

Background Paper

World Bank Group Activities in the Extractive Industries

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World Bank Group Activities in the Extractive Industries

Background Paper

Introduction

The World Bank Group (WBG) has long played an active role in the extractive industries – oil, natural gas, and mining. Changing WBG priorities, industry trends and a worldwide growing appreciation of the complexity of the issues and trade-offs related to the contribution of extractive industries to sustainable development have led the WBG to decide that a review of its activities in the extractive sectors was both necessary and timely¹.

As part of the review process, this paper is intended to provide some background information for participants in a proposed consultation process. It is intended to describe the WBG's view of the key opportunities, risks, and challenges in the oil, gas, and mining industries and of the appropriate role for the WBG in those industries, together with information about current WBG activities. It is intended as a discussion document, with the hope that other stakeholders in the consultation process will provide comments. For further information about the consultation process, see www.eireview.org (from September, 2001).

The Extractive Industries: Opportunities and Risks

The oil, gas, and mining industries are integral to worldwide growth and the quality of life. Demand for their output is strong and growing, especially in the developing world. A continued expansion of these industries is virtually certain over the next 20 to 30 years, and WBG client countries will play an increasingly important role in that expansion on the demand side and, given the shift in exploration and development investments toward developing countries and countries in transition, also on the supply side.

The extractive industries have been, and in many cases remain, important to the economic development of industrialized countries such as the United States, Australia, Canada, Norway, the United Kingdom, and the Netherlands. They can be expected to fulfill a similar role for developing countries. For countries where extractive industries are very large relative to GDP, the vision is for : (a) significant resource flows for the national economy; and (b) sound macroeconomic management and governance that ensure that national resource wealth is successfully converted into social capital and leads to broader-based overall economic development and poverty reduction for the country as a whole.

¹ The Review is not intended to be a standard setting exercise for the extractive industries generally and is not intended to duplicate or displace ongoing initiatives by other stakeholders in the sector.

While extractive industries can provide significant opportunities for developing countries, at the same time, there are substantial risks that need to be managed and mitigated by governments, investors, and communities. These can be grouped into three broad categories of impact: economic, social, and environmental. The importance of each of these will depend on circumstances and the economic appraisal of the benefits of extractive industry projects need to account for these risks. As discussed below, policies and institutions to deal with and manage many of the risks of extractive industry development exist and have been implemented in many countries and projects. However, the problems and risks associated with the *implementation* of good policies are a recurrent theme and a real issue in many areas.

Economic Growth and Poverty Alleviation. Economic growth is a well-documented prerequisite to sustainable development and poverty alleviation². Growth in national income has been shown in general to benefit all groups, including the poorest, and is strongly associated with other measures of well-being such as health, nutrition, and education. The extractive industries have enormous potential to promote economic growth through profitable investment and, in some cases, the generation of very sizable revenues and rents that can contribute to broader national development. Whether this potential is realized or not depends on the nature of the investment climate a country establishes and on the governance it exercises. For many economies, extractive industries will be a relatively modest part of their national economy, and most of the risks of development are local. For other countries, rich extractive industries will generate revenue flows that are very large relative to the size of the economy, posing governance and economic management risks of national significance.

The depleting nature of extractive resources, especially from a national and local perspective, make it particularly important that governments and economic policies ensure that the benefits of extraction contribute to the development of the human, social, and physical capital needed for sustainable development.

Unfortunately, in certain countries, neither investment nor significant extractive revenues have been able to guarantee economic growth or poverty reduction. In some cases, average per capita growth rates actually have been lower than those in resource-poor developing countries, and some resource-rich developing countries remain among the world's poorest. Further, the presence of major oil, gas, and mineral deposits in developing countries has sometimes been associated with a variety of negative social and environmental outcomes, including corruption, violence, human rights abuse, absence of the rule of law, and environmental degradation, all of which in turn will negatively impact growth and poverty reduction.

Failures of state-led development in the 1970s and 1980s demonstrated convincingly that the private sector is the most efficient engine of economic growth and development. This presents developing country governments with two challenges in their extractive sectors: (1) withdrawing the state from direct participation in the sector; and (2) establishing a

² For a discussion of the broader issues relating to poverty see World Development Report 2000/1 "Attacking Poverty".

legal, regulatory, and fiscal framework and associated institutional capabilities that will attract private investment in an environmentally and socially acceptable manner with adequate protection of legitimate public interests. Where governments have been successful in meeting these admittedly difficult challenges, the results have sometimes been significant in terms of new investment, production, and revenues.

The so-called “Paradox of Plenty,” where resource development fails to generate the sustainable benefits expected, is one of the most urgent challenges facing countries particularly where extractive industries are a significant share of GDP. At the local level, it is most likely to manifest as relatively prosperous extractive industry enclaves surrounded by poor communities receiving little sustainable benefits from the development. At the national level, it is evident in the form of large tax flows that do not translate into long-term growth in human and physical capital, which forms the basis for sustained growth. Clearly, in such cases, the highest priority should be to learn from those countries and communities that have managed to use their resources as an engine for sustainable development, as well as learning from some major mistakes that have been made. Key policies include: (a) transparency and accountability with respect to revenues earned and their disposition; (b) consultation with principal stakeholders in developing plans for the use of resource revenues; (c) credible oversight and audit of the implementation of these plans; and (d) serious attention to building local institutional capacity.

Social Impacts. Regardless of the size of the extractive industries sector relative to GDP, the vision for all countries is for extractive industries development that takes place in a socially acceptable manner, especially at the local and regional levels, where most social impacts occur. The vision is for extractive industries development where all that is possible is done to avoid catastrophic events such as terrible accidents, and where the industries lay the basis for long-term community and regional development rather than promote enclave projects operating in extreme isolation from surrounding communities.

The need to comprehensively address environmental and social impacts has become increasingly urgent over the past 10 years. While it has often been a characteristic of the extractive industries that development can take place in remote areas, the probability of this being the case has increased. In response to limited access to reserves in traditional producing areas and to liberalization and incentives offered by host governments in developing and transition countries, industry investors have extended their exploration and development operations to more geographically remote areas. Such areas are often home to isolated local and indigenous populations, and also to fragile ecosystems and unique biodiversity. Importantly, it is in such remote areas that governments and local communities are likely to have the least capacity to deal effectively with the issues. Such remote communities are also more likely to experience being on the fringe of rich “enclave” developments whose economic links to them are relatively weak.

Furthermore, workers in the extractive industries are often migrant workers, living without their families and within disrupted social contexts. This situation can contribute to a high prevalence of HIV/AIDS and other communicable diseases at or around extractive industries developments. Often, HIV infection rates in mining communities dramatically exceed national averages.

Properly managed, oil, gas, and mining operations can be expected to provide major benefits to the communities in which they take place. A partial list of potential benefits would include: (a) increased local employment and incomes; (b) the transfer of a variety of technical and commercial skills and development of local capacity; (c) a share in fiscal revenues at the local level; (d) enhancement of local social infrastructure and improvement in the delivery of services, especially in areas such as health, education, transport and power as a result of increased public funds and investor contributions; and (e) positive multiplier effects in and beyond the communities in which the extractive operations are located.

As the record to date shows, extractive operations bring risks as well as opportunities at the social level. Where improperly or insensitively planned, developments can have adverse social impacts whose costs outweigh the gains. These risks, which are most acute in remote, poor communities, include: (a) loss of livelihood when local populations are forced out of traditional productive activities; (b) local hardship as a result of upward pressure on the prices of basic goods; (c) mismanagement or diversion of revenues intended for distribution at the local level; (d) disruption of local populations and culture, especially indigenous populations, through forced resettlement or in-migration; (e) health risks from social contact or local environmental pollution; (f) human rights abuse as a result of poorly supervised security operations and other sources of social tension; and (g) dependence and lack of preparation for the inevitable oil field or mine closure.

At first sight, managing the social risks appears daunting, but there are signs of progress. A growing number of approaches are being adopted, among them: (a) identification and clear articulation by governments and investors, in consultation with local communities and civil society generally of clear and appropriate policies on social impacts; (b) incorporation of policies into laws, regulations, and contractual obligations; (c) effective and continuous local consultation in project design, implementation, and operation; (d) rapidly increasing requirements for detailed social impact assessments (SIAs) as part of project preparation, including plans for addressing all areas of concern; (e) continuous monitoring and evaluation of social impacts as operations proceed; (f) clear provisions for compensation in the event of any harm, and investor social funds to proactively address social concerns; (g) effective participation in the project benefits at the local level, including sharing of fiscal revenues; (h) investment in institutional capacity in local government and local populations; and (i) increased corporate sensitivity to social concerns at both project and management levels.

Small-scale and artisanal mining can present special social and environmental challenges. Small-scale mining is in many places an important source of employment and income for miners, their families, and communities. However, more often than not, small-scale mining is poverty driven, practiced by a largely itinerant, often poorly educated populace with little other employment alternatives, typically as a consequence of recent loss of employment in other sectors or other regions. Many of the miners and their families have little choices other than pursuing small-scale mining and they expose themselves to harsh working conditions and significant health risks while remaining trapped in a low revenue earning cycle. At the same time, mining methods employed tend to cause grievous

environmental damage. Cooperatives are often the only means for small-scale miners to improve their own situation, to manage and reduce environmental, social, and cultural risks within which they have to operate, or to improve their access to technologies or marketing structures that could enhance their own economic opportunities.

Environmental Impacts. The environmental vision is for extractive industries development that takes place in an environmentally sustainable manner where the ecological footprint of the project is minimized, environmental impacts are properly managed during project life, all that is possible is done to avoid any catastrophic events such as oil spills or tailings spills, and adequate reclamation and rehabilitation take place at the end of the project.

The environmental risks of oil, gas, and mining operations are well documented and include: (a) removal of soil and forest canopy; (b) soil, air, and water pollution, including impacts on global warming³; and, (c) the destruction of fragile ecosystems and diminished biodiversity.

In the past, extractive industry operations have sometimes wreaked significant damage to the environment leaving unfortunate legacies that, when reversible, may need extensive programs to remedy. Over the past 20 years, however, the extractive industries have increasingly recognized the need and obligation to identify and mitigate any adverse environmental consequences of their activities. The expectations of local communities, national governments and others about the effectiveness of extractive industries in addressing environmental concerns have risen significantly, and these expectations are being reflected in policies, regulations and best practices.

The technology and knowledge needed to minimize or eliminate many adverse impacts exist and are in practice in many cases. Much of the key to addressing many environmental issues lies in the realm of policies, procedures, institutional capacity, and incentives directed at ensuring these are properly applied in a way to be effective for as long as needed. However, like other industrial and economic development activities, an extractive industries project will have an impact in its immediate footprint area and through its economic and other interactions with its surrounding region, and the commercial and economic benefits of these projects need to be evaluated against environmental risks. Such trade-offs may be involved in this respect through the whole length of the project life – from exploration, development, operation, closure and beyond – and they need to be thoroughly assessed by communities and governments.

The instruments and processes for managing, minimizing, and mitigating environmental risks closely resembles those for social impacts and includes: (a) clear guidelines for operations; (b) adequate laws, regulations, and standards, and local institutional capacity to implement such laws and monitor and audit operations; (c) thorough environmental impact assessments (EIAs) and associated action plans; (d) consultation with stakeholders

³ The venting or flaring of natural gas produced in association with oil (associated gas), and methane seepage from coal mines, in addition to causing local environmental damage, can contribute to global warming.

at all phases of operations; (e) procedures for identifying liability and appropriate compensation in cases of harm; (f) preparation of an initial closure plan at the time of project approval and subsequent updating on a regular basis during the project life; (g) provision of the necessary resources to fully implement the closure plan; (h) post-closure monitoring and supervision as needed; and (i) investor “buy-in” to environmental priorities.

Remedies for global impacts (such as global warming and biodiversity loss) present a special challenge since the decisions about the options involved (e.g. development versus conservation) and the costs of actions needed are local issues while the benefits may be largely global. In some cases, it may be possible to obtain the desired results if mechanisms can be established that can find parties who are willing to pay the local costs needed to gain the global benefits. In the case of global warming, for example, the Kyoto Protocol framework is the first serious attempt to address this issue. It envisages the creation of global markets for carbon emissions that would provide investors (including investors in developing countries) with extra revenues for having invested to reduce emissions beyond what narrow commercial or national self-interest would have dictated.

As our knowledge of the scientific and operational issues has increased, the emphasis of environmental management is now shifting from mitigation and avoidance of any harm to the generation of environmental benefits that creates a more favorable net impact from development. Examples might include new investors undertaking the remediation of past bad practices by others. Or, in addition to the application of best practice to their own operations, investors might support the safeguarding of other areas of possibly greater importance that are under threat (referred to as “offset areas”), or fund or participate in environmental research, for example in biodiversity surveys or experimental research.

Defining Responsibilities

The past decade has seen a growing appreciation among stakeholders of the need to work together on extractive industry issues that no one group can fully deal with alone. Over most of the period, however, the appropriate boundaries of each stakeholder group’s contribution remained blurred and a source of confusion and tension. Even the definition of “stakeholders” is not without some controversy, with the relative interests, responsibilities and direct exposure to risk of the various groups covered by this umbrella term varying hugely. However, more recently, a consensus, albeit incomplete, seems to be emerging regarding potential roles and responsibilities.

Governments. Governments are ultimately in charge of setting the rules by which extractive development takes place in a given jurisdiction, and their actions will be critical to achieving sustainable benefits from extractive industry operations for the national economy. They must provide strategic direction; the requisite legal, regulatory, and institutional frameworks to pursue social and environmental goals; accountability, openness, and inclusion; and systems to achieve widespread and tangible benefits for the country’s citizens.

Local communities. The rights of local communities, who will be most directly affected by extractive industries development, can be safeguarded if their concerns are listened to and respected and if they are able to take an active role in understanding and influencing extractive operations. Sometimes, assistance to increase the capacity of local communities may be needed to allow them to participate effectively during consultation and in monitoring operations. Increasingly, the division of the fiscal benefits from resource development has become an issue for local communities. This needs to be seen in the overall context of national taxation collection and spending arrangements, but some form of revenue sharing through the various levels of government down to the local community would be a way of ensuring sharing of the costs and benefits of development.

The private sector. The private sector is expected to provide the capital, technology, and managerial expertise to run extractive operations. It must also comply with all local laws, regulations, and contracts, including those that deal with social and environmental topics, and normally go beyond this where home-country standards, operations in other countries, or internal guidelines set higher standards. Issues arise as to the appropriate boundaries of private sector action when, perhaps faced with the incapacity of governance structures, the private sector is asked to address a whole range of issues outside its traditional mandate. Many companies see as this as a part of the process of ensuring that, beyond the legal license to operate, they have a social and political license to operate, although in many instances their capacity or authority to act as communities might want may be limited. In considering the private sector, the range of potential investors needs to be kept in mind: from the largest international companies to small local companies and even artisanal miners. Capacities, incentives, and priorities may vary hugely and present particular issues.

Civil society. Members of civil society, including local and community-based organizations, have at times been an effective monitor of the impact of extractive industries and an advocate for change by government, industry, and international development agencies. They have, at times, won praise for advancing the development agenda and for drawing attention to issues that might have been overlooked or not given sufficient importance. Many civil society organizations, including local community-based organizations, are active in implementation of policies and programs designed to promote sustainable development and reduce poverty. In the case of the extractive industries, Non Governmental Organizations (NGOs) and Community Based Organizations (CBOs) may sometimes be able to play a role in areas such as, for example, the delivery of social services and the administration of project trusts and infrastructure or capacity building with regard to social and environmental monitoring.

International development agencies. International development agencies such as the WBG are well-placed to support both government and the private sector by assisting in sector reforms and the preparation of investment frameworks; providing loans, equity finance, or political risk insurance to investors; and advising on governance, social, and environmental reforms. International agencies have a unique ability to operate at the interfaces between governments, investors, and civil society groups. The leverage of their development funding can be persuasive in securing the enactment and

implementation of sector reform; effective management and mitigation of risks; and evolution toward socially acceptable and environmentally sustainable development. Their objectivity and global experience can also give these agencies special credibility and convening power that can enable them to play a useful role locally or internationally at the request of governments and other stakeholders. Such agencies can use their convening power to bring a variety of groups together in a way that facilitates constructive dialogue and paves the way for participatory processes, especially those that spread across national boundaries.

Bilateral Donors. Bilateral Donors are often a partner in WBG supported projects and this is also the case for the extractive industries, either directly, or through their export credit agencies or through trust funds or similar arrangements. The partnerships may take various forms, ranging from co-financing or parallel-financing to complementing WBG activities with grant resources, particularly for capacity building and for specific environmental and social activities related to the project. In general, partnerships are established on a case-by-case basis. There are of projects in which bilateral donors have a competitive advantage in assisting governments and civil society achieve certain development goals, notably in certain types of capacity building and training programs.

Partnerships. Over the past decade, many governments and investors have come to recognize that they can no longer “do it alone” and partnerships are needed to successfully develop extractive industries. Civil society in general, and affected communities in particular, need to be fully consulted and supportive if extractive industries development is to take place in a satisfactory and sustainable manner. Trust among stakeholders, developed over time through joint undertakings, while respecting each others’ role or comparative advantage, has become almost a prerequisite to sustainable extractive industries development – that is, development that brings net benefits to the community, the region, and the country long after the resource has been extracted and the project completed.

Codes and Guidelines. A growing body of mostly voluntary agreements, codes, or inventories of best practice is shaping performance in the extractive industries in a positive way. Effective consultation and partnerships can lay the basis for development and implementation of such codes and guidelines which can be applicable at both the sector level and that of an individual project. To be effective, of course, codes and guidelines, need stakeholder groups to have the capacity and motivation to effectively fulfill their respective roles.

The World Bank Group and the Extractive Industries

The World Bank Group has been involved in financing and technical assistance operations in the extractive industries for more than three decades. All of its major institutions (IBRD/IDA, IFC, and MIGA) are active in the sector (for details of these institutions, see Annex I).

Scale of Recent Activities

There have been important changes in focus over the last two decades that reflect changing WBG priorities, industry trends, and a growing appreciation of the important issues and risks relating to the local and national contribution of extractive industries to sustainable development.

Changes have involved both volume and content. IBRD/IDA have withdrawn to a large extent from helping governments and state-owned entities finance new investment in productive capacity, and instead have been increasingly focused on sector reform (Technical Assistance Lending). At the same time, the proportion of IBRD/IDA projects with objectives related to social, environmental, and governance issues has increased substantially. The largest loans and credits in recent years have actually financed social and environmental mitigation in the context of the restructuring of coal industries in Eastern Europe and Russia, including the closure of uneconomic mines.

Over the last 20 years, IBRD/IDA lending approvals supporting government activities for extractive-industry-related projects have averaged nearly \$0.65 billion per annum, close to 4 percent of total IBRD/IDA lending approvals in the period (although much higher at times in the case of individual countries). As activities moved towards sector reform, during the last third of this period, the overall level of approvals was maintained only by a small number of exceptional, relatively large activities. The underlying downward trend in the volume of lending activities in the sector is evident in that during the past three years aggregate approvals have fallen to average about \$0.2 billion, annually.

Both the IFC and MIGA have been active in helping catalyze finance for private sector extractive industry investments although on a highly selective basis that accounts for only a small proportion of total private sector investment flows in the developing and transition countries. On average, over the last eight years, IFC and MIGA's extractive industry involvement as a share of their total business have been about 8 percent and 15 percent respectively. In absolute terms, together they have averaged around \$0.4 billion per annum.

Further to their lending activities, IBRD/IDA have also included extractive industry issues such as resource revenue management in broader WBG programs such as Structural Adjustment Loans (SALs). In addition, there is an active program of advisory work, often financed from bilateral and other trust funds, designed to help governments address particular issues and needs, and areas of broader industry interest.

Basis for WBG Involvement

The WBG's involvement today is based on an understanding that:

- a) The development of extractive industries can contribute to sustainable development and poverty reduction.
- b) There may be trade-offs in terms of benefits, costs and risks that policymakers need to be aware of and manage if potential benefits are not to be lost.
- c) Demand and supply of extractive industry outputs in developing countries is going to increase over the next two to three decades and the sector will continue to be an important one for many of the WBG's developing country members.
- d) An institution such as the WBG has some comparative advantages and a role to play in helping its member countries minimize and mitigate the risks and maximize the benefits available from the development of their resources.

Overall Directions

In brief, WBG activities that reflect these core understandings can be described in terms of their contribution to economic growth and poverty reduction and their social and environmental impacts.

- a) Support the contribution of extractive industries to **economic growth and poverty reduction** through:
 - ?? Assisting governments reform their oil, gas, and mining sectors and create effective frameworks for sustainable private sector investments (including small scale mining).
 - ?? When needed, helping finance and mobilizing finance for private investments, and, where appropriate, working with private sector investors to enhance the positive impact of their operations towards economic growth and poverty reduction.
 - ?? Providing technical and financial assistance to governments to build the necessary institutional capabilities to manage the transition to market-based, competitive, and socially and environmentally sustainable development, including restructuring and privatization of state enterprises.
 - ?? Helping governments develop better governance and management of resource revenues and its impacts to ensure a more effective and contribution by the sector to sustainable development locally and nationally.

- b) Help mitigate adverse **social and environmental impacts** by:

- ?? Providing technical and financial assistance to governments to develop strategies, policies, legal frameworks as well as institutional capacities on all levels that will foster private sector investment while manage the social and environmental impacts of extractive industry development (and decline). Such assistance would include the legal framework for environmental and social assessment, and assistance to the public sector in capacity building for such assessments done by the private sector.
- ?? When needed, working with private investors, in the context of project finance, towards advising them with regards to their Environmental Impact Assessments (EIA) and Social Impact Assessments (SIA) as well as their remediation and consultation plans and activities.
- ?? Providing technical and financial assistance to governments to deal with negative environmental and social legacies, including providing support for groups in society adversely affected by privatization of state oil and extractive industries companies.
- ?? Playing a leading role in developing consensus and best practices in the area through WBG guidelines, and informally through best practice groups and partnerships – including, increasingly, going beyond mitigation of adverse impacts to maximizing the positive impacts.
- ?? Encourage the preparation of strategic studies which assess the environmental and social costs of potential investment in a given area, and analyze potential alternatives.

The Context of IBRD/IDA Involvement - Country Focus

In practice the extent of the Bank Group's involvement is also going to depend on specific country circumstances and WBG strategy for the country (for details of WBG activities in the sector, see Annex II). The overall level of WBG activities within any one country is set by the Country Assistance Strategy (CAS) which builds on the country's own development goals and strategy and describes how the WBG will help the country achieve them over the medium-term. The CAS, which WBG Management presents to the WBG Board for discussion, prioritizes areas for WBG involvement and sets out specific operations to be financed. The programs adopted reflect the country's circumstances and needs; the government's overall policy objectives and programs; alternative sources of financing available to governments; and the comparative advantage and priorities of the WBG.

Increasingly, CASs are prepared in the context of Comprehensive Development Framework (CDF) and Poverty Reduction Strategy Papers (PRSP) processes, through which countries elaborate their long-term poverty reduction and growth strategies and set out a framework for coordination of development assistance, including WBG support.

Organizational changes within the WBG that have strengthened the role of country teams and country-specific solutions have also reinforced this approach.

The CAS approach and focus on country goals, needs, and performance has some important implications for WBG activities in the extractive industries. Whenever the WBG is active in the extractive industries sector, its operations are set in an overall framework for WBG activities and development assistance. Conversely, the priorities set by the CAS can also mean that the WBG may not be active in the extractive sector because there are higher priorities for WBG activities in other sectors in the country.

The Context of IFC and MIGA Involvement - Private Sector Investments

Private sector oil, gas, and mining projects supported by the WBG usually take place in countries that other financiers avoid because of perceived political risk. Private sector investments that are supported by the WBG need to meet WBG guidelines, as well as host country requirements, and criteria such as a sound economic and financial rate of return; good technology; good social and environmental practice. By providing support for the financing of private investment in the extractive industries, WBG involvement, through IFC and MIGA, can provide on-the-ground, real-life examples of good practice in oil, gas, and mining. IFC can also provide advice and assistance to help enhance the local economic impact of extractive industries development.

Furthermore, a number of companies are now starting to use WBG guidelines and criteria for their own activities, irrespective of whether the WBG is involved in the project. This voluntary use of WBG guidelines broadens the positive impact the WBG is having on the industry. In addition, there is an important role for the WBG in supporting the privatization of state-owned enterprises.

In the case of financing for private investment in the extractive industries, such support depends to some extent on the potential investment needs and decisions of private investors. The CAS in this respect provides a relatively general framework to set overall priorities for private sector financing support that will be supplemented by the more specific private sector country development objectives of IFC and MIGA. In the case of IFC, for example, its involvement is highly selective and focused on developments in countries perceived by investors to be high-risk areas, where the need for financial support and the opportunity for a high value-added contribution from IFC (in addition to financing) is the greatest.

Impact of WBG Activities

On a project-by-project basis, WBG staff continuously evaluates individual projects and their implementation, assessing success or failure with regard to objectives defined during project design. Typically, projects are evaluated within the direct project framework – and not with regard to larger issues as raised in the first section of this paper (for example, what impact did a country's mining sector reform have on overall economic growth, or what impact did an IFC financed project have on a country's

governance structures). To address these larger and broader issues, the Bank Group's evaluation departments⁴ are embarking currently on a comprehensive review of such questions, focusing on projects where implementation has begun long enough ago for actual results and impacts to be clear and measurable. With regard to more recent projects, WBG staff will provide a separate report, summarizing results of the project-by-project assessments undertaken by sector staff during project implementation.

Looking Forward

Over the next 20-25 years, two billion people will be added to the world's population, all of whom will be in developing countries. In the same countries, approximately 2.5-3 billion people live today on less than US\$2 per day. Providing for today's population and for future generations in a manner that is sustainable in the long-term will present a variety of challenges. Growth in production and per-capita consumption around the world will place additional pressure on natural resources, including environmental resources and amenities, and may generate increased social tensions within and between countries.

How natural resources, including non-renewable resources, are developed and managed is going to be crucial to the sustainability of the development path that the World will take. Institutions and processes that contribute to balancing the often diverging interests of various groups and stakeholders with regard to these resources will be critical in the future. The WBG will be but one amongst many working towards identifying and promoting solutions that would facilitate the achievement of this common goal.

The WBG is seeking a dialogue with stakeholders about the role of the WBG in extractive industries. The ultimate objective is to have a better understanding of stakeholders' views and ideas on what is the best future role for the WBG in the extractive industries and the key issues that should inform that role. On the basis of such better understanding the WBG intends to focus and possibly redesign as needed WBG programs and processes in the sector given its ultimate objectives. Possible areas for dialogue could include, for example:

a) The contribution of extractive industries to sustainable development and poverty reduction:

- ?? The WBG's understanding of the balance of opportunities and risks concerning the contribution of extractive industry development to sustainable poverty reduction.
- ?? Its understanding of the policies, mechanisms and other solutions to minimize, mitigate and manage the risks.

⁴ Independent project evaluation and assessment is done, within the Bank Group, by the Operations Evaluation Department (OED) for IBRD/IDA operations and by the Operations Evaluation Group (OEG) for IFC operations.

b) The WBG's relative strengths and its role in extractive industries.

The WBG has a number of strengths and characteristics that should help fill an effective role in the development of its member countries extractive industries by itself or in partnership with others.

- ?? The WBG's role as a development institution, its focus on poverty reduction, the country focus of its programs, and its interactions with governments and other institutions provide a consistent framework to help assess the potential conflicts, risks and trade-offs for its country members resulting from activities in their extractive sectors.
- ?? It has the capacity to catalyze private investments in countries that investors perceive of as high risk and would otherwise stand back from investing in.
- ?? As a global institution, it has the capacity to help promote best practice nationally and globally and has a strong convening power that can be used at the local or the global level.

Given these strengths and characteristics:

- ?? Are there better solutions for governments to help balance the trade off between benefits and risks from extractive industry operations than those currently promoted by the WBG?
- ?? Can the WBG better leverage its global reach to help develop and promote the widespread implementation of best practice solutions to extractive industries issues (including ways to go beyond "no harm" and maximizing the positive impacts and linkages of developments)?
- ?? Can the WBG more effectively support the private sector in developing extractive industries in ways that contribute to sustainable development?
- ?? Are there perceived particular gaps in the existing WBG safeguard policies or their implementation relating to its activities in the extractive industries?
- ?? Are there more effective ways for the WBG to better use its convening power to bring together different stakeholder groups and participatory processes that can address key issues at the local and global levels?

Reactions to this paper and other submissions are expected to help inform the proposed consultation process and help shape its agenda.

Annexes

- I WBG Organization and Instruments
- II WBG Investment and Other Activities in the Extractive Industries
- III Past Trends and WBG Response

Annex I

WBG Organization and Instruments

A1.1 Agencies and Financial Instruments. The activities of the WBG in the extractive industries are channeled through the organizational structures and financial instruments available to it. It consists of five specialized multilateral agencies: the International Bank for Reconstruction and Development (IBRD); the International Development Agency (IDA); the International Finance Corporation (IFC); the Multilateral Investment Guarantee Agency (MIGA); and the International Center for the Settlement of Investment Disputes (ICSID). Each of these agencies has played an important role in the WBG's involvement in the extractive industries, and has a range of instruments at their disposal to address sector needs and concerns.

- a) **IBRD/IDA.** Collectively called the "World Bank", these agencies offer a wide variety of both project- and policy-based lending, technical assistance loans and credits, and non-lending services to governments or state-owned enterprises (SOEs). As noted earlier, World Bank support to investments by SOEs in the extractive sectors has declined sharply. Bank assistance to the sectors is now focused on support for policy reform, social infrastructure, and environmental protection. The Bank is also able to provide a variety of guarantee instruments to private sector creditors to reduce their perception of non-commercial or political risk, thus facilitating private sector investment (www.worldbank.org/whatwedo).
- b) **IFC.** The IFC lends at commercial rates to the private sector, syndicates other commercial loans, and may take an equity position in a project. IFC participation acts as a catalyst to private investment by reducing perceptions of non-commercial risk or by providing finance not otherwise available to small local private sector entities. IFC's activities must, at a minimum, not displace willing private investors and where possible are expected to have a developmental impact beyond pure finance, such as on corporate governance (www.ifc.org).
- c) **MIGA.** MIGA supplies political risk insurance, at commercial rates, to private sector investors against a range of non-commercial risks. Within the extractive industries it has seen more activity in mining than in oil and gas. Like IFC with respect to other investors, MIGA does not seek to displace private sector insurers. In addition to providing insurance, MIGA advises governments on suitable investment frameworks (www.miga.org).
- d) **ICSID.** ICSID provides facilities for the arbitration of investment disputes. Arbitration clauses, critical components of any petroleum or mining contract, frequently bind the parties to refer to ICSID in the event of dispute (www.icsid.org).

A1.2 Non-financial Instruments. The WBG institutions also use a broad range of non-financial instruments to support environmentally and socially acceptable extractive industries development. These include support for training courses, workshops,

seminars, conferences, and research work and publications on relevant issues, including macroeconomic, legal, fiscal, technical, social, and environmental issues.

A1.3 Beyond the formal structure and instruments of the WBG, there are a variety of internal and external processes designed to improve the effectiveness of WBG assistance. Most notably, over the recent years, the WBG has emphasized country context and country collaboration in determining assistance priorities. Two processes – Country Assistance Strategies (CAS) and Poverty Reduction Strategy Papers (PRSP) – are particularly important in this regard:

- a) Country Assistance Strategy (CAS). WBG involvement in the extractive industries of any particular country depends on fitting into the priorities in the Country Assistance Strategy (CAS) for the country. The CAS identifies how the WBG will help a country meet its development goals over the next three to five years and provides an overall framework for WBG activities in a country. The CAS may or may not envisage activities in the extractive industries. In recent years, the WBG has moved to strengthen the effectiveness of the CAS and its relationships with countries generally. This has included promoting the country focus in its activities and establishing the WBG country team (increasingly located within country) as the prime counterpart in dialogue with countries.
- b) Poverty Reduction Strategy Papers (PRSP). In September 1999, the World Bank Group and the International Monetary Fund (IMF) determined that country-owned participatory poverty reduction strategies should provide the basis for all their concessional lending and for debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. This approach, building on the principles of the Comprehensive Development Framework – a new way of thinking about development that emphasizes a holistic approach – has led to the development of Poverty Reduction Strategy Papers (PRSPs) by country authorities. The papers, which are prepared by member countries through a participatory process that includes the WBG, describe the country's macroeconomic, structural, and social policies and programs and set out a three-to-five-year plan to promote broad-based growth and reduce poverty.

A1.4 **Networking.** The multiplicity of stakeholders in development work and the growing importance of cross-sectoral and cross-regional linkages has led to new organizational arrangements designed to facilitate networking and the formation of joint teams both inside the WBG and with outside partners, including:

- a) Matrix Structures. In recent years, matrix organizational structures have developed within the WBG in recognition of the overlap of developmental interests across geographical regions and across sectors. These structures allow those working on extractive industry issues in one region to compare notes with colleagues working on similar issues in another region, thus facilitating the identification and transfer of best practice. Similarly, the new structures allow those working on extractive industries to partner with colleagues in other relevant

sectors, such as the social and environment sectors, or in relevant functional areas, such as development economics or public sector management.

- b) **Global Product Groups.** Another organizational innovation is the creation of Global Product Groups (GPGs). These consolidate IBRD/IDA (“World Bank”) and IFC staff working in sectors where strong synergies exist between policy and public sector activities on the one hand, and the private sector on the other. Oil and gas, as well as mining, are both set up as GPGs within the WBG. Ideally, they will provide policy advice that is better informed with respect to private sector requirements, and private sector investment transactions that are more sensitive to good policy, including social and environmental considerations.
- c) **External Partnerships.** Both the World Bank and the IFC have placed increased emphasis on external partnerships with governments, the private sector, civil society, and other development agencies. These partnerships, which recognize the importance of stakeholder collaboration to successful development outcomes, have become critical organizational features of today’s WBG, and are especially important in the extractive industries.

A1.5 Quality Control and Enhancement. Finally, over the past few years, the WBG has put in place a number of new policies and procedures meant to maintain or enhance the quality of its operations, including:

- a) **Safeguard Policies.** The WBG has established a series of safeguard policies covering the social and environmental dimensions of projects. Several of these have direct relevance to the extractive industries, such as those on resettlement and on indigenous peoples, and must be reflected in the design and implementation of WBG projects. The safeguard policies have proven to be enormously important, and have had an impact well beyond the WBG’s own projects – even where the WBG is not involved, project sponsors and financiers often look to the WBG’s policies for guidance (www.worldbank.org/safeguards).
- b) **Evaluation and Quality Control** IBRD/IDA and the IFC have separate Operations Evaluation units that evaluate and provide independent advice to the WBG’s Board of Executive Directors on the effectiveness (outcome, sustainability and institutional development impact) of projects, programs and processes. Both these groups assess the quality and relevance of self-assessment based reports provided by the respective operational departments (for example, Project Completion Reports in the case of IBRD/IDA projects) to ensure high quality. Both units from time to time do major in-depth studies of the effectiveness and outcome of WBG activities in particular sectors and countries. MIGA has also recently established an Operations Evaluation unit to perform similar functions. In addition, the Bank has a Quality Assurance Group that does rapid assessments of ongoing projects to monitor portfolio quality and assist Management in improving portfolio quality (“quality at entry” and “quality of supervision”).

- c) Sustainability. The IFC is currently in the process of putting in place a new program to ensure and enhance its' projects contribution to sustainable development –through careful attention to the governance, social, and environmental performance of its private sector projects and clients, as well as through other means and initiatives.

A1.6 **Public Information and Appeal.** An important check on WBG performance comes through arrangements it has established for enhanced public access to project information and appeal in the event of complaints:

- a) Information. Key project documents, covering the several stages of project progress of all WBG project, are now generally available to the public through the Bank's Public Information Center (www.worldbank.org/infoshop), facilitating comments and inputs from outside stakeholders. For example, documents made available by IFC include Environmental Assessments as well as project summaries. However, in the case of IFC and MIGA, confidentiality of undertakings vis-à-vis commercial clients may place some limits on access to information.
- b) Appeal. The WBG has appointed a Compliance Advisor/Ombudsman, reporting directly to the President of the WBG, to handle complaints by locally affected communities regarding IFC and MIGA financed projects and to work with all parties to achieve positive outcomes and the constructive engagement of all parties (www.ifc.org/cao). The Bank has for some years had an independent Inspection Panel⁵, which covers IBRD/IDA activities (www.worldbank.org/inspectionpanel).

⁵ Three extractive industry-related projects have been referred to the Inspection Panel in recent years. In the case of two of these – the Chad-Cameroon project (4558-CD, 3316-CD,3373-CD) and the India Coal Sector Environmental and Social Mitigation Project (2862-IN, 4226-IN) – the Panel's reports are still outstanding. In the case of the third – Ecuador: Mining Development and Environmental Control TAP (3566-EC) – the report found that the Bank was substantially in compliance but in apparent violation of some policy provisions. Details of complaints in the Ombudsman process (IFC and MIGA projects) are not disclosed by the CAO; confidentiality is often an important feature of conciliation and mediation processes. However, reports of the CAO following an investigation will be communicated to the WBG's president, the complainant, and, as appropriate, to IFC an MIGA management, and disclosed to the public. Where non-compliance issues have emerged in the course of an Ombudsman investigation, the CAO may decide to undertake a compliance audit following the closure of the Complaint process. Policy issues may similarly be dealt with by the CAO in the exercise of her or his Advisory role. To date, the CAO has 10 complaints three of which relate to the extractive industries.

Annex II

WBG Lending and Other Activities in the Extractive Industries

A2.1 All WBG investments must be approved by the WBG's board. Staff appraisal processes are intended to ensure that investments are consistent with WBG policies, meet all appropriate standards and guidelines including environmental and social requirements, and that projects being financed will generate sustainable net benefits for the country. Country Assistance Strategies (CAS) and related documents provide a framework for investment approvals. WBG investments will have either the host government as a counter party (IBRD/IDA) or are made with the approval of the host government where the private sector is the counter party (IFC, MIGA).

A2.2 From 1980 to date, WBG approvals for extractive industries-related lending and other investments have averaged around \$800 million per year, or about 4 percent of total WBG approvals. Annex III describes how the broad pattern of WBG strategy has changed over the last three decades.

A2.3 The major trends in terms of involvement in the extractive industries:

- a) For most of this period, oil and gas-related investment approvals averaged about 70 percent of total extractive industry investment approvals. Mining-related investment approvals averaged about 30 percent. Mining's share increased to above 50 percent in the last 8 years as a result of a few large coalmine closure programs (see below).

	1980-86	1987-93	1994-2001
Mining	270	271	574
Oil & gas	555	541	433
Total	825	813	1006
# of projects pa	22	18	21

- b) The level of involvement, in dollar terms, has been volatile from year to year, with no strong trend in overall volume of activities. In the last three years, however, investment approval levels declined in dollar terms:

FY	1994	1995	1996	1997	1998	1999	2000	2001
\$m	1497	950	1195	723	1866	703	655	458

⁶ Figures include: approved IBRD/IDA loans and credits and IFC loans, equity and other financing, and also MIGA's involvement measured in terms of issuance of insurance coverage (maximum aggregate liability for coverage issued - see further below for details). Numbers do not include other projects, such as, for example, Structural Adjustment Lending programs that might have had a component referring to the extractive industries.

- c) A major change has taken place – in dollar terms – in the balance between projects that finance government activities and those that support the private sector. Investments to catalyze or facilitate private investment (IFC and MIGA) have increased as a share of the total from 10 percent to more than 30 percent in the last eight years, and the share of government financing (IBRD/IDA) has fallen accordingly.

Financial Years	1980-86	1987-93	1994-2001
IBRD/IDA	5226	4085	4738
IFC	551	1386	2089
MIGA	–	217	1221
Total Value	5777	5688	8046

For IBRD/IDA and IFC: Board approvals for loans, credits, and financing. For MIGA: Issuance of coverage/liabilities assumed.

A2.4 In the case of IBRD/IDA, whose role is to support government activities, the major changes in the focus of their investments have been:

- a) The World Bank has to a large extent withdrawn from financing government/state-owned projects whose sole or dominant objective is to invest in new production capacity in oil and mining. As discussed earlier, the WBG approach is predicated on the evidence that production investments and operations are generally best made and operated by the private sector within an appropriate regulatory and market framework. As a result, from the late 1980s, IBRD/IDA programs emphasized financial and technical support to countries to enable them to undertake regulatory and institutional reforms. Exceptions to this general approach have included a few large “sector rehabilitation projects” whose objectives included a combination of reform measures and steps to increase production or productivity, and some gas development projects.
- b) In addition, governance, social and environmental objectives have figured more prominently⁷. For example:

Financial Years	1980-86	1987-93	1994-2001
Broad Policy Reform objectives	15	13	31
Governance objectives	1	4	15
Social objectives	2	0	14
Environment objectives	1	13	31

- c) The end of the Soviet Union led to a significant increase in WBG extractive industry activities in the former Soviet Union (FSU) and Eastern Europe. From FY 1994-

⁷ Many projects, especially since the move by IBRD/IDA away from capacity/production investments, have included multiple objectives. Also, general program lending (e.g. Structural Adjustment Loans) may also contain objectives relating to extractive industries, relating for example to governance.

2001, more than 60 percent of IBRD/IDA investment approvals (when measured in value; 33 percent in project numbers) occurred in those regions. In the case of oil and gas, activities took place against a backdrop of low prices, rapidly falling production, and a legacy of environmental problems and poor practices. In the case of mining, sharp falls in activity and restructuring of industry and energy markets across the region left a huge social, environmental, and economic problem of redundant and non-competitive coal mines.

Table 2.5 IBRD/IDA Share of Approvals 1994-2001

Regions	Share of total Lending Volume (in percentage)	Share of total number of projects (in percentage)
FSU and Eastern Europe	62	33
Asia/Pacific	24	19
Africa	8	29
Latin America	5	15
Other	1	4
Total	100	100

- d) In dollar terms, recent IBRD/IDA approvals have been strongly influenced by a small number of large programs focused on mine closure (Russia and Eastern Europe) and two large sector rehabilitation loans (India – coal, Russia – oil sector). However, by far the largest share of all project activities has been in sector reform (oil and mining).

Table 2.6 IBRD/IDA Approvals by sub-sector FY1994-2001

	Number of Projects	Total lending volume (in \$m)	Relative share with regard to overall lending volume (in percent)
Coal mine closures (Russia, Ukraine, Poland, Romania)	7	1986	41
Russia – Oil Rehabilitation II	1	500	11
India – Coal Sector Rehabilitation	1	532	11
Gas Development (China, Thailand, Bangladesh)	7	772	16
Sector Reform	21	530	11
Others	12	418	10
Total	49	4738	100

A2.5 In the case of IFC, whose focus is private sector development, major trends over the period were:

- a) The overall level of IFC extractive industry investment approvals rose over the period to average around \$260 million annually in the period 1994-01. While the absolute level of volume increased until the early part of the 1990s, extractive industries investments as a share of total investment fell as IFC's other activities expanded. In addition to its own investment commitments, IFC often mobilized additional loan financing through partnerships with commercial banks through its B-loan syndication

scheme. Total B-loan financing over the period was roughly the same as IFC's investment for its own account.

Financial Years	1980-86	1987-93	1994-2001
Number of Investments	8	12	12
Value (\$m)	79	198	261
B-Loan Syndications	68	233	241

- b) On a year-by-year basis, IFC's investment approvals have been volatile, with no clear recent trend, although in 2001 the volume of approvals was below trend.

FY	1994	1995	1996	1997	1998	1999	2000	2001
\$m	277	312	326	227	208	318	276	144

- c) The balance between mining and oil and gas has been broadly even. In the case of mining investments, different products have been supported, with gold and copper being the most important single commodities. In the case of the oil and gas sector, investments have been predominantly to help support oil production, but have also included gas production, and for a period in the 1980s included the support of investments in oil exploration. More recently in the case of both mining and oil and gas, IFC has helped finance investments in oil and mining service companies.

Financial Years	1980-86	1987-93	1994-2001
Oil and Gas	30	99	154
Mining	49	99	107
Total	79	198	261

- d) IFC provided a mixture of finance to private investors including loans, quasi-equity finance, and equity.

Financial Years	1980-86	1987-93	1994-2001
Loans	61	126	184
Equity	8	27	34
Other	10	45	43
Total	79	198	261

- e) For most of the period, IFC's investment approvals were concentrated in Latin America and Africa. With the collapse of the former Soviet Union, governments in this region opened up their resources to private investors, and in 1993 IFC made its first investment in Russia. In a number of cases, extractive industry investments were

among the first areas for private foreign investment in the newly opened up region, and IFC's investments in oil and mining were among the first investments it was able to make in Russia and Central Asia. Through the 1990s, commercial financing became more available for oil, gas, and mining in many Latin American countries. By the end of the 1990s, IFC had largely withdrawn from new investments in the sector in countries such as Chile, Argentina, and Brazil. With the Asia crisis in the late 1990s, IFC found itself facing new demands to help support private sector investment in parts of Asia where it had not been active in the sector for some time.

Table 2.11 IFC Investment Approvals By Region (\$m pa, Share %)

	Current Held Portfolio (\$m)	New Investment Approvals (Percentage share)			
		1980-86	1987-93	1994-2001	1999-2001
Africa	255	21	36	30	40
Asia	4	16	10	10	27
FSU E.Europe	297	0	5	27	22
Latin America	333	55	40	30	11
Other	45	7	9	3	0
Total	934	100	100	100	100

A2.6 In the case of MIGA⁸ key trends have been:

- a) In MIGA's early years, extractive industry investments accounted for a large share of MIGA's small but growing business. Currently, this share has reduced to less than 15 percent of the coverage issues.

Table 2.12 Average annual volume of MIGA coverage issued (\$m pa)

Financial Years	1990-93	1994-2001
Extractive Industries	31	153

- b) More recently, coverage issues does not show any very distinct trends, although both FY2000 and FY2001 were relatively strong years.

Table 2.13 MIGA Coverage Issued in Extractive Industries 94-2001

Financial Years	1994 ⁹	1995	1996	1997	1998	1999	2000	2001
In \$ m	93	206	175	59	152	68	200	268
In % of MIGA total	25%	31%	20%	10%	18%	5%	12%	13%

- c) Overall, support for mining has accounted for close to 80 percent of the \$ value of the coverage issued by MIGA in the extractive industries, and oil and gas around 20 percent. Latin America has been the most important destination for coverage issued by MIGA in these sectors, followed by Africa and the FSU.

⁸ MIGA's maximum aggregate liability for coverage issued.

⁹ 1994 figures refer to cumulative liabilities (gross) up to 1994)

	Number of Projects	Total volume (in \$m)	Relative share with regard to total volume (in percent)
Africa	7	352	24
Asia/Pacific	2	127	9
FSU	5	278	19
Latin America	15	606	43
Other	2	75	5
Total	31	1438	100

A2.7 Advisory and Non-Investment Activities

- a) In addition to activities that it has helped finance, mentioned in the analysis above, the WBG also undertakes large amounts of non-lending or -investment related advisory and analytical work financed from other sources. This work has covered a wide range of areas. The WBG has focused on helping individual governments deal with particular oil, gas, and mining issues, including some that might have been identified in the context of WBG-financed activities. Work in this category could, for example, include assistance to governments to increase capacity in areas such as the management of environmental issues, to negotiate with and regulate private investors, or to manage and deal with local community issues.
- b) It can also include assistance in the form of independent analysis of key issues or sectors to help provide guidance to governments for policymaking, for example, in areas such as the development of a strategy for gas development or the minerals industry. Activities in these areas are identified by the government and WBG and are funded usually by grants (trust funds) from bilateral donors and represent additional resources that are available relatively quickly to address issues that might not otherwise get the resources and attention needed. At any one time, there could be up to 10-20 such activities underway across the WBG, usually concentrated in IBRD/IDA.
- c) In addition to country-specific issues, the WBG also is active in investigative and research-focused activities. Work in this area can be financed on an ad hoc basis by trust funds from bilateral donors, from WBG internal programs, and also from more formal program arrangements between the WBG and other organizations. In the energy-related area, including oil, gas, and coal, much work has been carried out by ESMAP, a joint WBG and UNDP program supported by bilateral donor trust funds (www.worldbank.org/esmap).
- d) The WBG is involved and contributes to a number of important “partnership arrangements” with other stakeholders – governments, civil society, and companies and industry associations – in the extractive industries. These are designed to promote the identification and promotion of best practice in relevant areas.

- ?? Best Practice Group on Social Mitigation: The WBG is working on a number of initiatives to mitigate and enhance the positive social impact of oil and gas developments, as a part of a "Best Practice Group on Social Mitigation". The group, which includes representatives from the oil and gas industry and NGOs, was established in 1998. It is working on issues relating to oil and gas development and their impact on the societies in which they take place (www.worldbank.org/html/pdf/energy/oil&gas/BestPractices/index.html).
- ?? Business Partners for Development: The WBG is a founding partner in "Business Partners for Development", whose members include private corporations, civil society organizations, and government bodies. The "Natural Resources Cluster" of the partnership seeks to enhance the role of oil, gas, and mining in sustainable development (www.bpdweb.org and www.bpd-naturalresources.org).
- ?? Energy, Environment, and Population Program: The World Bank, along with OLADE (The Latin American Energy Organization), sponsors the "Energy, Environment and Population Program" (PEA). This program was set up in response to a request from 11 countries to support activities to enhance the impact of oil and gas developments on local communities, especially indigenous peoples. The PEA program is based on a tri-partite dialogue involving governments, industry and indigenous peoples. Activities include developing information systems, improving regulatory frameworks, studying the distribution of oil rents, and training on participatory issues. In addition to these regional activities, the Bank is involved in individual country programs enhancing capacity to deal with the social and environmental impacts of oil and gas developments (www.olade.org.ec/redeap).
- ?? Clean Air Initiative: The Bank has active programs assisting governments to deal with air pollution by helping them design and implement cost-effective strategies improving oil product quality. Through the Clean Air Initiative, the Bank is working with countries in all regions to eliminate lead additives from gasoline. A campaign to eliminate the use of lead additives in Latin America has been successfully completed: only 15 percent of the gasoline used in this region still contains lead, and leaded gas will be entirely phased out by 2005.
- ?? Government Dialogue: World Mine Ministries Forum (WMMF). The WBG's Mining Department is a member of the WMMF's Steering Committee, a forum for mines ministers, policy makers, senior government officials, mining company executives and representatives of non-governmental organizations from around the world to discuss some of the key challenges facing mining countries. (www.wmmf.org).
- ~~??~~ Industry Dialogue: Mining, Minerals and Sustainable Development Project (MMSD). The WBG's Mining Department is a member of the project's Sponsor Group, as well as of its Assurance Group. MMSD is a two-year research and

consultation effort to better understand and assess global mining and minerals use in terms of the transition to sustainable development – its track record in the past and its current contribution to and detractor from economic prosperity, human well-being, ecosystem health and accountable decision-making (www.iied.org/mmsd).

~~the~~ Small Scale Mining: Consultative Group on Artisanal and Small Scale Mining (CASM). The WBG's Mining Department acts as CASM's secretariat, an initiative to coordinate donor support and exchange of best-practice on improving the livelihood of Small Scale Miners around the World (www.casmsite.org).

A2.8 Approval, Supervision, and Assessment Processes. The WBG has a structured supervision and assessment process to ensure that projects achieve their objectives and maintain a high level of quality. This process also is used to assess outcomes.

- a) In both IBRD/IDA and IFC staff regularly monitor projects against objectives and prepare annual supervision reports. In the case of IFC, where commercial viability is a very important factor, the supervision process focuses on monitoring immediate financial performance and downside risks, including compliance to the environmental and social requirements specified in the loan agreement. In the past few years, IFC's regular reporting system has been broadened to include a more systematic monitoring of non-financial performance criteria, including environmental and social issues. In the case of IBRD/IDA, the range of objectives of a project can be very wide, and regular supervision/assessment of progress reflects this. In both cases, compliance with environmental and social guidelines is regularly assessed in terms of both reporting requirements and on the ground, through site visits (www.ifc.org/enviro).
- b) On final disbursement of loan/credit funds, IBRD/IDA staff complete Project Completion Reports (PCRs) that assess the effectiveness and outcomes of the project. Such reports are reviewed and a sample audited by the IBRD/IDA's operations evaluation department (OED). In the case of IFC, annual supervision reports are supplemented by evaluations of a random sample of five-year old projects. These evaluations address a project's development outcome (incl. impact on economic growth, living standards, and environmental and social effects), its investment outcome for IFC, IFC's effectiveness in administering the operations, and lessons learned. They are written by the investment department and independently reviewed and rated by the IFC's operational evaluation group¹⁰ (OEG). Both OED and OEG, from time to time, conduct in-depth evaluations of IBRD/IDA and IFC activities in specific sectors or countries. In the case of the extractive industries, no recent sector evaluations have been completed. In 1993, IFC's relatively short-lived program to support oil and gas exploration was reviewed, subsequent to which IFC stopped financing of pure exploration ventures.

¹⁰ For the evaluation framework used by IFC, see <http://www.ifc.org/oeg/xpsrs/xpsrs.html> and <http://www.ifc.org/oeg/xpsrs/NonfinMarkets/nonfininstructions.html>. For frameworks and assessments by the IBRD/IDA's evaluation group see: <http://www.worldbank.org/html/oed/>.

A2.9 Examples for WBG financed projects. Even though a comprehensive and exhaustive assessment of the impacts of WBG financed projects is not available, some project descriptions are provided below to illustrate at more detail scope and objectives of some of these projects.

- a. Mining Sector Reform in Argentina. In Argentina, the World Bank Group has worked with the government to reform the policies and the mining code, emphasizing the role of the state as a regulator instead of both regulator and operator, thereby creating a vibrant and growing mining sector that will contribute to economic growth for the entire country. About ten years ago, notwithstanding a favorable geology and of well-established mining neighbors such as Brazil, Bolivia and Chile, Argentina had only few mines, most of them small-scale operations and involved in the non-metals sub-sector (industrial minerals). In 1992, the World Bank Group began supporting a government led sector reform process which included: (i) encouraging private investments and stability; (ii) ensuring sector contributions to sustainable economic and social regional development; (iii) promoting consensus regarding mining policy between federal and provincial authorities, through the creation of a Federal Mining Council; (iv) better defining the respective responsibilities of the provincial and federal mining authorities and of the private sector; (v) divesting state owned mining interests and restructuring and modernizing the sector agencies, (vi) improving access to mineral land; and (vii) modernizing the legal framework by amending the Mining Code and promulgating complementary legislation. Today, more than 80 foreign mining companies are active in Argentina, compared with 4 in 1990. The total mining production value has increased from US\$341 million (1992) to an estimated US\$1.31 billion in 1999.

- b. Encouraging private sector investment in mining in Zambia. In Zambia, a World Bank Group team assisted the government of Zambia in the privatization of Zambia Consolidated Copper Mines Ltd. (ZCCM), at a time when achieving a successful privatization was as critical for the survival of the mines as it was for the economic, social and political stability of Zambia as a whole. ZCCM produced about 100 percent of Zambia's copper, and copper exports represent about 80 percent of Zambia's total export revenues. Immediate access to funding was imperative to prevent further deterioration in the condition of the mines, which would have led to their closure and, hence, to severe adverse impacts on the local physical and social environment. IDA funding was provided for external legal and financial advice to the Government of the Republic of Zambia (GRZ) and also for the preparation of an extensive environmental and social due diligence on the existing facilities. IFC participation in the investor consortium was an essential element in bringing the privatization to a successful conclusion. IFC brought regional private sector experience and political thrust to the table that was critically needed in the investment climate in Zambia. To further assist in the transition to privatization, the Bank also (i) has supported the Mine Township Services Project (\$37.7 million) to provide for continued water and sanitation services to communities; and (ii) is preparing the Copperbelt Environment Project (\$55 million) to assist the Government in addressing

its environmental liabilities.

- c. Mitigating environmental and social impacts of mine closure in Romania. In Romania, a World Bank assistance program supports the closure of 29 uneconomic mines, serving as a model for 174 further mine closures, while developing a manual for mine closure and financing social mitigation measures and environmental rehabilitation. The decision to stop uneconomic mining was taken by the Romanian government as subsidies to uneconomic mines by the mid-1990s drew around \$400 million annually from the state budget. By 1997, 83,000 miners – out of 173,000 – had left the industry and production had stopped in 160 mines, resulting in a sharp increase in unemployment, social hardship, and social unrest such as the unions' march on Bucharest. The Bank-sponsored program: (i) closes 29 uneconomic mines in an environmental acceptable manner (ii) finances social mitigation (support for mine workers and their families, as well as for social services and communities dependent on the mine); (iii) supports labor market interventions (workspace centers, employment assistance, training, micro-credit schemes); and (iv) helps redesign the regulatory framework for managing mining, including the definition of environmental and social responsibilities. The program's total value stands at US\$44.5 million.
- d. Financing for the first large private mining project in Bolivia in the 1990s. In Bolivia, mining has been the dominant economic activity ever since the sixteenth century. Hundreds of different deposits have been worked throughout the country; however, much of Bolivia's mineral wealth remained untapped. The collapse of international tin prices in the 1980s had led the government to abandon the previous statist model of economic development, and following changes in macro-economic policies most of the state mine corporation's high-cost mines were closed. In 1991, IFC's Board of Directors approved financing of \$40 million for the Inti Raymi project, a gold and silver mine at Kori Kollo, the most important mine in Bolivia. Battle Mountain Gold, a U.S. mining company that is now Inti Raymi's foreign majority owner, had sought IFC involvement due to the political risks and uncertainties associated with investing in Bolivia at the time. This highly visible operation, in the context of the government's new policy framework, and the obvious financial success of Inti Raymi have encouraged other foreign mining companies to invest in the Bolivian minerals sector since. The ripple effects from developing this mine have improved lives throughout the local and regional economy. Inti Raymi's tax payments make up about half of the revenue from the entire Bolivian mining sector, and with Bolivia's growing fiscal decentralization, local governments receive an increased portion of these taxes. From the start, Inti Raymi has taken particular care in addressing environmental concerns, introducing new technologies appropriate to manage the mine's impact on its surroundings. At the same time, in addition to improving local infrastructure, the company has spent substantial amounts in purchasing local goods and services. It has also established the Inti Raymi Foundation that finances social programs for over 1000 families living in the 25 communities around the Kori Kollo mine, including the provision of primary health care, support of education in rural schools, a handicraft project and a livestock

breeding project (www.ifc.org/economics/pubs/results).

- e. Support for environmentally and socially responsible small scale mining in Ecuador. In Ecuador, a Bank-financed program supports environmental and social improvements for small-scale miners. Following a boom in small-scale mining in hard rock gold in the southern regions of the country in the 1980s, the situation for many of the miners had deteriorated by the early 1990s. Unsafe mining techniques had led to severe environmental damage causing living conditions that endangered people's lives and the environment. The Bank-financed PRODEMINCA project allocated funds to a fully integrated program, addressing the environmental and social problems while taking into account complex sociological questions, ranging from migration to gender issues. The project has made a significant contribution to: (i) developing sustainable remedial measures to limit the environmental degradation caused by small scale mining, controlling the occupational and toxicological problems related to mining; and (ii) facilitating the organization and management of small-scale miners' associations with the view to up-grading the efficiency and performance of the sector. The project was also instrumental in setting up a network within Ecuador among NGOs, other agencies working on small-scale mining and government authorities with a view to taking a systematic and collaborative approach in addressing the issues.

In December 1999, the Bank's Inspection Panel received a request for Inspection related to this project. After an Evaluation, the Panel concluded that Management of the Bank was substantially in compliance with its procedures but in apparent violation of some policy provisions. Currently, specific actions are being undertaken to address the Panel's findings on these.

- f. Bolivia Hydrocarbon Sector Reform and Capitalization: In 1995, the Bank provided an US\$11 million credit to Bolivia, one of the poorest countries in Latin America, to help in the design and implementation of its novel "capitalization" scheme that has privatized the management of the oil and gas industry. The country also reformed its regulatory environment and fiscal terms and around \$5 billion of new private investment has been committed to its oil and gas sector. Gas reserves have been substantially increased, and exports to Brazil have begun, generating vital revenues. The capitalization also involved the establishment of Bolivian pension funds to take 50 percent ownership of the newly capitalized oil and gas corporations, so the benefits of the investments will flow to more than 3.5 million Bolivian citizens, many of them old and poor. An area of concern shared by NGOs and the Bank involved potential negative environmental and social consequences of increased exploration activities. To address this, the Bank has assisted in the preparation of regulations for operations in indigenous peoples' lands. A new Learning and Innovation Loan is helping to develop capacity among government agencies, industry and local community stakeholders for implementing a participatory approach in the execution of oil and gas projects.

g. Argentina Public Enterprise Reform Project: In 1991, the World Bank approved a US\$23 million loan to help the Government carry out its Public Enterprise reform program, which included the restructuring and privatization of the state oil and gas companies and strengthening of the Government's regulatory capabilities. Following liberalization, IFC helped mobilize private sector financing for local and international investors in the oil and gas sectors. The results have been impressive, and today Argentina's oil and gas industry is considered one of the most competitive and efficient in the world. Oil and gas production have increased, and the country has turned from a gas importer to a gas exporter. The sector, which used to be a drain on state resources, is now a significant generator of taxes and other incomes to Government.

h. Developing Local Gas Resources:

Cote d'Ivoire. IFC helped finance the CI-11 oil and gas development offshore: Cote d'Ivoire, which was the first private investment in the country's oil sector in many years. The project's gas is largely dedicated to new gas fired power generation, including a new private power plant, which IFC subsequently also helped finance. The project's success provided the necessary impetus for the development of other oil/gas fields in Cote d'Ivoire. The combination of local privately developed gas and power has provided Cote d'Ivoire with a competitive reliable source of electricity, as well as generating significant fiscal benefits.

Mozambique. The World Bank's first mini gas turbine-electrification project using natural gas was recently implemented in Mozambique. Natural gas from the Pande field is transported by plastic pipeline to the small towns, of Vilankulo and Inhassaro, where gas is used to generate electricity in five mini gas turbines. The construction of an electricity distribution network and installation of gas-fired generators was completed at a cost of about US\$2 million. Service connections were initially made to about 250 consumers, but electricity demand has been strong, with the number of consumers increasing by 60 percent over the first few months of operation. Cost recovery tariffs were implemented sufficient to provide a reasonable return on capital investment. No subsidies are given to consumers except for a small number who pay life-line tariffs. The billing and collection has been beyond expectation, exceeding 98 percent, and technical operation has been excellent.

Electrification has promoted economic activities and improved the social welfare. Small businesses have started-up or expanded their existing operations. Schools now provide a better learning environment, and clinics operate longer hours and provide safer services because of the reliable electricity supply. Street lights have provided safer streets and prolonged the economic and social life in the towns.

i. The Chad Cameroon Pipeline Project: This project was approved by the Bank in June 2000, and it involves a pioneering attempt to create a good framework to transform oil resources into direct benefits for the poor. The project includes an innovative program to direct new revenues to support economic and social development in Chad, which is one of the world's poorest countries. The project will develop the oil fields

in southern Chad and construct a 1,070 km pipeline to offshore oil-loading facilities on Cameroon's coast. The WBG will provide about US\$200 million of the total financing requirements of \$3.7 billion, with the remaining balance provided by private oil companies, commercial banks and export credit agencies.

A law has been approved by Chad's Parliament that sets out the arrangements for the use of the revenues, with 10 percent of the royalties and revenues to be held in trust for future generations, 5 percent to be earmarked for regional development in the oil-producing area, and the bulk of the remaining 85 percent to be devoted to education, health, social services, rural development, infrastructure, environmental and water resource management. From the start, the environmental risks of this project were seen to be significant but manageable. The Environmental Impact Assessment and Management Plan, developed in accordance with the WBG safeguards and policies, were the subject of consultation with the affected people and exchanges of views with local and international NGOs aimed at ensuring that the project planners were studying the full range of potential risks and applying the appropriate standards of environmental protection. The pipeline will be buried and its effects on the natural and human environments will thus be limited. There will be almost no resettlement, and while a small amount of tropical forest (10-15 sq. km.) will be lost through construction, this will be compensated by the creation of two large new national parks (approximately 5,000 sq. km.) in Cameroon which will be managed for better biodiversity conservation. The Bank also approved two projects to help strengthen the capacity of Chad and Cameroon for environmental management and monitoring of the petroleum sector.

On March 22, 2001, the Bank's Inspection Panel received a request for inspection related to the project. On June 19, the Panel was given an extension of 90 days to submit their review.

- j. Bolivia-Brazil gas pipeline – Loan and Partial Risk Guarantee. In 1997, the IBRD approved a US\$130 million loan and partial risk guarantee for the US\$2.2 billion Bolivia-Brazil gas pipeline. The Bank's investment was sufficient to catalyze the provision of financing from other sources, including other multilateral development banks, export credit agencies, and the project owners - Petrobras; the Bolivian Pension Funds and Private Sector companies. The project is of great importance to Bolivia for earning export: revenue, and allows the Brazilian economy to diversify away from environmentally polluting fuels including high sulfur fuel oil and wood. Natural gas as a fuel for power plants is also the only feasible solution to meeting Brazil's need for power over the short term. The project was in an area containing some of the world's most ecologically sensitive zones and indigenous populations. The pipeline is buried, and the route was selected to minimize disturbance to sensitive areas, with many special construction techniques used to avoid disturbance to aquatic life and ecosystems. In Bolivia, no new access roads were created so as to avoid opening previously undisturbed areas to colonization. An Environmental Management System unprecedented in Latin America was set up to ensure effective implementation of environmental and compensation measures, including an ombudsman to act as liaison to civil society groups and NGOs. Innovative public

dissemination strategies included placing the Environmental Assessment on a web page with dissemination in national newspapers and the establishment of a toll-free public response hot line in Brazil. The project included many socioeconomic programs to benefit nearby communities, and Indigenous Peoples' Development Plans were prepared in accordance with World Bank OD4.20¹⁸ with the participation of the affected indigenous peoples themselves. Such programs included water wells, community centers, medical facilities, sewage systems, housing, agriculture, healthcare, education for indigenous women, and the first major program in Latin America to provide legally protected land titles, for indigenous peoples. Numerous ecological compensation projects were also supported including a reforestation project in the state of Rio Grande do Sul and the establishment of a fund to be used for the sound environmental management of the Chako National Park in Bolivia. Natural gas is flowing to the Brazilian market, and the project has played the key role in the privatization of both the Bolivian and Brazilian hydrocarbon sectors.

Annex III**Past Trends and WBG Response**

A3.1 This section outlines shifts that have occurred in the extractive industries and more broadly in the thinking about developmental issues over the last three decades, and summarizes the WBG's response.

The 1970s: Resource Nationalism

A3.2 During the 1970s, state-led development policies – including nationalization of many “strategic” industries or sectors (the “commanding heights” of the economy) – were pursued. The oil, gas, and mining sectors featured prominently in this movement, especially from the mid-70s. Ownership of petroleum and mineral resources was transferred to the state, governments began to play a much more active role in both sectors, and national petroleum and mining companies were established. Government objectives were to capture a greater share of sector revenues, assume control of the sector, and develop indigenous capacity. The World Bank responded to these trends by providing project loans and technical assistance to state institutions and state-owned enterprises (SOEs).

A3.3 In contrast to what happened in many other developing country productive sectors, however, the capital and technology requirements of the extractive sectors assured the international private sector of a major continuing role. In recognition of this, at least in the oil sector, World Bank support to the state typically included technical assistance loans and grants to help establish a legal, fiscal, and contractual framework to attract international private capital, often to work in joint ventures with the newly established National Oil Companies.

A3.4 At the end of the period, the IFC had begun to complement this type of assistance by providing loans and equity to private sector investors in situations where investors remained concerned about country risk, or where financing constraints prevented the participation of smaller international or local investors.

A3.5 Environmental and social considerations did not feature prominently in the agendas of either governments, the private sector, or the WBG during the 70s, and civil society was largely absent from any discussions on sector policies.

The 1980s: Breakdown of State-Led Solutions.

A3.6 The 1980s saw the failure of state-led development policies. Growing recognition of the poor performance of government and SOEs led to a shift in WBG policies toward macroeconomic stabilization on the one hand, and an increased emphasis on sector policy reform and the promotion of private sector development on the other. World Bank lending conditioned on policy adjustments at both the macro and sector levels became

increasingly important, as did technical assistance in these areas. Toward the end of the 1980s, the disappointing results of work by the Bank and others on the commercialization of state-owned enterprises began to be replaced by a focus on their privatization. More and more, the Bank discontinued direct support to SOEs and/or individual investments that the private sector might be better placed to undertake. IFC and MIGA now became the main WBG vehicles for direct support to investment through their assistance to private sector firms. While these developments occurred across all sectors, they were especially pronounced in the extractive sectors.

A3.7 During the second half of the 1980s, the WBG's focus on reform and private sector development began to be complemented by increased attention to first environmental and then social issues, prompted in part by the increased engagement of civil society in these areas. Environmental departments were established in both the Bank and the IFC and, at the end of the period, safeguard policies were first introduced. Because of their potential for harm to the environment and social disruption, as well as their potential to produce environmental and social benefits if properly structured, projects in the extractive sectors were often assigned to "Category A", necessitating the strictest form of Environmental Assessment. The private sector, too, was beginning to assign greater weight to environmental and social concerns in both preparing and implementing its investments. This period of growing sensitivity to these issues was, however, characterized by considerable tension and not infrequent confrontation among the various stakeholders.

The 1990s: Holistic Approaches to Development.

A3.8 The 1990s saw an evolution in thinking about development, in response to lessons learned during the preceding two decades and, equally importantly, to a rapidly changing environment. In the mid-90s, the Bank proposed the Comprehensive Development Framework (CDF) approach, a new way of thinking about development that emphasizes a holistic approach, recognizing the growing importance of cross-sector linkages and global trends in influencing development, and, given the multiplicity of stakeholders involved, the need for consultation, partnerships, and ownership if development impacts are to be sustained. The networks, sector boards, global product groups and external partnerships mentioned above are all following this new approach, which now transcends the WBG and is increasingly shared among governments, development agencies, civil society and the private sector. Further, although differences certainly remain, and although there have been exceptions, the late 90s brought a growing consensus among stakeholders that problems should be approached collaboratively rather than confrontationally. At a minimum, there should be engagement.

A3.9 The 1990s also saw a continued commitment to reform, privatization, and private sector development. Efforts to create working market economies dominated the development agenda in the new transition economies, but were found elsewhere as well. Reform and deregulation programs were accompanied by privatization projects in an effort to undo the nationalizations of the 1970s and earlier.

A3.10 Finally, governance became a prominent theme in the development community during the latter half of the 90s, encompassing effective macroeconomic and sector management; transparency and accountability in government and industry; the rule of law; democratic institutions; and reduced corruption. One of the “pillars” of the CDF, good governance is regarded as critical to successfully addressing environmental and social issues and to the creation of properly functioning markets and a responsible private sector.