

STRIKING A BETTER BALANCE: THE EXTRACTIVE INDUSTRIES REVIEW

Executive Summary

In November 2003, the Board of the International Finance Corporation (IFC) approved a loan of up to \$125 million for the Baku-Tbilisi-Ceyhan pipeline, which will bring oil from landlocked Azerbaijan to the Mediterranean coast of Turkey—one of the longest pipelines of its kind in the world. . . . In China, the World Bank Group (WBG) is involved in developing and restructuring the gas sector in Sichuan province. . . . In Chad, one of the world's poorest countries, a WBG-supported project will develop oil fields in the south and build a 1,070-kilometer pipeline to offshore oil loading facilities on Cameroon's coast.

Are these projects and others in oil, gas, and mining consistent with the World Bank Group's overall objective of achieving poverty alleviation through sustainable development? That is the issue at the heart of the debate about WBG involvement in extractive industries.

In June 2000, at the annual meeting in Prague, WBG President James Wolfensohn responded to criticism from the nongovernmental community about WBG involvement in extractive industries with a promise to review the Bank's role in this sector. In July 2001, the Extractive Industries Review (EIR) was initiated with the appointment of Dr. Emil Salim, former Minister of the Environment for Indonesia, as Eminent Person to the review.

The EIR was designed to engage all stakeholders—governments, nongovernmental organizations (NGOs), indigenous peoples' organizations, affected communities and community-based organizations, labor unions, industry, academia, international organizations, and the WBG itself—in a dialogue. Regional workshops were held in Brazil, Hungary, Mozambique, Indonesia, and Morocco—each preceded by an open forum of testimonies by civil society. The EIR secretariat commissioned six research projects, visited four project sites, attended relevant international conferences, and held informal consultations with stakeholders worldwide.

The basic question addressed throughout this process was, Can extractive industries projects be compatible with the WBG's goals of sustainable development and poverty reduction? Based on more than two years of consultations and research, the answer is yes, *the Extractive Industries Review believes that there is still a role for the World Bank Group in the oil, gas, and mining sectors—but only if its interventions allow extractive industries to contribute to poverty alleviation through sustainable development. And that can only happen when the right conditions are in place.* The three main enabling conditions are:

- pro-poor public and corporate governance, including proactive planning and management to maximize poverty alleviation through sustainable development;
- much more effective social and environmental policies; and
- respect for human rights.

In order for the WBG to be able to promote these conditions, the institution itself needs to implement a number of serious reforms, including improvements and reinforced implementation of its Safeguard Policies and changes in WBG staff incentives.

Pro-poor Governance

The first consideration if the WBG is to help countries reduce poverty while seeking to develop extractive industries is that programs should be tailored to the specific requirements and needs of the country and to the existing adequacy of governance—taking into account the nature of the resources the area is endowed with, the relative importance of current and expected resource revenues in the government’s budget, and the anticipated social and environmental impacts.

The criteria of governance adequacy should be developed transparently and with the involvement of all stakeholders. It should include minimum core and sectoral governance criteria, such as the quality of the rule of law; the absence of armed conflict or of a high risk of such conflict; respect for labor standards and human rights; recognition of and willingness to protect the rights of indigenous peoples; and government capacity to promote sustainable development through economic diversification.

The more specific building blocks of governance required for extractive industries include the following:

- promote transparency in revenue flows,
- promote disclosure of project documents,
- develop the capacity to manage fluctuating revenues,
- develop the capacity to manage revenues responsibly,
- help governments develop modern policy and regulatory frameworks, and
- integrate the public in decisionmaking processes at local and national levels.

Governance should be strengthened until it is able to withstand the risks of developing major extractions. Once that has happened, the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) can add support for the promotion of a well-governed extractive sector. Similarly, when the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) consider investing in an oil, gas, or mining project, they need to specifically assess the governance adequacy of the country as well as the anticipated impacts of the project and then only support projects when a country’s government is prepared and able to withstand the inherent social, environmental, and governance challenges.

It is important for the WBG to promote partnerships to develop incentives for and advance the international application of best practice, such as through corporate responsibility, reputation risk, and the adoption of international norms and codes of conduct, as well as the creation of financial instruments such as performance bonds, mandatory insurance, and fines.

IFC and MIGA should only support projects that benefit all affected local groups, including vulnerable ethnic minorities, women, and the poorest members of the community. They should decline to finance projects where this is not the case or should redesign them to guarantee that the standards of living for local groups clearly improve.

To help ensure that local communities receive benefits from extractive industry projects, the WBG should:

- require companies to engage in consent processes with communities and groups directly affected by projects in order to obtain their free prior and informed consent,
- require revenue sharing with local communities,
- mandate the use of poverty indicators that are monitored systematically,
- encourage the incorporation of public health components in all extractive industry projects,
- urge NGOs to build the capacities of affected communities, and
- help set up independent grievance mechanisms.

At the country level, in light of the potential of artisanal and small-scale mining (ASM) to lessen the burden of poverty, IBRD and IDA should help governments develop policies that recognize this as a distinct sector and that distinguish between community-based and itinerant miners, giving communities clear priority over mining rights. WBG activities related to ASM should always recognize indigenous peoples' rights. To address these issues, the WBG needs to build up the required internal capacity and should form a special ASM unit that is adequately funded to meet these challenges.

National ASM policies should also address the integration of the sector in the national economy, giving artisanal and small-scale miners access to markets. Social and environmental regulations should go hand in hand with the legalization of the sector, addressing such issues as gender imbalances, child labor, and environmental management.

Solutions to the problems associated with ASM could be more effectively addressed through rural development. Government capacity to deal with this sector could be improved through exchange programs, with officials visiting countries where a legalized ASM sector has clearly contributed to poverty alleviation. The WBG should try a micro-lending approach to ASM in cooperation with other aid agencies and donors; pilot projects could be developed in partnership with, for example, CASM—the Communities and Small-Scale Mining initiative—or CAMMA, the Mines Ministers of the Americas.

Environmental and Social Components of WBG Interventions

The second enabling condition that will allow extractive industries to contribute to poverty alleviation through sustainable development involves a strengthening of the environmental and social components of WBG interventions in this sector. In some cases, this will entail revisions in current WBG policies; in other cases, new requirements or guidelines are called for.

- Require Integrated Environmental and Social Impact Assessments. The WBG should take a holistic, multidimensional approach to assessments, identifying cumulative impacts of projects and socioeconomic linkages to environmental issues. Social impacts should be fully identified, including health impacts and projects' effects on vulnerable groups. And a strategy for impact prevention, minimization, and mitigation is needed. Extractive industry projects should be classified as Category A projects—likely to have significant adverse environmental impacts—unless there are compelling reasons to the contrary.

- Update and Fully Implement the Natural Habitat Policy. The WBG should not finance any oil, gas, or mining projects or activities that might affect current official protected areas or critical natural habitat or areas that officials plan to designate in the future as protected. Any extractive industry projects financed within a known “biological hot spot” must undergo additional alternative development studies. Clear “no-go” zones for oil, gas, and mining projects should be adopted on the basis of this policy.
- Update and Fully Implement the Resettlement Policy. IFC and MIGA should engage in consent processes leading to free prior and informed consent before resettlement takes place. This means projects would only result in voluntary resettlements, not forced ones. Compensation and project-derived benefits should lead to genuine improvement, assessed by independent reputable third parties, when traditional subsistence patterns are being rapidly transformed by development.
- Revise the Disclosure Policy. The WBG Disclosure Policy should be broadened to include a series of documents currently protected by confidentiality agreements between IFC, MIGA, and companies. Protection of the proponent’s technical processes should be guaranteed, but this needs to be achieved with less confidentiality. There should be an independent and impartial Information Ombudsman to monitor disclosure policy implementation and to ensure that people have the right to appeal when they feel they have been wrongly denied information.
- Develop Sector-specific Guidance for Tailings Disposal, Waste Management, and the Use of Toxic Substances. The WBG should develop a list of criteria for tailings placement for all mining projects. All disposal options should be rigorously evaluated, with an emphasis on the need for ongoing monitoring of waste and tailings dumps, but no WBG-supported mining project should use riverine tailings disposal. Submarine tailings disposal (STD) should not be used until balanced and unbiased research, accountable to balanced stakeholder management, demonstrates its safety. Whatever the outcome of the research, STD and riverine tailings disposal should not be used in areas such as coral reefs that have important ecological functions or cultural significance or in coastal waters used for subsistence purposes. WBG support for mines using toxic materials such as cyanide and mercury should be minimized; where possible, safer substitutes should be used. The WBG needs to revise its cyanide effluent guidelines to be consistent with the most advanced guidelines in Canada, the United States, and the European Union or to be adequate to prevent environmental degradation.
- Develop Guidelines for Integrated Closure Planning. IBRD and IDA should develop clear guidelines and require provision for sufficient funds to be built up in the balance sheet for closure from the start of any new development. IFC and MIGA policies should specify the outlines of the integrated closure planning process to be conducted at projects; the type of analysis of acid drainage potential that is acceptable and how this information will be shared with those potentially affected; and the creation of a fund or guarantee mechanism that will ensure resources are available to pay end-of-life social and environmental costs identified during planning.

- Develop Guidelines on Emergency Prevention and Response. WBG emergency response plan guidelines should involve ways to establish good lines of communication for warning local communities, sufficient recognition of potential impacts, and adequate monitoring and maintenance. Such practice should be required in IFC and MIGA projects and encouraged in reforms of national legislation and regulation.
- Address the Legacy of the Past. IBRD and IDA should make a strong commitment to helping governments tackle the legacy of extractive industry projects. Compensation funds should be established for people affected by past developments. In cooperation with other funding agencies and in partnership with all the stakeholders, the WBG should establish a targeted program aimed at restoring degraded lands, improving the life of the poor who are affected by previous project closures, and generating employment and skills training.

Human Rights

The third key EIR recommendation regarding WBG involvement in extractive industries is to respect human rights. The WBG and its clients have obligations under international law to promote, respect, and protect all human rights. A system-wide policy needs to integrate and mainstream human rights into all areas of WBG policy and practice. The WBG should ensure that it does not undermine the ability of its member countries to faithfully fulfill their international obligations or that it facilitates or assists violation of those obligations. It should systematically incorporate experienced, independent, and reputable third parties to verify the status of human rights in all relevant projects. A central Human Rights Unit is essential, with regional counterparts, together with a clear policy and a mandate for monitoring, verification, and transparent annual audits.

IFC and MIGA should assess the human rights records of companies they work with and ensure that WBG-funded projects are designed and implemented in a manner consistent with applicable international human rights standards. Adoption of and demonstrated compliance with human rights principles should be a prerequisite for companies seeking WBG support for extractive industries.

Given WBG endorsement of the Core Labour Standards (CLS) of the International Labour Organization (ILO) as being consistent with and supportive of the institution's poverty alleviation mandate, IBRD and IDA should adopt the CLS as contractual requirements for project financing by including them as mandatory elements of the WBG's Standard Bidding Document. And IFC and MIGA should adopt all four, not just two, of the Core Labour Standards as part of their Safeguard Policies. The WBG should work with governments, trade unions, industry groups, and other organizations, as well as the ILO, to promote the implementation and enforcement of the standards.

IBRD and IDA should also work with governments to clarify and strengthen, where necessary, the legal basis for resource and tenure rights. Indigenous peoples and many other communities have felt the negative impacts of extractive industry developments. Their resettlement should only be allowed if the community has given free prior and informed consent, as a result of a consent process, to a proposed project and its expected benefits for them. Indeed, the WBG should not support extractive

industry projects that affect indigenous peoples without prior recognition of and effective guarantees for their rights to own, control, and manage their lands, territories, and resources.

The WBG's Safeguard Policies should become an explicit tool for ensuring that the WBG respects human rights. IBRD/IDA Safeguard Policies and other operational approaches should clearly recognize the rights of women through a commitment to nondiscrimination—a basic tenet of human rights—but also through ensuring that social management, community development, and consultation plans and exercises reach out to women and protect them from gender-based human rights violations, such as forced prostitution and rape. The current draft Safeguard Policy on indigenous peoples (OP 4.10) should be reviewed and there should be high-level discussions with indigenous peoples on its revision, including a legal roundtable on making the policy consistent with internationally guaranteed human rights.

Institutional Priorities

At the moment, the WBG is not set up to effectively facilitate and promote poverty alleviation through sustainable development in extractive industries in the countries it assists. So if it is to make any progress on the key elements of its involvement in extractive industries—pro-poor governance, more effective social and environmental policies, and respect for human rights—it must take certain steps to rebalance its institutional priorities.

In terms of staff and budget allocation, the WBG does not appear to be as committed to the social and environmental aspects of sustainable development as it is to the economic aspects of development. Success indicators for career development need to be improved: instead of putting an emphasis on quantitative lending targets, staff should be rewarded for contributions to ensuring compliance with Safeguard Policies and maximizing poverty alleviation impacts. The WBG should also adjust the skill mix of its staff, including the staff of consulting firms, to increase the ratio of people with knowledge of social, environmental, and human rights aspects of development.

The activities of IBRD/IDA, the IFC, and MIGA need to be much better coordinated. IFC and MIGA extractive industry projects can have significant impacts on a country and on regions as a whole, which should be planned for at the national and regional level in order to ensure maximum benefits. Coordination might best be provided through the Country Assistance Strategy (CAS) process.

Given the large potential positive and negative impacts of extractive industries, the CASs of countries with significant or planned extractive industries need to address the challenges posed by these sectors regardless of whether the WBG is involved directly in them in a given country. The CAS should outline clearly what governments need to do to assure that the conditions are in place for extractive industries to contribute to poverty alleviation and sustainable development.

The structural framework within which the oil, gas, and mining sectors exists is of fundamental importance to achieving pro-poor development outcomes that are sustainable. Poverty and the environment should be accorded strategic importance in designing and implementing structural reform programs that involve extractive industries.

Serious efforts should be made within the WBG to review, improve, and update the Safeguard Policies relevant to the extractive industries within the framework of poverty alleviation through sustainable development. This effort should include the active involvement of relevant stakeholders, as noted earlier in particular with regard to the policy on indigenous peoples.

In addition to these institutional changes, WBG priorities within the energy sector need to be rebalanced. IBRD and IDA should position themselves to help governments adopt sustainable energy strategies that address the energy needs of the poor and that minimize climate change, which will disproportionately affect the poor. Countries should be helped to remove subsidies from carbon-based fuels. And WBG lending should concentrate on promoting the transition to renewable energy and endorsing natural gas as a bridging fuel—building new pipelines and renovating leaking ones.

On this basis, the WBG should phase out investments in oil production by 2008 and devote its scarce resources to investments in renewable energy resource development, emissions-reducing projects, clean energy technology, energy efficiency and conservation, and other efforts that delink energy use from greenhouse gas emissions. During this phasing out period, WBG investments in oil should be exceptional, limited only to poor countries with few alternatives. And the WBG has for the last few years not invested in new coal mining development. This should continue.

The WBG should aggressively increase investments in renewable energies by about 20 percent annually, thereby moving toward a better balance between support for fossil fuel projects, currently 94 percent of the energy portfolio, and support for renewables projects, currently just 6 percent. The promotion of renewable energy that is needed in poverty alleviation efforts and in response to climate change should be done by setting up a specialized WBG unit or team for renewables and energy conservation. The WBG should take the initiative to coordinate research globally on sustainable energy development.

Conclusion and Follow-up

In essence, all the recommendations in the Extractive Industries Review are aimed at the need to strike a better balance of life and development in this world. Their ultimate goal is:

- to lift up civil society so it is balanced in the triangle of partnership between governments, business, and civil society;
- to raise social and environmental considerations so they are balanced with economic considerations in efforts at poverty alleviation through sustainable development; and
- to strive for a human-rights-based development that balances the material and the spiritual goals of life.

To follow up on the recommendations in this report, a global consultation workshop should be held in 2005 to assess the extent to which the World Bank Group has succeeded in moving the extractive industry sector on to a sustainable development path that contributes to poverty alleviation worldwide.