

Annex 2. The World Bank Group in Extractive Industries

This Annex draws on information from the World Bank Group and elsewhere to look at the WBG's activities in extractive industries, including what they are and how they have evolved over time. Only upstream activities, exploration and production, are considered; downstream activities, refining and marketing, are not included.

The WBG consists of five institutions, each with a distinct role in the effort to fight poverty and improve living standards for people in the developing world. These institutions are the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), which combined are also known as the World Bank; the International Finance Corporation (IFC); the Multilateral Investment Guarantee Agency (MIGA); and the International Centre for Settlement of Investment Disputes (ICSID).

The role played by the WBG in extractive industries is seen as part of its commitment to reducing poverty and meeting the Millennium Development Goals adopted by the international community at the United Nations in September 2000. These goals are to eradicate extreme poverty and hunger; achieve universal primary education; promote gender equality and empower women; reduce child mortality; improve maternal health; combat HIV/AIDS, malaria, and other diseases; ensure environmental sustainability; and develop a Global Partnership for Development.

The WBG believes that the development of extractive industries can contribute to sustainable development and poverty alleviation. Extractive industries can encourage economic growth in developing countries by generating revenue and employment and by acting as a trigger for infrastructure development, education, training, and entrepreneurial activity. The large revenues that governments receive from extractive industries projects can be used effectively to support other development priorities. Extractive industries in developing countries are expected to continue to grow over the next two to three decades, in large part responding to growing demand for their outputs in these countries. The sector will thus be an important one for economic development for many WBG developing-country members.

Yet investments in extractive industries involve tradeoffs between benefits, costs, and risks that need to be managed carefully by governments, investors, and communities. These tradeoffs fall into three broad categories of impact: economic, social, and environmental. WBG involvement in extractive industries is designed to help in managing these tradeoffs and in maximizing the contribution that extractive industries will make to sustainable development and to meeting the Millennium Development Goals.

The World Bank Group works with governments, private industry, civil society, and other stakeholders in the extractive industries sector. The objectives of WBG activities include:

1. Supporting the contribution of extractive industries to economic growth and poverty alleviation by:
 - assisting governments to reform their oil, gas, and mining sectors and creating effective frameworks for sustainable private-sector investments;
 - mobilizing finance for private investments and working with private-sector clients to enhance the effectiveness of their operations;
 - helping governments manage the transition to market-based and sustainable development, including restructuring and privatizing state enterprises; and
 - helping governments improve their governance and management of resource revenues.

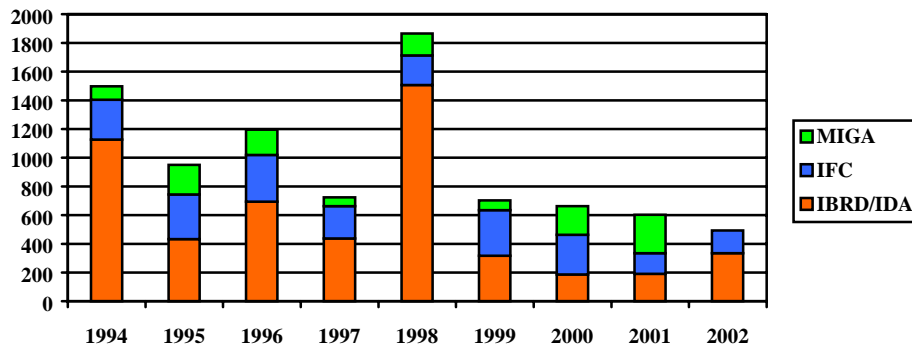
2. Helping improve governance in developing countries by:
 - reducing poverty through the wise use of resource wealth;
 - equipping governments to effectively manage natural resources, focus on revenue management and governance, work with local communities, and deal with the legacies of past investments;
 - helping governments provide the best framework for private industry;
 - providing support for the private sector in high-risk and frontier countries; and
 - adding development value by promoting small- and medium-sized enterprise development, building local skills, and maximizing local benefits.

3. Helping mitigate adverse social and environmental impacts by:
 - advising private investors on environmental impact and social impact assessments and on their remediation and consultation plans and activities;
 - providing assistance to governments to deal with negative environmental and social legacies;
 - using best practice groups and partnerships to develop consensus and best practices in the application of WBG guidelines, even in projects where the WBG is not directly involved; and
 - encouraging the preparation of strategic studies to assess the environmental and social costs of potential investment in a given area and to analyze potential alternatives.

The WBG's Portfolio in the Extractive Industries

In the years since the 1992 Rio Declaration at the U.N. Conference on Environment and Development, the pattern of WBG lending in extractive industries has been volatile, with an overall decline in recent years.¹ (See Annex Figure 2–1.) The share of extractive industries in the Bank's overall lending declined from 4 percent in the 1980s to under 2 percent in the 1990s. This reflects in part changing WBG priorities and industry trends. IBRD and IDA have increasingly withdrawn from direct lending to governments and state-owned entities looking to finance new investment in productive capacity in favor of sector reform and institutional capacity building. At the same time, the WBG has become involved in the Former Soviet Union and Eastern Europe, particularly in connection with privatization initiatives or mitigation of the impacts of the closure of uneconomic mines. More and more investment in extractive industries is taking place in the private sector. Accordingly, the IFC and MIGA share of overall investment has increased.

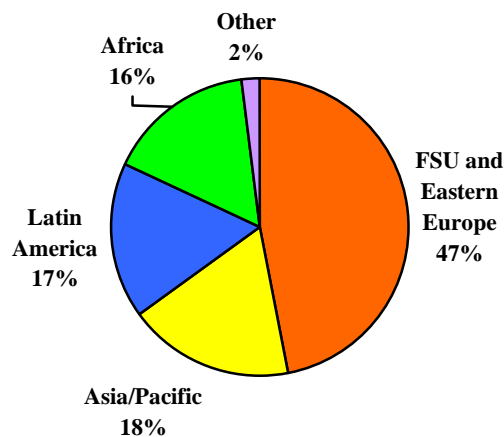
WBG Involvement in Extractive Industries, FY 1994-2002 (\$m)



The majority of WBG lending in the past decade has been to the Former Soviet Union and Eastern European countries (see Annex Figure 2–2), many of which have restructured their extractive industries sectors, opening them to outside investment. Since the mid-1990s, there have been increased opportunities for investment in Asian countries.

The different parts of the WBG have coordinated and complementary roles in their approach to extractive industries and resource-rich countries. IBRD/IDA is responsible for country policy dialogue and tends to focus on broader structural and social issues, including sector policy reform and institutional capacity building, with a focus on poverty reduction. IFC focuses on attracting private-sector investment, particularly in “high-risk” countries, where its projects were expected to have a catalytic effect in attracting new investments and demonstrating sound management of environmental and social impacts. MIGA specializes in providing political risk guarantees and ensures that the projects it supports comply with applicable environmental and social performance standards. Since the late 1990s, WBG project and policy work in the extractive industries has been coordinated through joint Bank-IFC Global Product Groups in the oil and gas and the mining sectors and through joint Bank-IFC-MIGA Country Assistance Strategies.

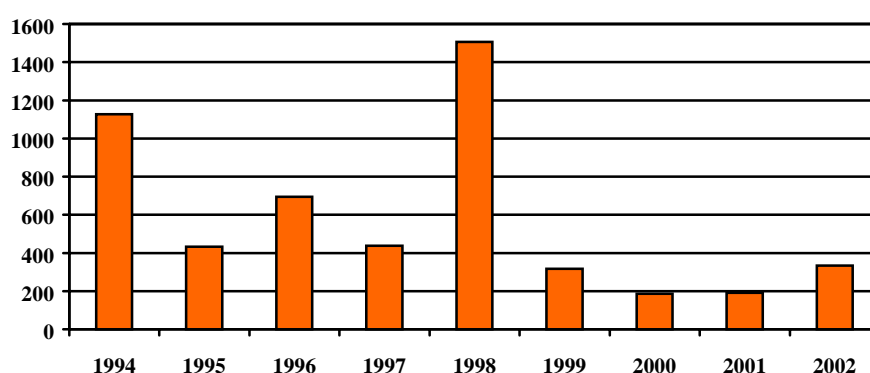
WBG Involvement by Region 1994-2001 (% share)



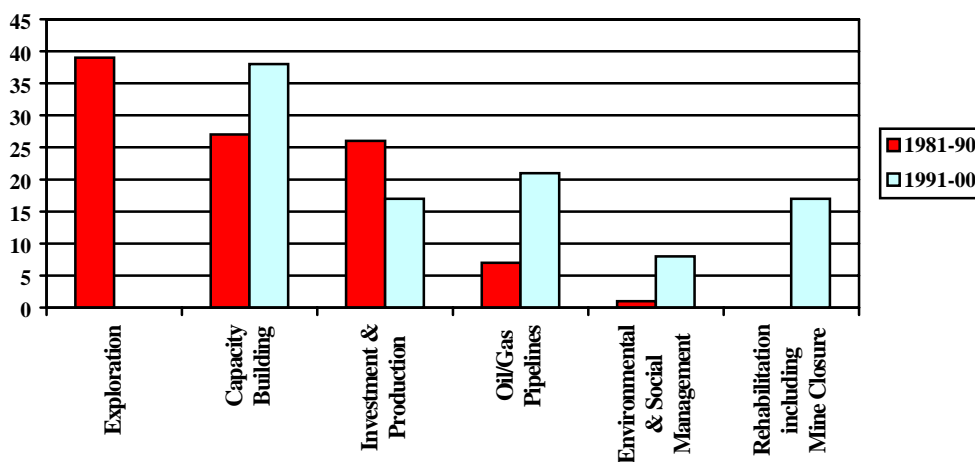
The World Bank (IBRD/IDA)

The Bank's role has evolved from mainly supporting exploration and production activities (1960s–early 1980s), to sector policy reform and commercialization of state-owned enterprises (1980s), and then to a greater emphasis on capacity building and private-sector development (1990s). (See Annex Figures 2–3, 2–4, and 2–5.) Also in the 1990s, the Bank began to help transition economies to maintain production levels, to rehabilitate or close uneconomic facilities, and to attract foreign investment. Since the mid-1990s, the Bank's approach has been evolving toward greater collaboration with private companies, civil society, and local governments.

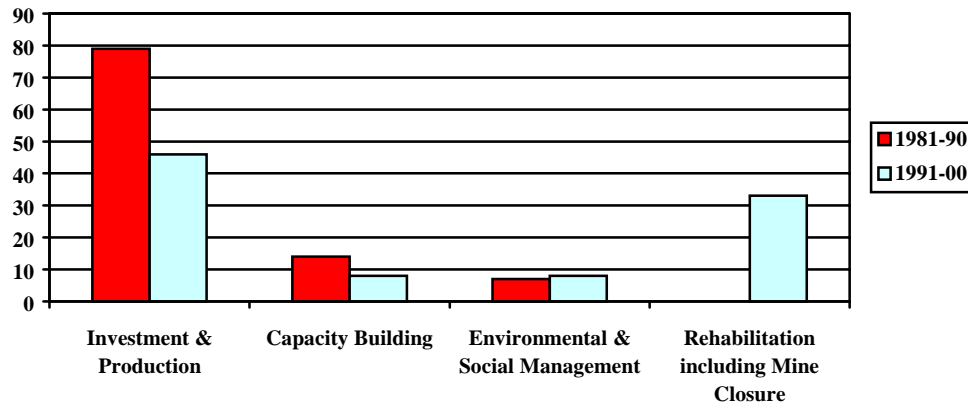
IBRD/IDA Investment Approvals in Extractive Industries, FY 1994-2002 (\$m)



Primary objectives of IBRD/IDA Oil & Gas Projects 1980-2000 (% of occurrences of objective)

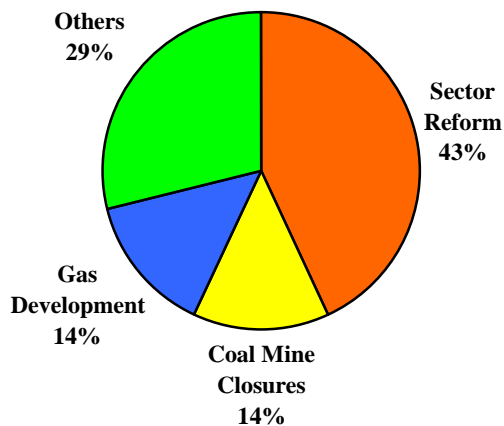


Primary objectives of IBRD/IDA Mining Projects 1980-2000 (% of occurrences of objective)



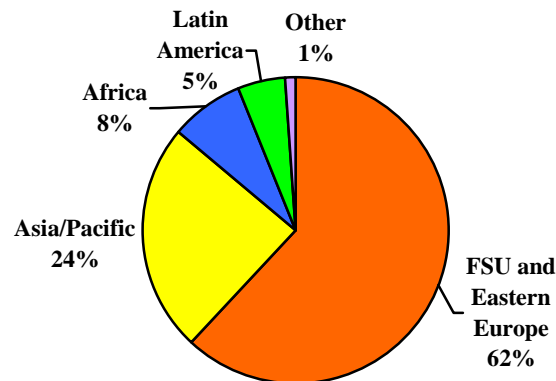
The World Bank has to a large extent withdrawn from financing government/state-owned projects whose sole or dominant objective is to invest in new production capacity in oil and mining. The WBG approach is predicated on the evidence that production investments and operations are generally best made and operated by the private sector within an appropriate regulatory and market framework. As a result, as of 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,” the objectives of which included a combination of reform measures and steps to increase production or productivity, and some gas development projects. (See Annex Figure 2–6.)

IBRD/IDA Approvals by sub-sector FY 1994-2001 (% share of total number of projects)



The fall of the Soviet Union led to a significant increase in WBG extractive industry activities in the Former Soviet Union and Eastern Europe. IBRD/IDA investment approvals in this region accounted for more than 60 percent of total extractive industry lending by volume for the period 1994–2001. (See Annex Figure 2–7.)

IBRD/IDA Investment Approvals by Region 1994-2001 (% share of total lending volume)



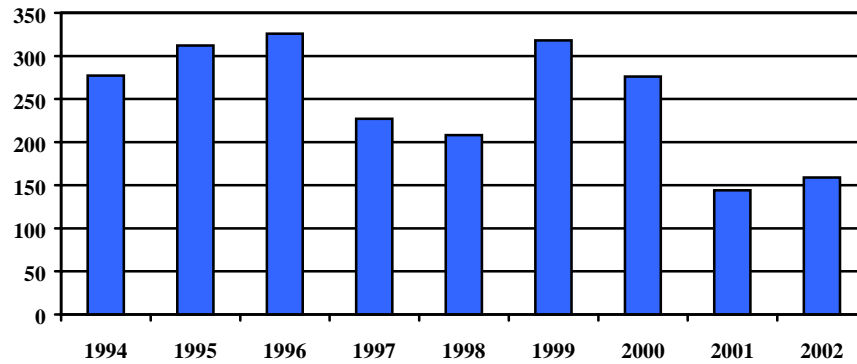
The International Finance Corporation

IFC has focused on countries where its value added, as a catalytic agent and neutral third party between governments and private investors, was greatest. During the period 1980–92, IFC approvals in extractive industries increased dramatically, from \$80 million to \$400 million. This increase was broadly inline with overall growth throughout the institution. Investments in extractive industries are volatile, due to the large size of individual projects and commodity price cycles. Approval volumes during 1980–92 ranged from \$30 million to \$400 million, and the sector accounted for between 5 and 25 percent of total IFC approval volume.

The share of extractive industries investment in IFC’s total lending portfolio has decreased substantially since 1992, from 22 percent in 1990 to 6 percent in 2001. Overall approval volume, while volatile, fell from \$400 million in 1992 to \$150 million in 2001. (See Annex Figure 2–8.) There were a number of reasons for this, the main ones being falling commodity prices, which lowered investment; a change in strategy, de-emphasizing extractive industries in favor of investments in other sectors (notably financial services and infrastructure); and a decision to discontinue investments in oil and gas exploration in 1992, mainly because of poor results and difficulties associated with assessing exploration risks.

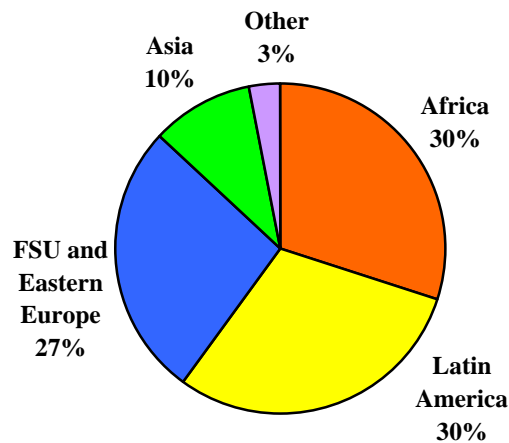
Since the mid- to late 1990s, IFC has increasingly focused on sustainability, especially environmental, health and safety, and social issues, and most recently, on revenue management and distribution. Many of IFC’s sustainability initiatives (such as SME linkages and IFC Against AIDS) have a particular relevance to and focus on the extractive industries sector.

IFC Investment Approvals in Extractive Industries, FY 1994-2002 (\$m)



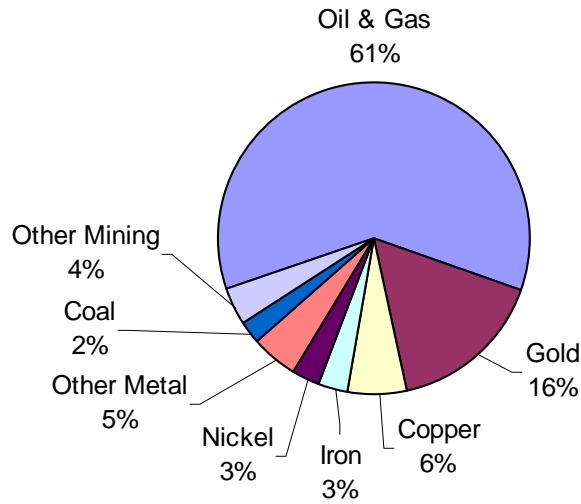
During the 1980s and 1990s, IFC's investment approvals were mostly concentrated in Latin America and Africa. As the 1990s progressed, commercial financing for extractive industries became more readily available in Latin America, and IFC began to scale back involvement in the region, largely withdrawing from new investments in Chile, Brazil and Argentina. After the fall of the Soviet Union, governments in the region began opening up their resources to private investors, and IFC began making investments. (See Annex Figure 2-9.) With the Asia crisis in the late 1990s, IFC found itself facing new demands to support private sector investment areas where it had not been active for some time.

IFC Investment Approvals by Region 1994-2001 (% share of total lending volume)



IFC's extractive industries portfolio is concentrated in oil and gas, while gold and copper are the most important minerals. (See Annex Figure 2-10.)

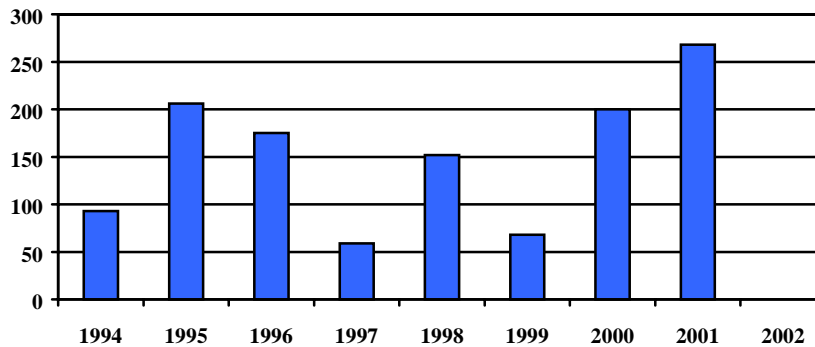
IFC Investment Approvals by Sector 1990-2002 (% share of total lending volume)



The Multilateral Investment Guarantee Agency

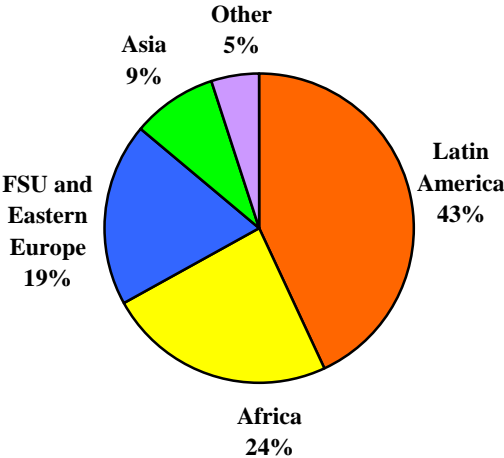
MIGA has supported extractive industries with political risk guarantees and, to a lesser extent, technical assistance and advisory services. MIGA's early involvement was heavily concentrated in the mining sector. Between 1990 and December 2002, MIGA provided guarantees for 31 projects in extractive industries, most of them in mining. Throughout the 1990s, there was high demand for MIGA insurance, with large operations in countries with higher political risk profiles. (See Annex Figure 2-11.) Due to the low volume of new guarantees in extractive industries projects since 2001, and cancellation and expiration of MIGA coverage for some projects, the sector's share in MIGA's portfolio has continued to decrease and is now 11 percent.

MIGA Coverage Issued in Extractive industries, FY 1994-2002 (\$m)

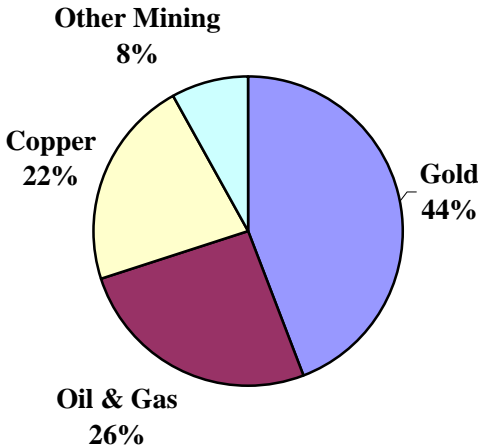


Latin America has been the most important destination for coverage offered by MIGA in extractive industries, followed by Africa and FSU/Eastern Europe. (See Annex Figure 2–12.) MIGA’s guarantee portfolio is concentrated in gold, oil and gas, and copper. (See Annex Figure 2–13.)

MIGA Coverage Issued by Region 1994-2001 (% share)



MIGA Coverage Issued by Sector 1990-2002 (% share)



Examples of WBG Projects

Mineral Resources Governance in Madagascar (1998–Active)

The project is intended to build capacity and improve governance at a local and regional level through strengthened transparency and governance in mining, key institutional reforms for the decentralized management of mineral resources, promotion of private investment and value-added in the sector, and project coordination and management.

Building Mining Sector Capacity in Mauritania (1999–Active)

IDA is working to develop capacity through local economic development in mining areas, geo-information and development, capacity building of public mining institutions, and project management. IDA is also implementing a small grants program to help artisanal and small-scale miners diversify into other areas of economic activity, including supply-chain activities, services, agriculture, manufacturing, packaging, and tourism.

Mitigating Environmental and Social Impacts of Mine Closure in Romania (2000–Active)

An IBRD/IDA assistance program supports the closure of 29 uneconomic mines, which serves as a model for 174 further mine closures. The program developed a manual for mine closure and provided financing for social mitigation measures and environmental rehabilitation.

Developing Gas Resources in China (1994–2003)

IBRD/IDA is involved in developing and restructuring the gas sector in Sichuan province. Activities include restructuring state-owned enterprises, gas-field development and rehabilitation, and institution-building. Project aims are to improve gas production and conservation, improve efficiency and reduce shortages, and reduce negative environmental impacts.

The Chad Cameroon Pipeline Project (2000–Active)

This joint IBRD/IDA project was approved by the WBG in June 2000. It involves a pioneering attempt to create a development framework to transform oil resources into direct benefits for the poor. An innovative program within the project channels revenues for economic and social development in Chad, one of the world's poorest countries. The project will develop the oil fields in southern Chad and construct a 1,070-kilometer pipeline to offshore oil loading facilities on Cameroon's coast.

Bolivia-Brazil Gas Pipeline (1998–2001)

In 1997, the IBRD approved a \$130-million loan and partial risk guarantee for the \$2.2-billion Bolivia-Brazil gas pipeline, thereby catalyzing private investment. The project aims to help Bolivia earn export revenue while allowing Brazil to meet short-term future power needs and diversify away from environmentally polluting fuels, such as high-sulfur fuel oil and wood. Given the environmentally sensitive location of the project, 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.

Why Has WBG Involvement in Extractive Industries Changed?

WBG involvement in extractive industries has changed over time. In the past decade, the shift in the pattern of involvement has generally reflected changes in economic and financial realities. IBRD/IDA's decision to scale back involvement in exploration and production reflected a view that these activities are more efficiently carried out in the private sector. IBRD/IDA activity is now concentrated in sector reform, capacity building, rehabilitation, and mitigation of social and environmental impacts of extractive industries. The role of extractive industries as a share of IFC has fallen in recent years, as noted earlier, in part due to falling commodity prices and a decision to exit from exploration of oil and gas fields for commercial purposes. The geographic dispersion of investments has also changed to reflect political and economic trends. Eastern Europe and the Former Soviet Union have become important areas for investment as the collapse of communism opened up these areas to the World Bank Group. Latin America has become less important for the IFC as private sources of funding become increasingly available.

The falling share of WBG involvement in extractive industries as a percentage of total WBG investments is also due to a strategic shift in management thinking in favor of investment in other areas, notably financial services and infrastructure. The new focus on these areas reflects an increasing belief in their importance for economic development.

Contribution of WBG Involvement in Extractive Industries to Poverty Alleviation and Sustainable Development

IBRD/IDA's Operations Evaluation Department (OED) has described the rationale for IBRD/IDA projects in extractive industries as "based on the expectation that they will support the country's development goals"—an expectation based on an economic appraisal of projects. Economic benefits, as listed by the OED, can include: increased production, increased investment, increased productivity, increased fiscal revenues, job creation, improved environmental conditions (for example, for cleanup projects), and improved legal and regulatory frameworks. There can also be negative social and environmental impacts, including: disruption to local populations, toxic spills, deforestation, air pollution, soil erosion, and increased unemployment after a project's closure.

The WBG has many ways of gathering and analyzing information for measuring development impacts. The Country Assistance Strategy (CAS) is a WBG document prepared in consultation with the country authorities and other stakeholders, intended to provide a framework for development. Based on a country's own development objectives and strategy, the CAS sets out a tailored program to be supported by the WBG. The expected benefits of projects are calculated by using net present value and internal rate of return analysis to calculate the expected financial performance of the project and using economic rate of return analysis to capture all economic impacts of the project within the country, including social and environmental impacts where possible. Project impacts that cannot be quantified are also discussed. IBRD/IDA uses Implementation Completion Reports to document and evaluate the outcomes and impacts of the project. Many of these reports include revised estimates of the economic impact of the project.

In the past, development specialists have focused on assessing the impact of development on economic growth, on the assumption that growth is a prerequisite for poverty alleviation. Research commissioned by the EIR examined the impact of extractive industries on poverty alleviation and found that it is very difficult to draw a direct connection, due to a lack of available data.² Among the issues raised by the report are the lack of regional data on poverty alleviation in the area around a project, a lack of qualitative information on the changes of the quality of life for those affected by the project, and inconsistencies in how and when data are gathered. The report states that the WBG often has to resort to proxy estimates of poverty alleviation based on information on employment data from the project, assuming spin-off effects of employment and adding government revenues and taxes.

WBG Partnerships in the Extractive Industries Sector

The WBG uses its convening power to enter into partnerships with other development actors, organize conferences, and encourage the sharing of knowledge and best practice in the extractive industries arena. Examples include the Global Gas Flaring Reduction Initiative, the World Forum on Energy Regulation, and the Communities and Small-Scale Mining initiative (CASM).

The WBG was one of the sponsors of the CASM initiative in March 2001. CASM aims to improve the economic, social, and environmental performance of artisanal and small-scale mining (ASM) activity. It operates as a forum bringing shareholders together to discuss and share “best practice” in ASM, and to improve the level of information available regarding the sector. It also aims to match potential projects with sources of funding. Several IBRD/IDA projects have had ASM issues as significant components; project involvement included improvement of the legal framework or formalization of ASM activities, increasing tax revenues, capacity building for the government in dealing with the ASM sector, improving production and efficiency, and improving environmental awareness and management.

Safeguard Policies

IBRD and IDA have the following Safeguard Policies and procedures in effect; IFC and MIGA policies and procedures are broadly similar:

- OP/BP 4.01 Environmental Assessment
- OP/BP 4.04 Natural Habitats
- OP 4.09 Pest Management
- OP/BP 4.12 Involuntary Resettlement
- OD 4.20 Indigenous Peoples
- OP 4.36 Forestry
- OP/BP 4.37 Safety of Dams
- OPN 11.03 Cultural Property
- OP/BP 7.50 Projects on International Waterways
- OP/BP 7.60 Projects in Disputed Areas

Several of these have particular relevance to projects involving extractive industries. OP/BP 4.01, for example, requires an assessment of projects proposed for IBRD/IDA financing to help ensure they are environmentally sound and sustainable. The diligence of the environmental assessment (EA) depends on the potential impact of the project; IBRD/IDA undertakes an environmental screening of each proposed project to determine the appropriate scope of the EA. Projects are categorized depending on their likely environmental impact:

- *Category A:* Likely to have significant adverse environmental impacts. Borrower is required to conduct a full EA, examining the project's potential negative and positive environmental impacts, comparing alternatives (including a "no project" option), and recommending any measures needed to prevent, minimize, mitigate, or compensate for adverse effects and improve environmental performance.
- *Category B:* Likely to have less significant adverse effects than a Category A project. As before, an EA is required to examine impacts and provide remedies. The scope of the EA varies from project to project, but is narrower than for Category A projects.
- *Category C:* Likely to have no or minimal environmental impact. No EA required.

Under OP/BP 4.04, IBRD/IDA does not support projects that degrade or convert critical habitats. Projects that affect noncritical natural habitats should only be supported where no alternative exists, where the benefits significantly outweigh the costs, and where acceptable mitigation procedures are established (for example, minimizing habitat loss or establishing and maintaining an ecologically similar protected area).

Under OP/BP 4.12, involuntary resettlement should be avoided where feasible, or minimized, exploring all viable alternative project designs. Displaced persons should be meaningfully consulted and should have opportunities to participate in planning and implementing resettlement programs. Displaced persons should be assisted in their efforts to improve their livelihoods and standard of living, or at least to restore them in real terms to pre-displacement level or to the level prevailing prior to the beginning of project implementation, whichever is higher.

IBRD/IDA's objective under OD 4.20 is to ensure that indigenous peoples do not suffer adverse effects during the development process, particularly from IBRD/IDA-financed projects, and that they receive culturally compatible social and economic benefits. IBRD/IDA's policy is that the strategy for action must be based on the informed participation of indigenous peoples themselves. If an investment project affects indigenous peoples, the borrower should prepare an indigenous peoples development plan that is consistent with this policy. The plan should incorporate:

- a legal framework covering the status and rights of the indigenous peoples;
- baseline studies covering, for example, the habitat and social structure of the Indigenous population;
- information on land tenure of the indigenous peoples, which should be strengthened where necessary;
- a strategy for local participation by indigenous peoples; and

- provisions for independent monitoring and evaluation when the borrower has weak capacity.

Under OP/BP 7.60, IBRD/IDA should only undertake projects in internationally disputed areas when all parties have no objection to the project, unless it can be shown that an objecting party would not be adversely affected or if IBRD/IDA is satisfied that the claim to the area has not won international recognition or been actively pursued.

Notes

¹ WBG 2003c; OED, OEG, and OEU 2003; WBG 2001j.

² Gibson 2003.