Summary of OED Draft Review of the World Bank Group's Activities in the Extractive Industries: Factoring in Governance

Introduction

In January 2003, the World Bank's Operations Evaluation Department (OED) produced a draft assessment of how the Bank factors governance[1] into its extractive industries operations (EI). OED recommended that the Bank should stop promoting increased investment in extractive industries in countries with weak governance. Instead, the Bank should focus its efforts on helping those countries to maximize the economic benefits, and control the risks, of their existing EI sector.

This report offers a devastating critique of the Bank's basic strategy in the extractive industries in most of the countries in which it operates. If implemented, OED's recommendations would require a radical transformation of the Bank's current operations in the extractive industries.

Summary of Key Findings

1. Extractive industries investment leads to bad development outcomes in countries with poor governance. "Increased investment in the EI sector has the potential to bring important development benefits but it is not a universal good. In fact, the evidence suggests that it is more likely to lead to bad development outcomes when governance is poor. Because of the Bank's focus on poverty, and the links between poverty and poor governance, this means that increased EI investment is likely to lead to bad development outcomes *for many if not most of the Bank's clients*." (para. 5.1, emphasis in original).

2. The Bank should not support increased extractive industries investment in countries whose governments lack the capacity to benefit from or manage such investment. The report calls for a "fundamental reorientation" of the Bank's work in the EI sectors away from prioritizing the attraction of new investment in countries with weak governance. (para. 4.11). Instead, the Bank should focus on strengthening governance to help the government "better maximize the benefits and minimize the risks of the existing

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[1] OED defines governance as "the manner in which power is exercised in the management of a country's economic and social resources for development." It includes issues such as institutional capacity, transparency and accountability, quality of financial management (including freedom from corruption), openness to civil society inputs, and commitment to the rule of law. (para. 2.6)

sector, by, for example, strengthening management of EI revenues, supporting the government's efforts to implicate local communities in EI decision making processes, helping the government regulate environmental impacts, or mitigating the local impact of mine closure." (page 21).

In framing its recommendations, OED distinguished between "core" and "sector" governance.[2] Where core governance is sound, but sectoral governance is weak, OED recommended that the Bank only support extractive investments that are specifically designed to overcome the identified weaknesses in sectoral governance. (page 21).

3. The Bank should not support increased EI investment on the assumption that its parallel efforts to strengthen governance will mitigate current risks. OED found that "the Bank's mixed success in supporting governance reforms shows clearly that the parallel efforts . . . are not a reasonable risk mitigation strategy. The results of support for governance reforms are too uncertain for the Bank to assume that existing governance problems will be addressed in time to assure a positive development benefit from increased sectoral investment." (para. 3.24). OED specifically called into question the Bank's operations in Chad, expressing its concern that the Bank had underestimated the governance risks in its parallel approach to governance reform and oil development.

4. The Bank should tailor its EI assistance to the governance capacity of the Borrower: The OED noted that the Bank has historically adopted an "investment first" approach to the EI sector, in which the primary objective is to "facilitate private investment and help reduce the country and project-related risks for the private investor." (para. 3.18). The OED found that the "investment first" approach "should be replaced by a more selective policy." (para. 3.25). According to OED, "[t]he Bank should support an objective of growing the sector only where there is a net development benefit, taking into account the quality of governance as it affects the government's ability to manage benefits and risks. (page 21).

5. The Bank should improve its efforts to assess the governance risks of its extractives operations: The report concluded, "[g]iven that the quality of governance determines the development outcome of EI activities, due diligence requires the Bank to know about the quality of governance in order to evaluate the benefits and risks of supporting EI activities." (pages iii-iv). Yet, OED found "no record" that the Bank assessed how governance weaknesses were likely to affect the success and sustainability of its extractive industries projects. (para. 3.16). OED attributed much of this failure to the fact that, until the late 1990s, the Bank interpreted governance issues to be outside of its mandate. Even after governance became an accepted part of Bank discourse, however, governance questions still did not inform its approach to the EI sector. (para. 3.17).

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[2] Core governance refers to the general quality of the country's public administration—its public financial management, adherence to the rule of law, control of corruption, capacity to manage resources, and ability to use revenues effectively and wisely. Sector governance refers to the legal, regulatory, and institutional framework in place to effectively manage the costs and benefits of the extractive sectors. That is, its ability to assess and limit environmental risks, protect local communities, enforce compliance with existing regulations, etc. (para. 4.3)

Conclusion

If implemented, OED's recommendations would fundamentally alter the World Bank's operations in the extractive industries. For instance, they would preclude the Bank from supporting such highly controversial projects as the Chad-Cameroon pipeline. Moreover, while the Review did not explicitly consider the operations of the World Bank Group's private sector arms—IFC and MIGA—its findings and recommendations are equally relevant for those institutions. As such, they directly call into question the utility of many, if not most, of the projects in their extractives portfolios, and the wisdom of projects such as IFC's proposed support of the Baku-Tbilisi-Ceyhan pipeline, and MIGA's potential involvement in the West Africa Gas Pipeline.

In many ways, this report echoes the criticisms that civil society organizations have made of the World Bank's operations in the extractive sectors. Many civil society organizations from around the world, including Friends of the Earth, have called upon the World Bank to phase-out financing of extractive industries projects. These organizations have argued that the Bank could better achieve its poverty alleviation mandate by shifting its investments into sectors that will deliver more direct poverty reduction benefits, improve standards of living, and achieve more equitable and sustainable forms of growth. With the release of this report, OED has essentially endorsed this call with respect to most of the countries in which the World Bank operates.