

**EXTRACTING SUSTAINABLE ADVANTAGE?
(REPORT ON THE CAO REVIEW)**

WORLD BANK GROUP MANAGEMENT RESPONSE

SEPTEMBER 17, 2004

Management Response to CAO Report: Extracting Sustainable Advantage? A Review of how sustainability issues have been addressed in recent IFC/MIGA extractive industry projects

Introduction

As a contribution to the WBG's review¹ of its role in extractive industries, the CAO's office conducted an assessment of how sustainability issues were addressed in recent IFC/MIGA extractive industry projects. The specific objectives of the report were to consider whether the interpretation and application of Safeguard policies and guidelines had enhanced project sustainability and whether all relevant issues were considered during project appraisal. The basis of the review was an examination, including some country visits, of eight recent IFC and MIGA EI projects that were too recent to have been included in the OEG and OEU evaluations of IFC and MIGA activities in EI.

The review did not assess the net sustainable contribution of the projects, it was too early in their life, and, the review was not intended to do that. It considered how IFC and MIGA had approached the appraisal and review of projects from the perspective of a comprehensive set of sustainability dimensions. Some of these dimensions had mandatory criteria that needed to be addressed in existing safeguard policies and guidelines and others that did not. Typically, specific mandatory criteria exist for environmental and social processes and standards, and not for broader economic and governance dimensions

Report Findings and Recommendations

The report had a number of key findings and made a number of recommendations for how IFC and MIGA could better address key sustainability issues. As the report makes clear, it was intended to be forward looking and to assess to what extent the two institutions were addressing sustainability issues beyond those mandated in their safeguard policies and guidelines. Overall, the review found that, against, “ a review methodology that holds all projects to a very high standard”, the institutions scored highest in addressing environmental and social dimensions where there were mandatory criteria and least well in addressing economic and governance dimensions where there were no mandatory criteria.

It also found that there was significant variability between specific projects and that in a number of areas there was scope for IFC and MIGA to refine or develop guidelines and processes and also to improve implementation.

¹ These reviews consisted of: *Extractive Industries and Sustainable Development: An Evaluation of the World Bank Group's Experience*, OED/OEG/OEU, June 2003, available at www.worldbank.org/oed
Extracting Sustainable Advantage?, CAO, April 2003, available at www.cao-ombudsman.org.
Striking a Better Balance, EIR, January 2004, available at www.eireview.org.

Proposed Response

Management welcomes the report that provides valuable insights and suggestions about how IFC and MIGA's activities in EI can be enhanced. It has some concerns about the lessons that can be drawn from a small sample size of projects, particularly in the case of MIGA where only two recent projects were reviewed. In addition, it believes that in some areas, consideration of issues such as governance and political risks was more extensive than identified by the review process, because it was done in a more informal way than, say, the review of specific, mandatory environmental and social criteria. Overall, however, it sees the review as a useful exercise and welcomes it as one that can help guide IFC and MIGA's approach to EI in the future. It helps identify the broadening concept of sustainability and scope for value added that is consistent with Management's own thinking, and the direction in which IFC and MIGA activities in EI have been heading.

Detailed responses to the recommendations of the report are attached in Annex 1. Many of the specific and general issues raised in the CAO review have been covered in the EIR report, and the joint OED/OEG/OEU Evaluation of WBG activities in EI. An extensive discussion of the issues in, many cases, is given in the Management Responses to these reports.

As is the case with these other reviews, the full implementation of Management's response to this reports recommendations will depend on the outcome of other processes of review that are now underway. In areas such as the recommendation that the WBG should recognize increased awareness of the human rights and labor rights dimensions of WBG activities, Management proposes to wait the outcomes of ongoing IBRD/IDA and IFC reviews of this issue. In this respect, IFC presented proposals addressing labor rights to CODE in July 2004 in the context of its proposed revision of its safeguards.

Since the delivery of the CAO report, Management has produced its response to the broader CAO review of IFC's safeguard policies² and has embarked on the process of revising IFC safeguards policies and guidelines. This process, will give priority to EI related issues, will address many of the CAO's specific recommendations. IFC's ongoing review of its disclosure policy will provide an overall framework for greater disclosure to communities about the economic, social and environmental impacts of projects that affect them.

² A Review of IFC's Safeguard Policies. Core Business: Achieving Consistent and Excellent Social and Environmental Outcomes. January 2004 available at www.cao-ombudsman.org.

ANNEX 1

DETAILED MANAGEMENT RESPONSES

Recommendations of the CAO Report

	Recommendation of the CAO	Management Response
1	IFC and MIGA have a more considered approach to tackling the environmental and social development dimensions of sustainability than the economic and governance dimensions. IFC and MIGA should reinforce their existing guidance to more clearly encompass a wider set of sustainability concerns. As the sustainability agenda is evolving, a flexible approach to introducing revisions should be adopted. This should enable both organizations to update internal guidance efficiently and systematically in response to emerging best practice, in support of continuous improvement. Where appropriate, the guidance should clearly identify mandatory requirements.	The review by IFC of its safeguard policies and response to the CAO report will provide an overall revision of scope, content, and approach to safeguards. This is now underway and an overall framework will be considered by CODE in June. The process will identify areas where it is considered appropriate to include new safeguard policies and guidelines. In addition, Management proposals to give greater focus to governance issues and more explicitly address governance risks will also help address concerns in this respect. In practice, IFC does update its policies and guidelines periodically as needed. MIGA is working with IFC in the update of the IFC safeguard policies. The effort will be valuable to MIGA, and following its completion, MIGA will revise and update its own safeguard policies, as per MIGA's commitment to the Board in May 2002.
2	The rating of individual projects against the sustainability review criteria was highly variable, although IFC's category B projects outperformed MIGA's. MIGA's management should consider and take a position on this disparity: either it maintains the status quo whereby MIGA projects subscribe to the standard of do-no harm (which the Safeguard Policies are primarily concerned with), or it takes action to ensure closer convergence with IFC's broader sustainability remit.	MIGA has just undergone a major reorganization of its functional groups, to integrate better its environmental, social, and economic analyses. With this new organizational structure, MIGA Management is committed to promoting projects with the greatest development impact, that are environmentally, socially, and economically sustainable.
3	IFC and MIGA lack sector-specific guidance on how to undertake comprehensive risk assessments. IFC and MIGA should develop sector specific guidance on how comprehensive environmental risk assessments should be undertaken. In addition, IFC should finalize and fully implement its draft guidance on cyanide handling.	IFC will finalize and implement its international best practice guidance on cyanide in its draft Precious Minerals Mining Guidelines (July 2004) that are being revised as a component of the revision of its safeguards. It will consider IFC-wide guidelines on comprehensive risk assessment as a part of this process, and MIGA, with its recent reorganization, will reassess its approach to comprehensive risk assessment.
4	Despite the existence of the Natural Habitats and Environmental Assessment Policies, there is insufficient guidance on ecological assessment and mitigation. IFC and MIGA should develop and implement improved guidance on ecological assessment and mitigation.	The ongoing IFC review that will consider the updating of this, and the other safeguard policies will be used to review measures for addressing these challenges. As noted in (1) above, MIGA will follow with its own review
5	While at least some financial provision is made for closure of mining projects, this is not the case for oil and gas projects. IFC and MIGA should strengthen the available guidance on closure to apply to all extractives projects, and include a requirement to ensure that social considerations are taken into	IFC will produce guidelines for a consistent approach to mine closure. Key aspects of this will be requiring investors to have a mine/oil and gas field closure plan that deals with environmental and social issues and is regularly updated to account for changed circumstances; public awareness of closure plans; and appropriate financial

	Recommendation of the CAO	Management Response
	account. They should also develop and implement measures to ensure that funds allocated to closure during their involvement with a project are ring-fenced, even after they exit.	provision for closure consistent with country requirements and nature of project. In this latter respect, ring-fenced funding or equivalent will be put in place, when feasible. MIGA intends to act in consonance with the expected revisions and modifications to IFC guidelines.
6	While most clients are undertaking pre-approval consultation well, there is little or no acknowledgment of the influence that public consultation has had on the design and implementation of projects. IFC and MIGA should more explicitly acknowledge and report on the influence that public consultation has had on the design and implementation of projects. The benefits of ongoing consultation and engagement throughout a project's life cycle should routinely be articulated to clients, and required for the period of IFC or MIGA's involvement.	IFC/MIGA agree that, when possible, it will advise those involved of the outcome of consultations. New IFC projects will be required to provide information to local communities and establish an appropriate program of consultations. MIGA will review its guidelines on the information to be provided local communities and on the consultation process with local communities.
7	The communities in the vicinity of IFC and MIGA projects would benefit from an explicit adoption by both organizations of a commitment to promote more sustainable community development projects and programs by its clients. IFC and MIGA should ensure that all clients are familiar with IFC's Investing in People guidance, and understand the importance of direct community participation and explicit consideration of the longer-term sustainability of community investment projects.	IFC and MIGA agree that all EI clients should be made familiar with IFC's "Investing in People" good practice manual. A major component of the IFC approach to sector activities is to add value. Programs such as the SME Linkages are one such effort. Encouraging sponsors to develop meaningful community relationship programs with longer-term sustainability objectives is another.
8	Neither IFC nor MIGA systematically consider the broader human rights and labor rights issues associated with extractives project. Instead, IFC and MIGA should more systematically consider potential risks to human rights at the project level, take appropriate steps to mitigate them, and provide clearer guidance to clients on both of these aspects. Where relevant, these aspects should be reported on at the project level.	There are many aspects to the human rights issue. Project appraisal should identify immediate issues that may directly impact project outcomes. How far to go beyond this stage in terms of identifying risks to human rights and mitigating them needs to be set by the broader WBG approach to human rights. Both IFC and IBRD/IDA are now in the process of reviewing their approach to these issues and the outcome will provide a framework for activities in EI. IFC presented draft proposals for an approach to labor rights in the context of its safeguards revision that was discussed by CODE in July, 2004. In the specific context of EI, IFC/MIGA will expect new investors to follow a guideline relating to the use of security forces along the lines of the "Voluntary Principles on Security and Human Rights" that were developed through a multi-stakeholder process of dialogue between the Governments of the U.K. and the U.S., extractive industry companies, and NGOs.
9	A number of other social issues are not systematically assessed and mitigated across all projects. IFC and MIGA should develop improved guidance on how to deal with these issues, and integrate it into improved guidance on social assessment, as recommended by the CAO Safeguard Policy Review.	IFC's Good Practice Note, "Addressing the Social Dimensions of Private Sector Projects" (December 2003), will assist in identifying, analyzing, and addressing social issues. It will be an integral part of IFC's environmental and social assessment process. Since Board approval of MIGA's safeguard policies and their implementation framework in May 2002, MIGA has been applying an

	Recommendation of the CAO	Management Response
		<p>integrated approach to the safeguard policies, positioning the EA process (and the EA Policy) as a key “integrator.” In this approach, the issue-specific safeguard policies become the norms by which one evaluates if the proposed mitigation/compensation measures identified in the project’s EA are reasonable and acceptable, while retaining at the minimum that the project must do no harm to directly affected parties. This approach to integrating MIGA’s issue-specific safeguard policies and MIGA’s environmental guidelines through the EA process (and under the umbrella of the EA Policy) was identified by the DGO in the May 2002 Board discussion of MIGA’s interim safeguard policies, as a model of a holistic, multidimensional approach to incorporating safeguard policies in assessments. The environmental and social assessment for the project also is the opportunity to assess social concerns and needs to done so that MIGA’s clients can determine appropriate ways of going beyond compliance to further sustainable community development.</p>
10	<p>Revenue management and distribution is a critical issue for the future involvement of the World Bank Group in these sectors, and neither IFC nor MIGA have a coherent strategy on how to respond to this challenge. IFC should consider revisiting the current definition of high-impact to be more inclusive. It is currently based on the relative contribution of a single project to fiscal incomes, whereas it might be extended to include large projects (above a defined threshold) in countries where the sector as a whole makes a significant contribution to GDP. For high-impact projects, IFC should report on the steps taken to mitigate adverse impacts and enhance revenue management and distribution. For low-impact projects, IFC and MIGA should report on their rationale for providing support to such projects, having fully considered the potential positive and adverse economic, social and environmental impacts. IFC and MIGA should also continue to collaborate with the World Bank on the inclusion of these aspects in Country Assistance Strategies (CAS), and engage with the Bank and IMF to seek coordination of work programs that address public expenditures management, which are beyond the mandate of IFC and MIGA.</p>	<p>Weak governance can potentially lead to poor oversight of the EI sector and poor management and use of revenues from EI. IFC and MIGA’s approach will be to (a) work with IBRD/IDA to ensure that EI issues are addressed in the CAS (see response to recommendation of the Overview report 1 b above); (b) support IBRD/IDA efforts on transparency initiatives such as EITI; (c) for “significant” new projects (usually large enough to generate 10 percent or more of government revenues) to require adequate mitigation measures to be put in place to reduce the risks that revenues will be wasted; (d) have smaller projects carefully evaluate the risks that revenues will not be used well compared with other expected benefits and review issues in the Summary of Project Information (SPI); (e) to require transparency about EI payments to governments and the terms of key contracts with governments for all “significant” new projects; and (f) within two years, to expect transparency about material EI payments for all IFC- and MIGA-supported projects.</p> <p>IFC/MIGA will also work with and support the IBRD/IDA, as appropriate, in preparation of CASs, transparency initiatives, and IBRD/IDA initiatives on revenue management.</p>
11	<p>IFC has no systematic basis for reporting the significance of public corruption, political instability, and conflict during project preparation, and neither IFC nor MIGA have the leverage to take proactive action on these issues. IFC and MIGA should collaborate closely with the World Bank to ensure that these issues are explicitly dealt with in the appropriate operational instruments (e.g., Public Expenditure</p>	<p>As IFC and MIGA adopts the approach to dealing with governance and EI projects set out above, they will need to mitigate or evaluate the impact of governance (including but not limited to corruption, etc.) on project outcomes. In their project appraisal, both IFC and MIGA will review and follow any indications of project-related corruption. They will work with IBRD/IDA in helping to identify sectors/issues and in identifying appropriate responses. A</p>

	Recommendation of the CAO	Management Response
	Reviews, CAS) of the countries where they are likely to support oil, gas and mining. In addition, the investment and underwriting departments should collaborate with their environmental and social counterparts to more explicitly analyze and report the potential for in-country corruption, political instability, or conflict to result in adverse impacts at the project level, or to increase as a result of the project.	major part of IBRD/IDA activities in poor-governance countries is focused on dealing with such governance issues (such as, for example, IBRD/IDA's approach to LICUS (low income countries under stress) countries). The status of IBRD/IDA (and IMF) programs in the country and the CAS will also be taken into account in IFC and MIGA evaluations of country-level governance issues. And in addition, a range of WBG and other qualitative and quantitative indicators (such as IBRD/IDAs CPIA assessments (country policy and institutional assessment) will be reviewed.
12	While IFC and MIGA voluntarily consider issues like maximizing local, regional, and national procurement and employment opportunities, there is further scope to maximize economic opportunities arising from extractive sector projects. IFC and MIGA should clarify where the responsibility lies for ensuring that economic development issues (such as employment, procurement, and basic economic infrastructure) are dealt with. They should develop improved guidance, both for internal use and for clients, on the economic development issues that should be considered and how, the obstacles that often exist to maximizing potential opportunities, and how to overcome such obstacles to gain the maximum advantage from extractives projects.	Mainstreaming environmental and social issues and growing experience and awareness among investment officers about SME linkage programs, etc, will help IFC to add value in terms of broadening the impact of projects financed. IFC is considering preparing guidance notes for staff and others to help identify opportunities in different sectors. MIGA recently added staff expertise in social and economic impact assessment and in the recent reorganization has consolidated responsibility for such assessments in one group. Core responsibility for decisions involving employment, procurement, and basic economic infrastructure should continue to be with the private sector investors, and not lenders or insurers.
13	Sustainability innovations are emerging – albeit in an ad hoc manner. Although informal sharing of ideas between specialists takes place, IFC and MIGA should explore more formal mechanisms to record and share experiences.	IFC does put in a lot of effort in spreading information among staff about sustainability issues. The ongoing IFC sustainability-learning program that almost all staff in the Oil, Gas, Mining and Chemicals Department have been through is one example. MIGA has recently reorganized to consolidate its work in this area, and has augmented this with recently acquired staff capacity in social and economic impact assessment.
14	If the business case for sustainability is to be made persuasively, the concept that sustainability innovations have a return on investment should be demonstrated. IFC and MIGA should develop mechanisms to buy-down or reduce the perceived incremental costs of higher risk sustainability innovations where the returns on investment are not readily demonstrable. Such mechanisms should avoid the provision of any subsidy to the project, while supporting innovation.	See responses to recommendations 12 and 13 above. IFC has a sustainability database that provides investors with examples of developing country projects that benefit from a sustainability approach. In 2004, MIGA intends to explore the possibility of such mechanisms further.
15	MIGA's response to the challenge of enhancing the sustainability of extractives projects is limited by the 'do no harm' focus of its procedures, which in turn is linked to its business model. MIGA should consider whether the broader advisory services capacity on sustainability within the Bank Group could be harnessed and applied where MIGA clients express an	In 2004, MIGA intends to explore ways in which an investment insurer may offer added value to its clients, with the recent reorganization of its functional groups as a mechanism to exploit these opportunities as they are identified.

	Recommendation of the CAO	Management Response
	<p>interest, as an extension of its advisory services. MIGA should also more systematically assess clients' capacity for social and environmental management.</p>	