IFC has increasingly focused on sustainability, especially environmental, health and safety and social issues, and, most recently, on revenue management and distribution. Many of IFC's sustainability initiatives (such as SME linkages, IFC Against AIDS) have a particular relevance to, and focus on, the EI sector. IFC's EI portfolio is concentrated in oil and gas (half), gold, and copper (over 10 percent each).

7. *The Multilateral Investment Guarantee Agency*: MIGA has supported extractive industries with political risk guarantees and, to a lesser extent, technical assistance and advisory services. MIGA's early involvement was heavily concentrated in the mining sector. Between 1990 and December 2002, MIGA provided guarantees for 31 projects in EI, most of them in mining. Throughout the 1990s, there was high demand for MIGA insurance, with large operations in

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5. Seminal papers by Gelb (1988), Sachs and Warner (1997), Richard Auty (ed., 2001), and Isham (2002) have discussed the evolution of thinking on the subject in recent years. See References in Volume II, Annex D.

6. Analysis in the 1960s focused on how to manage the macroeconomic impacts of resource export income, which raised domestic prices and made other exports less competitive internationally (the so-called Dutch Disease). More recent analysis emphasizes poor use of fiscal revenues from resources.

countries with higher political risk profiles. Learning from its earlier experience, MIGA has increasingly paid more attention to environmental and social aspects of EI projects (and adopted its own environmental assessment and disclosure policies in 1999 and its own interim safeguard policies in 2002). Due to the low volume of new guarantees in extractive industries projects since 2001, and cancellation and expiration of MIGA coverage for some projects, the sector's share in MIGA's portfolio has continued to decrease and is now 11 percent.

8. *Complementary and Coordinated Roles*: The different parts of the WBG have coordinated and complementary roles in their approach to extractive industries and resource-rich countries. The Bank has responsibility for country policy dialogue, and tends to focus on broader structural and social issues, including sector policy reform and institutional capacity building, with a focus on poverty reduction. IFC has focused on attracting private sector investment, particularly in "high-risk" countries, where its projects were expected to have a catalytic effect in attracting new investments, and demonstrating sound management of environmental and social effects. MIGA specializes in providing political risk guarantees, while at the same time ensuring that the projects it supports comply with applicable environmental and social performance standards. Since the late 1990s, WBG projects and policy work in the extractive industries have been coordinated through joint Bank-IFC Global Product Groups in the oil & gas and mining sectors, and joint Bank-IFC-MIGA country assistance strategies (CASs).

From Economic Benefits to Sustainable Development

Project Outcomes

9. *The World Bank*: Overall, *ex post* evaluations show that about 80 percent of the Bank's EI projects[7] have had moderately satisfactory or better outcomes,[8] above the Bank-wide average of 75 percent. For the investment projects, the benefits derived mainly from increased production, increased private investment, and improved productivity. Adjustment and technical assistance projects, on the other hand, generated economic benefits through private sector development, improving production levels, institutional capacity building and policy reform, rehabilitation or closure of uneconomic mines, environmental cleanup, and the integration of artisanal and small-scale mines into the formal sector. However, the Bank's documentation and reporting on the economic benefits of the projects, such as *ex post* economic analyses and other quantitative indicators, has been limited.[9] Given the questions that have been raised about the justification for the Bank's continued involvement in the sector, improved reporting could inform stakeholders and strengthen accountability.

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7. The portfolio of projects chosen for review consists of all EI projects approved during or after fiscal 1993, the first full financial year after the WBG adopted revised safeguard policies. OED reviewed 76 Bank projects, comprising 48 closed (24 oil & gas, 24 mining) and 28 active projects (15 oil & gas, 13 mining).

8. The Bank's project completion reports are usually expected to assess economic benefits by calculating an economic rate of return or using a cost-effectiveness criterion to determine whether the project represented the expected least-cost solution to attain the identified benefits, but only 35 percent of the completion reports did so. Another 27 percent contained some quantification and valuation of benefits, but no analysis of their cost effectiveness.

9. See Volume II, Chapter 3.

10. The main finding that emerges from the review of the Bank's portfolio is that projects with satisfactory outcome ratings tended to be associated with greater government commitment to project objectives and adequate infrastructure, favorable commodity prices, and a high level of stakeholder involvement. The less successful projects appeared to be affected by poor government commitment, and unfavorable economic conditions or commodity prices.

11. *The International Finance Corporation*: Overall development results in IFC's EI projects[10] were about the same as in other sectors with 60 percent success. It is noteworthy that IFC's EI investments are concentrated in particularly difficult countries, where many development agencies are struggling to achieve positive results,[11] and are also subject to substantial risks (commodity price fluctuations, geological risks, etc.). About three-quarters of EI projects had satisfactory economic returns, with projects in oil and gas performing better than, and in mining about the same as those in other sectors. IFC's EI projects were often among the first investment opportunities in the country, frequently followed by other investments, notably small and medium-scale enterprises (SMEs). Several projects involved privatization and demonstrated that the private sector tends to operate more efficiently and in a more environmentally sound manner than state-owned enterprises. Most projects generated large government revenues, sometimes even where investors lost money. But when little or nothing flowed back to local communities this created problems — for local people as well as for investors. The distribution of benefits, considered one of the top issues in the sector, was not consistently and sufficiently addressed in IFC projects. Close cooperation within the WBG — in particular between IFC and the Bank's country departments — and between the WBG and the host government will be needed to effectively address this issue.[12]

12. IFC's EI projects typically created economic opportunities for people — notably direct and indirect jobs, often in remote areas. Many projects improved local roads, water, and power supply, and the best ones tried to maximize economic opportunities for the local community. Recently, IFC has increasingly focused on enhancing benefits and opportunities for local communities. For example, IFC's "SME linkage" program, which tries to increase supply linkages to large projects, was particularly active in extractive industries, and so was "IFC Against AIDS." IFC has also focused on helping clients improve their community development programs, often using trust funds. The most effective programs identified — through consultations — community needs, priorities, and aspirations. While overall positive economic effects dominated, there were also adverse consequences. For example, the economic opportunities often attract a large number of people, and companies and communities found it difficult to deal with this influx, particularly where government capacity was weak. Local people did not always have the requisite skills to take advantage of the opportunities. They sometimes lost agricultural lands, but, in a few cases, compensation did not restore livelihoods for everyone affected.

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10. OEG's review is based on in-depth evaluations of a random, representative sample of 22 projects approved in calendar years 1991–96 (12 oil & gas, 10 mining), supplemented by "mini" desk-evaluations of all other projects either approved after fiscal 1993 or still in IFC's portfolio. In total, OEG studied 45 projects or companies (23 oil & gas, 22 mining). Immature projects and projects with insufficient information (usually where IFC had exited early) are not included in these numbers, but OEG used them also to draw lessons and highlight issues.

11. See for example *WBG Work in Low-Income Countries Under Stress: A Task Force Report* (World Bank, 2002).

12. See also Volume III, Annex 4 for the perceptions of stakeholders outside and inside the WBG.

13. *The Multilateral Investment Guarantee Agency*: All evaluated MIGA projects[13] have been adversely affected by the fall in metal prices since the late 1990s, which reduced their financial and economic returns and sustainability. In most projects, however, economic benefits were above financial rates of return, due to the benefits accruing from creation of jobs and provision of training to the workforce, often in remote and depressed areas. Additionally, these projects (several in low-income, resource-rich countries) generated sizeable revenues to local and central governments, although governments holding equity shares in return for providing ore reserves were disappointed by lower-than-expected equity returns. Most projects also funded community initiatives, including a few that established exemplary community development programs.

14. All evaluated MIGA projects were generally consistent with the private sector strategies of their host countries. Most were in countries where international private investors had been reluctant to make large investments because of either limited experience with new governments or difficulties faced by previous investments in that country or sector. In these instances, MIGA's political risk insurance was significant in enabling investment flows into the mining sector, and in some cases has led the way for other investments in the host country.

Linking Project Benefits to Overall Country Assistance

15. Beyond the generation of project benefits, the WBG's involvement in the transformation of resource riches into sustainable development has been limited.[14] A review of the latest Country Assistance Strategies (CAS)[15] in poorly performing resource-rich countries found that 64 percent recognize the special issues associated with the management of resource rents, but only in a few instances is the discussion linked to specific interventions. The inadequacy of linkages between EI sector activities and sustainable development was also highlighted by 47 percent of the WBG's EI sector staff who responded to a survey; 50 percent attributed this to inadequate support from the relevant country department/country management unit.[16] In addition, the Bank's overall lending to resource-rich countries experiencing negative growth has been lower than average, with no indication of compensating non-lending interventions.[17]

16. A detailed review in a sample of five resource-rich countries indicates that Bank interventions were only modestly relevant and efficacious in addressing the challenge of improving fiscal policies and public expenditures, with the quality of governance emerging as the key fac-

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13. OEU reviewed six previously evaluated projects, all in mining (five gold, one cobalt) and conducted two additional in-field case studies of mining projects. Most of the projects were underwritten by MIGA in the early to mid-1990s. OEU also reviewed the consistency with safeguard policies of 12 projects (3 oil and gas, 9 mining). In total, OEU reviews covered 15 MIGA projects with active or cancelled contracts of guarantee (out of a total of 31 that MIGA guaranteed since 1990).

14. See Volume II, Chapter 5.

15. The Country Assistance Strategy (CAS) is the central vehicle for Board review of the WBG's assistance strategy for its borrower countries. The CAS is expected to (a) describe the WBG's strategy based on an assessment of the priorities in the country, and (b) indicate the level and composition of assistance based on the strategy and the performance of the country's project portfolio.

16. See Volume III, Annex 4 C for complete results of the staff survey.

17. See Volume II, Figure 5.2. However, following the launch of the WBG's Low-Income Countries Under Stress (LICUS) program in 2002, additional budget for activities designed to improve the policy and institutional framework has been allocated to many of these countries.

tor. This suggests that good governance is a prerequisite for enhancing the positive linkage between increased fiscal revenue flows and sustainable development.[18] Good governance was also important for development results and IFC's investment results — both were better where country governance was good.[19]

17. Taken together, these findings suggest that, while the WBG is aware of the underlying causes for the underperformance of many resource-rich countries — primarily unsound revenue management and poor governance — it has yet to formulate and implement viable approaches to address them. If the WBG is to have a more effective role in poorly performing EI-dependent countries, it will require government commitment as well as using the WBG's full influence to achieve sound fiscal management and build a supportive governance framework. The linkages between resource rents and sustainable development can best be made explicit through CASs, to guide the design of specific projects and the monitoring and evaluation of results.

Mitigating Environmental and Social Impacts and Beyond

18. Extractive industries tend to have a heavy "footprint" — large, wide-ranging and long-term environmental and social impacts. Effective implementation of the WBG's safeguard policies is therefore particularly important in this sector for sustaining the rationale for continued WBG involvement in a world concerned with sustainable development.

19. *The World Bank*: The assessment of a sample of Bank EI projects found the majority to be substantially consistent with applicable safeguard policies, but the degree of consistency varied depending on the environmental category of the project and the stage of the project cycle.[20] Thus, about 74 percent of the 'A' and 'B' projects were assessed to be substantially (or highly) consistent with safeguards at approval, with the share declining to 67 percent during implementation.[21] The decline may be associated with the finding that safeguards supervision inputs and reporting had been adequate in only 41 percent of the projects. Even so, these findings are more positive than those obtained from the survey of stakeholders, which points to their perception of a need for improved performance in the environmental and social areas.

20. Most important shortcomings in the Bank's implementation of safeguards can be traced to inadequacies at the initial project screening, especially for sectoral adjustment and technical assistance projects, where the guidance has been subject to varying interpretations.[22] Inadequate supervi-

18. See Volume II, paras. 5.5 ff.

19. See Volume III, para. 59.

20. The sample of 38 projects was purposively chosen from the EI portfolio of 76 projects to include projects that were likely to have adverse environmental or social impacts, and included 19 oil & gas and 19 mining projects. See Volume II, paras. 4.5ff.

21. The policy on Environmental Assessment (OP 4.01) defines project categories as follows:
'A': likely to have significant adverse environmental impacts that are sensitive, diverse, or unprecedented;
'B': potential environmental impacts are less adverse than for 'A'
'C': likely to have minimal or no adverse environmental impacts.

22. In the absence of an established approach for assessing a project's degree of consistency with safeguards policy requirements, the evaluation has synthesized the policy requirements into a set of basic criteria and used it for the subject review. The criteria for consistency have been benchmarked against those used by the Inspection Panel reports on EI projects, and discussed with the Quality Assurance and Compliance Unit (QACU) and the Legal Department. See Volume II, paras. 4.5 ff.

sion and reporting were another important source of problems: in only about 30 percent of the projects in the sample were environmental or social specialists involved in supervision and fewer than a quarter of the project completion reports had adequate reporting and discussion of this subject. [23]

21. While the validity of these findings is limited to the sample of 38 EI projects that was reviewed (half of all projects in the EI portfolio), the results make a strong case for strengthening the implementation of the Bank's safeguards framework, which is no different for extractive industries than for other types of projects. The findings point, in particular, to the need for clearer and more consistent guidance for the EA categorization of sectoral adjustment and technical assistance projects, the identification of applicable safeguards at the initial project screening, the appropriate scope and arrangements for monitoring of safeguards implementation, and the reporting and evaluation of results at project completion. Improvement would be particularly important for extractive industries, given its large share of sectoral adjustment and technical assistance projects, the inadequacies in monitoring and reporting, and the controversy surrounding the sector.

22. *The International Finance Corporation*: The evaluation of IFC projects found oil and gas projects performing significantly better, and mining projects significantly worse than those in other sectors concerning compliance with safeguard policies and guidelines. Judging from the desk review of portfolio projects, the performance of mining projects appears to have improved and is now in line with the IFC average.[24] The main problems in mining projects related to the handling of hazardous materials — where IFC has now developed guidelines — and difficulties in ensuring adequate mine closure. Oil and gas projects featured almost no compliance issues per se, but gas flaring was an issue in many projects, downstream transportation in some.

23. IFC's supervision of EI projects was significantly better than average, and IFC's environmental and social specialists spent more time on extractive industries (one-third in fiscal year 2002) than on any other sector. But gaps remain, in part attributable to insufficient management systems. For example, while project-level supervision was generally strong, there is no central database identifying which safeguard policies and key issues apply to which project. Clients expressed appreciation for IFC's environmental and social specialists, who helped improve the environmental and social aspects of numerous projects. But they cannot replace local monitoring, particularly since IFC usually exits from projects before project closure. Building local monitoring capacity — either that of local consultants or that of government agencies (through the World Bank) — could help address this issue. Disclosure of environmental monitoring data would likely improve trust and improve performance — possibly even after IFC's exit.

24. *The Multilateral Investment Guarantee Agency*: The review of a sample of MIGA EI projects[25] found that 73 percent were consistent[26] with MIGA's (2002) issue-specific interim safeguard policies at the time of MIGA Board approval. The consistency improved during project implementation (while under MIGA guarantee or at the time of cancellation of the MIGA guar-

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23. See Volume II, paras. 4.24 ff.

24. See Volume III paragraph 26, which also explains the difficulties comparing the two data sets.

25. The review of safeguard policy compliance for MIGA EI projects covered 12 out of 30 MIGA projects with active and cancelled guarantees issued since MIGA's inception. The review was commissioned from an external expert and is the first of its kind for MIGA.

26. The project was rated "consistent" when the policy requirements were generally met, or expected to be met, with only minor shortcomings.

antee). Although in at least two cases it played a direct positive role, in other cases these improvements were not clearly attributable to MIGA. The level of consistency was not uniform across all applicable safeguard policies. The review noted systemic deficiencies in the application of the social aspects of safeguards in the projects reviewed. OEU found that, in addition to lowering perceived political risks as a guarantee provider, MIGA had the greatest potential to add value with its support to environmental and social aspects of EI projects.

25. The evaluated projects showed an overall improving trend in safeguard policy consistency over time, implying institutional learning from experience and strengthened policies and implementation as MIGA expanded its operations. However, the shortcomings identified point to a lack of a proactive approach with its clients throughout its involvement with the projects to capture opportunities to add value by improving their environmental and social impacts.

26. *Need for Continued Updating*: The WBG's safeguard policies, guidelines, "good practice" manuals, and notes have received wide acceptance, even where the WBG is not involved — some other international financial institutions use them, and recently some of the largest private project finance banks have committed to adopt them. But some of them are inconsistent, incomplete, or lacking. For example, while industry leaders in extractive industries and some governments subscribe to "voluntary principles on security and human rights," the WBG has no comparable guidance. Given that human rights violations have frequently been alleged in connection with the site security of EI projects — including some WBG projects — this is one of the gaps that needs to be filled.[27] Another area is HIV/AIDS, an important issue for the sector, but not covered by guidelines.[28] Given the wide use of the WBG's guidelines, it is particularly important that they be comprehensive yet practical, and regularly updated to reflect lessons and evolving good practice standards. Their standard-setting character points to the potential for the WBG to continue building on its global mandate, public and private sector knowledge, and convening power for catalyzing good practice with respect to environmental, social, and other issues. Besides improving the results of WBG-supported projects, this would also help to define a level playing field among international financial institutions, and among different companies.

27. *Beyond Safeguards*: The WBG's efforts at "doing good" by addressing pre-existing environmental conditions and building capacity for the management of environmental and social impacts have yielded mostly satisfactory results. As part of its sustainability initiative IFC has started to focus on improving the impacts of its projects "beyond compliance" (for example, by maximizing linkages with local SMEs).[29] These findings point to the continuing potential for the WBG to make a valuable contribution to the development of the host countries and the extractive industries sector, in an area that the private sector alone cannot address.[30]

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27. See Volume III, paragraph 34.

28. Halting or reversing the spread of AIDS is one of the Millennium Development Goals. Initiatives in the WBG address HIV/AIDS, but addressing the issue in specific EI-projects are not mandatory. See also Volume III, paragraph 25 and Box 2.

29. See Volume II, paragraphs 4.32 ff and Volume III, paragraph 16 and Box 1.

30. For example, the May 15, 2002, Toronto Declaration of the International Council of Mining and Metals states (on behalf of the mining industry): "orphan site legacy issues are important and complex. However, they are beyond the capacity of ICMM to resolve. Governments and international agencies should assume the lead role in addressing them."

Addressing the Governance Challenge

28. High dependence on revenues from extractive industries has been associated with corrosive effects on economic and political life in many countries, including rent-seeking and government ineffectiveness. Indeed, a review of the literature and feedback from NGOs suggest that good governance is central to creating an environment that fosters sustainable and equitable development, and is an essential complement to sound revenue management and safeguard policies. Figure 2 shows the negative association between the quality of governance and EI dependence.[31]

29. Countries such as Botswana and Chile[32] have successfully leveraged their natural resource wealth into sustainable growth through investment-friendly policies, fiscal discipline, and long-term planning. While the highest quality of macro and sectoral governance[33] may not be required for resource extraction to be beneficial to a client country, some minimum conditions should exist to help ensure that the benefits from EI projects are not squandered and the citizens left with costs that can include environmental damage, health risks, and conflict.

30. At least since the early 1990s, the WBG has been aware of the importance of addressing the governance challenge for ensuring the transformation of resource rents into sustainable development. But there is little discussion of sector-specific governance issues in the country strategies of EI-dependent countries. There are also few cases where a link can be discerned between a diagnostic assessment of governance, a governance-informed strategic approach to the EI sector set out in the country strategy, and the design of EI projects.[34] Where some links can be observed, such as in Papua New Guinea and Kazakhstan, experience suggests that governance issues take a long time to address, and working to establish good governance in parallel with, or after supporting increased investment in EI, is a high-risk strategy in countries with poor governance.

31. This points to the need for the WBG to tailor its support for resource extraction on the basis of an assessment of the quality of governance. Important indicators of macro governance include the quality of public financial management[35] and rule of law,[36] as a measure of the government's ability to address problems through formal institutional reforms. At present, while the Bank's economic and sector work frequently assesses the quality of public financial management, it has no diagnostic instrument to evaluate the rule of law or the quality of sectoral governance. These gaps need to be addressed. This governance analysis then has to inform the risk assessment, structuring, and investment or underwriting decision. Recognizing that fiscal revenues may be misused in countries with poor governance, IFC has developed a position paper outlining possible steps to ad-

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31. Here again, this relationship is statistically significant at the 95 percent confidence level (t-statistic = 2.44) and illustrates a conclusion that is widely accepted in the literature. No claim is made that EI dependence is the sole determinant of a country's quality of governance.

32. In Figure 2, Chile and Botswana are shown at the top of the graph, near the center and toward the right, respectively.

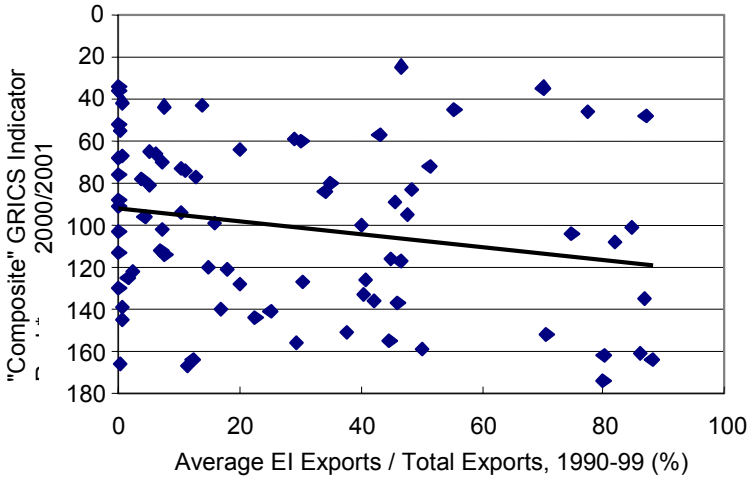
33. For a definition of macro and sectoral governance, see Volume II, paragraphs 6.22-23.

34. See Volume II, paras 6.27 ff.

35. Corruption, one particular public financial management shortcoming, is a possible proxy measure.

36. That is, the use of public power in accordance with the law.

Figure 2: Worse Country Governance with Greater EI-Dependence



* "Composite" GRICS (Governance Research Indicator Country Snapshot) ranks are a simple average of individual GRICS rankings for 2000/2001 for Voice and Accountability, Political Stability, Government Effectiveness, Regulatory Quality, Rule of Law and Control of Corruption.
Source: http://www.worldbank.org/wbi/governance/pdf/2001 kkzcharts.xls

dress this risk.[37] To date, MIGA has not yet addressed the issue of revenue management from extractive industries in a similar way.

32. The promotion of transparency is an essential tool for building good governance, and the WBG has long played a role, mainly in conjunction with its environmental assessment (EA) policy,[38] but also through institution building and policy reform efforts aimed at improving the enabling environment for the sector. About 15 percent of Bank EI projects have provisions for disclosure and dissemination of project information beyond the requirements of the EA policy, but with the exception of the recent Bank/IFC Chad-Cameroon Pipeline projects, the WBG has not required disclosure of fiscal revenues from EI, even though it sometimes recommends it. A few companies operating in the sector have started disclosing government revenues and some global initiatives advocate disclosure.[39] While some governments currently make such disclosure illegal, and companies are concerned that unilateral disclosure could harm them, industry overall appears to be in favor — if a level playing field can be ensured.

Recommendations

33. With its global mandate and country development perspective, combined with public and private sector experience, the WBG is well positioned to help countries transform resource riches into sustainable development. The Bank's research has broadened and deepened the understanding of the "paradox of plenty" and the WBG has led or participated in numerous initiatives to address EI issues. In most dimensions, the WBG's EI projects appear to perform at least as well or better than projects in other sectors, but much more needs to be done to improve implementation and monitoring of compliance with existing policies, and to address governance, transparency, and

37. At this point, the position paper (www.ifc.org/test/sustainability/docs/Revenue_Distri_Mgmt.pdf) focuses only on projects generating substantial revenues compared to the country's overall fiscal revenues, and the suggested steps are optional, not mandatory.

38. For all EA category A projects, the borrower is expected to consult project-affected groups, local NGOs, etc. and disclose relevant material in a timely and culturally appropriate manner. The requirements are somewhat more rigorous for 'A' than for 'B' projects, and IFC requires public consultation only for some category B projects.

39. The "Extractive Industries Transparency Initiative" and an NGO campaign — "Publish What You Pay" advocate disclosure.

revenue management issues. Unless the WBG improves its performance in these areas, it will not be able to maximize the sector's contribution to sustainable development and will face continued — and warranted — criticism. The key recommendations are summarized below. Volumes II, III, and IV contain additional specific recommendations for the Bank, IFC, and MIGA.[40]

Recommendation 1: Formulate an Integrated Strategy

34. The WBG has not devoted enough attention to the developmental needs of the poorly performing resource-abundant countries, many of which experienced negative growth during the 1990s. To address this gap, the WBG needs to formulate and implement integrated sector and country-level strategies for transforming resource endowments into sustainable development. Such an integrated strategy will start with the presumption that successful EI projects — whether financed by the WBG or not — have to provide not only adequate returns to investors but also revenues to governments and benefits local communities, and mitigate negative environmental and social effects. It will also need to address governance squarely and help to ensure that EI revenues are effectively used to support development priorities. It will also require much better cooperation within the WBG and with other stakeholders.

(a) *Formulate a WBG sector strategy*: The WBG needs to design and implement a sectoral strategy that closely integrates resource extraction with sustainable development through the effective management of EI revenues in support of developmental priorities and the reliable mitigation of adverse environmental and social impacts. Where macro and sectoral governance are weak, the WBG's assistance should focus on strengthening governance. In such cases, the WBG should carefully assess and report on the risks that EI fiscal revenues may not be used for development priorities. The WBG should not support significant sector expansion unless it can adequately mitigate these risks.[41] Where macro governance is sound but sectoral governance is weak, the WBG should focus on improving sectoral governance, and should only support the sector in conjunction with adequate provisions to overcome sectoral governance weaknesses.[42]

(b) *Address extractive industries in CASs*: For all resource-rich countries the WBG should explicitly address extractive industries in the CASs.[43] The CAS should explicitly discuss

40. Given the size and complexity of the WBG, and the diversity of issues that need to be addressed, it is expected that the responsibility for following up on these recommendations will not rest exclusively with the sector specialists, i.e., the Energy and Mining Sector Board, and the Oil, Gas, Mining and Chemicals Global Product Group. The Management Response is expected to identify the unit(s) responsible for following up on each recommendation.

41. "Significant" should be considered both in absolute terms and in relation to total sector production, based on analysis of past experience, and may vary by country. Supporting increased investment could be either through investments by IFC, guarantees by MIGA, or through World Bank assistance, e.g., to make the investment code more attractive. A possible mitigating measure could be "ring-fencing" of fiscal revenues from EI projects for development purposes. MIGA should consider adopting a position on revenue management and distribution similar to IFC's.

42. For example, the Bank should help countries establish appropriate laws and regulations to mitigate negative environmental and social effects and build capacity to enforce them. Private sector projects supported by IFC and MIGA could serve as "role models" for environmental and social performance, transparency and disclosure, and thus raise sector performance.

43. This recommendation also applies to countries that are expected to become resource-rich, for example, through a large, WBG-supported project. In all resource-rich countries, the WBG should also encourage client countries to include EI in their Poverty Reduction Strategy Papers.

the sector's current and potential economy-wide linkages (for example, the importance of government revenues, their management, distribution, and use for development priorities) and reference the underlying governance assessment. This should guide future project design, facilitate monitoring and evaluation, and provide an agreed framework for WBG-wide coordination and collaboration in the EI sector. The different agencies of the WBG should routinely work together to enhance the development impacts of EI projects, for example in the form of public-private partnerships with respect to community development programs.

(c) *Promote governance improvements*: The Bank should compensate for the lower level of lending that may be appropriate for resource-rich countries with weak macro and sectoral governance,[44] by devoting greater management attention and administrative budget for advisory and analytical activities aimed at improving the policy, institutional, and governance framework for EI. This would enable the Bank to establish and maintain continuity of engagement and facilitate responding quickly to opportunities for assistance when they arise.[45]

(d) *Support private sector development and environmental sustainability*: In all countries, the WBG should continue its support to close uneconomic mines, reform and privatize state-owned enterprises, and mitigate pre-existing environmental and social problems. Where appropriate, the WBG should help integrate artisanal and small-scale mining (ASM) with the formal sector and internalize their environmental and social impacts, while at the same time creating alternative employment opportunities and supporting the consolidation of ASM activities for greater efficiencies and economies of scale.

Recommendation 2: Strengthen Project Implementation

35. The WBG needs to strengthen the implementation of projects within its existing policy framework. Given the potential impacts of resource extraction and the controversy surrounding the sector, rigorous implementation of safeguard policies by the WBG is a minimum requirement for it to operate in a world concerned with sustainable development. In addition, in light of growing concerns about the sustainability of development, the WBG needs to more systematically define, monitor, document, and report on the economic, social, and environmental impacts of its projects. Specifically, the distribution of benefits, identified by many stakeholders as an important issue for resource extraction, needs to be explicitly monitored and evaluated.

(a) *Improve project screening and monitoring*: The WBG should provide clearer and more consistent guidance for the categorization of projects,[46] the identification of applicable safeguards at the initial project screening, the appropriate scope and nature of the EA instruments, and the reporting and evaluation of safeguards implementation. This needs to be followed up through the entire implementation framework, from good practice guidelines to appropriate monitoring and training.

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44. In line with the Bank's performance-based allocation of IDA credits.

45. This recommendation is consistent with the LICUS approach mentioned in footnotes 11 and 17.

46. For example for sectoral adjustment and technical assistance.

(b) *Involve specialists throughout*: The WBG should provide adequate resources and incentives for the participation of qualified environmental and social specialists at the preparation, appraisal, and supervision of all projects that are likely to have adverse impacts. This will ensure that such impacts are adequately addressed through the upstream design of appropriate mitigation strategies or project alternatives, as well as through the retrofit of timely remediation measures should unexpected impacts materialize during project implementation.

(c) *Enhance reporting of results*: The Bank should strengthen reporting of its results by ensuring that project completion reports include an *ex post* economic rate of return or net present value or, where that is not feasible, a cost effectiveness analysis to determine whether the project represented the least-cost solution to attain its objectives. IFC should develop and use a reporting template for environmental and socio-economic sustainability indicators, building on industry initiatives. MIGA needs to adopt more standardized and timely reporting mechanisms on environmental and social safeguards compliance and *ex post* development outcomes. The WBG should prepare completion reports for every significant non-lending/guarantee issuance activity.[47]

(d) *Evaluate the sharing of benefits*: At appraisal and during supervision,[48] the WBG should systematically estimate the distribution of project benefits among different stakeholder groups (government at different levels, private companies, and local communities), evaluate its sensitivity to different scenarios, and discuss the acceptability of benefit sharing with key stakeholder groups.

Recommendation 3: Engage the Stakeholders

36. Often in collaboration with other organizations, the WBG has brought together diverse stakeholders in extractive industries to address issues at the local, national, regional, and global levels. The WBG's convening role has been actively sought and has been significant because of its access to all stakeholders, private and public development experience, and ongoing involvement with project investment and technical assistance in the sector. But the WBG has inadequately addressed some areas — notably governance and revenue management. The WBG's performance in these areas can be enhanced through improved consultation with stakeholders, including local communities, and by systematically and transparently reporting on key sustainability indicators. Such an approach is also likely to raise standards and practices of the sector as a whole.

(a) *Update policy framework*: In consultation with its stakeholders, the WBG should periodically adjust its policy framework for extractive industries to ensure that it remains up-to-date with evolving industry practice. It should resolve remaining inconsistencies such as those between requirements for different mine types (such as funding for mine closure), onshore versus offshore oil projects, safety of dams, and involuntary resettlement. It should address identified gaps such as those related to consultation and disclosure, community development, social issues of mine closure, security, hazardous materials management, acid rock drainage, gas flaring, and transportation of oil.[49] It should also

47. Such as, for example, advisory work funded by trust funds.

48. For example, in project completion reports for the Bank and in project supervision reports for IFC.

49. See Volume III paragraphs 33-34 for more detail.

recognize the expanding awareness of the human rights dimension of WBG policies and projects, and explore possible avenues for addressing the issues, especially where it lags industry best practice, such as regarding site security.

(b) *Promote disclosure of fiscal revenues from EI*: The WBG should vigorously pursue country- and industry-wide disclosure of government revenues from EI and related contractual arrangements (such as production sharing agreements, concession and privatization terms).[50] The Bank should work toward and support disclosure of EI revenues and their use in resource-rich countries. IFC and MIGA should also strongly encourage (and consider requiring) their private sector clients to publish their payments to governments.

(c) *Develop and monitor sustainability indicators*: Together with other stakeholders, the WBG should develop indicators of economic, social, and environmental sustainability,[51] establish baseline data, provide for adequate monitoring over the life of the project, and report and evaluate the results during supervision and in project completion reports. The WBG should also encourage more independent outside monitoring, ideally using local capacity (which may have to be developed).

(d) *Increase local community participation*: The WBG should support enhanced community consultation and participation throughout the life cycle of EI-projects. The WBG should assist countries to increase involvement by local communities in EI decision-making processes, and ongoing consultation throughout the project life cycle, including closure

50. Several stakeholders have already sought IMF and WBG assistance in advocating or requiring disclosure and in developing a reporting framework.

51. Such indicators could include, for example, health and safety statistics, gas flaring (or greenhouse gas emissions), adequacy of mine closure preparations (including funding) and oil transportation arrangements, hazardous materials management and emergency response plans, availability of infrastructure and services (e.g., health and education), and revenues generated for governments.

Interim Management Response

I. Introduction

This paper presents the initial responses of the Managements of the World Bank, IFC, and MIGA to a four-volume evaluation of the World Bank Group's activities in the extractive industries (EI): Volume I is the overall summary of a joint OED/OEG/OEU sector review of the World Bank Group's activities; Volume II is OED's review of the Bank's activities; Volume III is OEG's review of IFC's activities; and Volume IV is OEU's review of MIGA's activities.

Extractive Industries Review. The reports and responses need to be considered in the context of the Extractive Industries Review (EIR),[1] an independent consultative exercise with stakeholders about the best future role for the World Bank Group in the extractive industries. Led by Dr. Emil Salim, the EIR has attracted the active involvement of a wide range of stakeholders, but it is still ongoing; it is scheduled to finish with the delivery of its report to the President of the World Bank Group in December 2003. In parallel to the EIR, OED/OEG/OEU carried out its evaluation of the World Bank Group's activities in the sector.

CAO Review. The Office of the Compliance Advisor/Ombudsman (CAO) has produced a separate review of the appraisal process of eight IFC and MIGA projects (too recent to have been included in the OEG review).[2] The CAO report contains a number of messages on IFC's activities in the extractive industries that will be addressed along with those arising from the EIR report. In addition, the CAO's office has recently delivered to IFC Management its final report on its review of IFC safeguards policies in general, which will soon be discussed at CODE.[3] How IFC addresses the findings of the safeguards report will have implications for its activities in the extractive industries.

Final Management Response. Because the EIR has raised, and is still discussing, many of the issues raised in the World Bank Group's Sector Evaluation, Management proposes to defer its final response until the EIR report is delivered. At that stage, Management will be able to frame its responses, and CODE will be able to judge them, in the broader context of the OED/OEG/OEU and CAO reviews and the EIR report.

II. Overall Report

This suite of reports provides a broad ranging review of Bank, IFC, and MIGA activities in the extractive industries sector. The reports have added to the World Bank Group's understanding of the issues in the sector and of its own performance, and they can contribute to the ongoing EIR process. They show that, on balance, World Bank Group activities in the sector have added value and have generally contributed to the development of the countries concerned. The reports lay out specific areas for attention and provide important perspectives going forward on key issues for each institution and for the Bank Group as a whole with regard to support to EI. In view of the ongoing EIR, it would be premature for World Bank Group Management to set out de-

1. See *Extractive Industries Review: Progress Report* (SecM2003-0266, IFC/SecM2003-0031), June 5, 2003.
2. Extracting Sustainable Advantage—A review of how sustainability issues have been dealt with in recent IFC and MIGA extractive industry projects. April 2003.
3. A Review of IFC's Safeguards Policies, January 2003.

tailed responses to these recommendations, and it will defer its full Management Response until the EIR report is received.

III. Interim Management Response to OED Report

Management welcomes OED's report, which provides a thoughtful and thorough review of the Bank's activities in the EI sector. The report makes a valuable contribution to discussion about future Bank activities in the sector and, together with its companion volumes, provides useful input for the recommended construction of an overall framework for World Bank Group activities in the sector.

Report Description. The report focuses on assessing economic effects, environmental and social effects, and governance issues associated with the Bank's interventions in the EI sector. More specifically it evaluates the Bank's effectiveness in enhancing the sustainable development contribution of the extractive industries. The evaluation was carried out in two phases. Phase I consisted of a review of the portfolio of World Bank EI projects supplemented by a review of Country Assistance Strategies (CASs) and a literature survey. Phase II, which built on the findings from Phase I, consisted of three Thematic Studies of the Bank's EI portfolio; five country case studies; reviews of twelve recent Project Performance Assessment Reports (PPARs) in seven countries; and two surveys. In a number of places the report has noted changes in the Bank's approach.

Classification and Supervision. Using a pilot approach and evaluating the degree of consistency with safeguards in line with the evolving interpretation of these policies, the report finds that a number of projects were wrongly classified with regard to environmental assessment category and thus were poorly supervised. These projects were largely of the sector adjustment type, for which potential impacts and classification are not always clear-cut. However, Management accepts the recommendations about the need for clearer guidelines on classification and supervision processes.

Implementation Completion Reports. The OED report asserts that the economic evaluations of EI projects in Implementation Completion Reports are not sufficient. In particular, it calls for more rigorous evaluation of technical assistance and adjustment projects (which make up over half the EI portfolio)—operations for which quantitative economic evaluations are very difficult and therefore have not normally been undertaken. The recommendations in this respect are probably generally applicable for similar activities across other sectors.

Final Management Response. Management will defer its full response until the EIR report is produced. The Management Response to that report will also address the OED recommendations in detail and present an overall World Bank Group approach for the sector.

IV. Interim Management Response to OEG Report

IFC Management welcomes OEG's report, which provides a thoughtful and thorough review of IFC's activities in the extractive industries sector. The report makes a valuable contribution to discussion about future IFC activities in the sector and, together with its companion volumes, provides useful input for the recommended development of an overall framework for World Bank Group activities in the sector.

Report Description. The focus of the report's investigation was 22 projects for which detailed evaluations had been performed. Typically these projects were approved at least five years ago and in some respects might not reflect more recent changes in IFC's approach to the projects it finances—particularly environmental and social due diligence and IFC's efforts to enhance and broaden the positive development impact of the projects it supports. However, to an extent, this was balanced by a review of 45 other projects approved after FY93 and still in IFC's portfolio—a broader set of projects that included some more recent projects and confirmed the evolution of IFC's approach. In a number of places the report notes changes in IFC's approach. OEG validated its review of evaluations through more than a dozen project visits in six countries.

Principal Messages. The major messages that Management takes from the report are as follows:

- The extractive industries have contributed to sustainable development, where projects in the sector meet appropriate environmental, social, and economic criteria. The report also provides evidence indicating that the overall World Bank Group approach to date of supporting the private sector as the most effective vehicle for new investment in the sector has been constructive.

- IFC's support for extractive industries projects has generally been effective. Projects have generated revenues for government and opportunities for people and have contributed to IFC as an institution.

- IFC has added value in the environmental and social aspects of its projects, and its safeguards and guidelines been useful to others even when it is not involved in projects. More recently, IFC has increased its focus on broadening the sustainable impact of the resource projects it supports.

- The report lays out a number of areas in which IFC can enhance its performance and its contribution to the sustainable impact of its projects.

Final Management Response. Management will defer its full response until the EIR report is produced—and will coordinate and integrate that response with its response to the CAO's recommendations on safeguard policies in general. The final Management Response to the EIR report will address all the recommendations in detail and will also present an overall World Bank Group approach for the sector.

V. Interim Management Response to OEU Report

MIGA Management welcomes OEU's report, which provides a thoughtful review of MIGA's activities in the extractive industries sector. It makes a valuable contribution to informing and guiding discussion about future MIGA activities in the sector and, together with its companion volumes, provides useful input for the recommended construction of an overall framework for World Bank Group activities in the sector. In the current ferment of new models and concepts about how best to facilitate development that is sustainable and productive at both local and macroeconomic levels, this series of reports will be useful.

Principal Messages. The major messages that Management takes from the OEU evaluation, recent CAO reports, and its own evaluation are as follows:

- The extractive industries have contributed to sustainable development, when projects in the sector meet appropriate environmental, social, and economic criteria.

- MIGA's support for extractive industries projects has generally been effective. Projects have generated revenues for government and opportunities for people and have contributed to MIGA's ability to function effectively and efficiently as an investment insurer.

- MIGA has added value in the environmental and social aspects of its projects where those opportunities are available and have been identified, and its safeguards and guidelines been useful to other investment insurers and lenders even when MIGA is not involved in projects. When MIGA issues its guarantees even to lenders or minority partners in projects, it has exercised good judgment in evaluating projects' environmental and social soundness and likely ability to produce an overall positive development impact.

- There are a number of areas, including areas identified by OEU, in which MIGA can enhance its performance and its contribution to the sustainable impact of its work.

Final Management Response. Management will defer its full response until the EIR report is produced. The Management Response to that report will also address the OEU recommendations in detail and CAO reports, and will present an overall World Bank Group approach for the sector.

Chairman's Summary: Committee on Development Effectiveness (CODE)

Background. This joint evaluation was one of the major sector evaluations in OED's FY03 work program. It was undertaken in parallel with the Extractive Industries Review (EIR), an independent, multi-stakeholder consultative exercise, headed by Mr. Emil Salim, former Minister of Environment of Indonesia. The EIR focuses on the future role of the World Bank Group (WBG) in extractive industries (EI, comprising oil, gas, and minerals and metals mining). The EIR was launched by Bank Management following the 2000 Annual Meetings in Prague, where a group of NGOs approached the Management of the World Bank with a proposal that the WBG should cease its support for EI projects, on the grounds that these projects did more harm than good in developing countries. Management decided to undertake a review of the WBG's involvement in this sector and the EIR is its response to this commitment.

Main Findings and Recommendations. Conducted in parallel with the EIR, the joint evaluation by the three WBG independent operations evaluation units assesses the effectiveness of WBG assistance to clients in enhancing the contribution of EI to sustainable development. The evaluation report's main message is that — while there are differences in performance between WB, IFC and MIGA projects — EI projects have produced positive economic and financial results and have contributed to sustainable development where projects meet appropriate social, environmental, and economic criteria. While the majority of WBG projects were in compliance with its environmental and social safeguards, the degree of compliance has been uneven. The WBG is well positioned to assist countries in overcoming the policy, institutional, and technical challenges to transforming resource endowments into sustainable benefits for their people. The OED/OEG/OEU evaluation reports include recommendations directed at the Bank, IFC, and MIGA, respectively.

The key recommendations for the WBG are that it remain engaged in El and that it should: (i) formulate integrated strategies for the sector and resource abundant countries that address the risk that EI contributions to fiscal revenues may not be used effectively for development priorities; (ii) not support significant sector expansion where the risk that EI fiscal revenues may not be used for development priorities cannot be adequately mitigated; (iii) strengthen the implementation of the existing policy framework, adapt the safeguard policies and guidance to be in line with evolving best practice, rigorously apply safeguard policies, and monitor, document, and report on the social, economic, and environmental/safety impacts of its EI projects and specifically monitor the distributional benefits; and (iv) proactively engage stakeholders with a focus on governance, revenue management, and community development, define and report on key sustainability indicators, and work toward and support disclosure of fiscal revenues from El. In its comments on the joint evaluation, the External Advisory Panel supports the recommendations but believes they should be made more comprehensive and binding.

Conclusions and Next Steps. The Committee welcomed the report's findings, including the positive performance of the World Bank Group (WBG) portfolio in EL It was generally satisfied with the scope and analysis presented in the OED/OEG/OEU evaluation. The Committee believed that the Interim Management Response (IMR) provided was appropriate and also agreed with Management's proposal to formulate a comprehensive Final Management Response (FMR) following completion of the external EIR (expected in December 2003). The Committee will have a fuller,

second-round discussion, focusing on the recommendations and their policy implications, at the time it discusses the FMR and the findings of the EIR. The Committee agreed with OED's recommendation that the joint evaluation, the IMR, CODE Chairman's Report, and the report of the External Advisory Panel will be disclosed following this first-round CODE discussion.

Governance. The Committee emphasized the importance of the Bank addressing governance and revenue management issues both in resource-abundant and resource-poor countries in a proactive and transparent way. Members supported the evaluation's recommendation on the need to develop a WBG strategy for sequencing its El interventions taking governance issues into account. They, however, also recognized the difficulty in implementing this in practice and cautioned against a one-size-fits-all approach. Members considered that there are questions about how issues of governance, including human rights, should, be addressed in El projects. These questions require further attention by all parties. The WBG's involvement in such issues should be consistent with its mandate and comparative advantage. At the same time, the approach adopted in each country needs to have local ownership.. Management noted the importance of governance issues and agreed to address them, as well as the question of CAS treatment of EI issues, in its FMR.

Revenue Generation from El Projects. The Committee noted that revenue generation from El projects constitutes a particular challenge. Some members noted that when assessing the impact of El the focus on revenues was too narrow and some underlined the importance of assessing the full impact of EI projects on poverty, employment and the environment. The Committee underlined the need for the WBG to be even more forthright in its dialogue with clients in addressing the issue of disclosure of revenues and noted that good models existed from Botswana and Chad-Cameroon project. Some members noted that they were not convinced by the "resource curse" arguments presented in the joint review and cautioned that resource-poor countries and non-EI sectors also have governance issues. The performance of resource rich countries could, however, be adversely affected by the so-called Dutch disease problem. They recommended that inclusion of examples from successful countries would provide a more nuanced understanding of the relationship between the EI sector and macroeconomic performance and were of were of the opinion that revenue management should primarily be addressed within the context of overall public finance management. Management agreed that it would be key to address transparency and distribution issues related to EI revenue management in its FMR

Safeguards and Performance of the Portfolio. Members asked for clarification of the recommendation that safeguard policies in extractive industries projects be rigorously applied, and in particular whether there would be a different standard for EI projects. The DGO responded that the recommendation was that existing policies be implemented and that this should apply to all sectors, not just EL Some members noted that the report suggested that there were still gaps and overlaps in safeguard policies, and that further consideration needs to be given to human rights issues. Management noted that considerable progress had been made by public and private entities in improving environmental management of EI resources.

Report of the External Advisory Panel. Members would have liked to have seen more substantiation of the conclusions of the OED/OEG/OEU's external advisory panel report. They did not agree with the advisory panel's assessment regarding the limited' value of a "rear view approach" and reemphasized the importance of evaluation to the Bank's operations. The DGO clarified that the advisory panels has been used for several major evaluations and that the role of the panel

was to advise OED/OEG/OEU in the development of the review but stressed that panel comments were conveyed to CODE as written by the panel.

Scope of the Final Management Response (FMR). Committee members' provided their expectations regarding the scope of the FMR. They asked that it provide a framework for WBG involvement in the EI sector and provide a clear assessment of the recommendations in both the evaluation and the EIR reports. Members also noted that the WBG should forge partnerships to address recommendations that touched on areas outside of the WBG's mandate.

Communication. The Committee suggested that Management consider a communication to the public explaining the background and process for the two-stage response by Management to the OED/OEU/OEG evaluation. It was also suggested that WBG Management consider a workshop on the results of the OED/OEG/OEU study, perhaps in connection with the EIR process. It was agreed that the Committee Chair would inform the Board concerning the discussion of the OED/OEG/OEU review and the two-stage process by which Management will respond to it.

Finn Jonck

Chairman