



World Bank Group Engagement in
Resource-Rich Developing Countries:
The Cases of the Plurinational State of Bolivia,
Kazakhstan, Mongolia, and Zambia

Clustered Country Program Evaluation Synthesis Report

AN INDEPENDENT EVALUATION



IEG
INDEPENDENT
EVALUATION GROUP

WORLD BANK GROUP
World Bank • IFC • MIGA

**WHAT
WORKS**



World Bank Group Engagement in Resource-Rich Developing Countries: The Cases of the Plurinational State of Bolivia, Kazakhstan, Mongolia, and Zambia

Clustered Country Program Evaluation Synthesis Report

An Independent Evaluation

© 2015 International Bank for Reconstruction and Development / The World Bank
1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

This work is a product of the staff of The World Bank with external contributions. The findings, interpretations, and conclusions expressed in this work do not necessarily reflect the views of The World Bank, its Board of Executive Directors, or the governments they represent.

The World Bank does not guarantee the accuracy of the data included in this work. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

Rights and Permissions

The material in this work is subject to copyright. Because The World Bank encourages dissemination of its knowledge, this work may be reproduced, in whole or in part, for noncommercial purposes as long as full attribution to this work is given.

Any queries on rights and licenses, including subsidiary rights, should be addressed to World Bank Publications, The World Bank Group, 1818 H Street NW, Washington, DC 20433, USA; fax: 202-522-2625; e-mail: pubrights@worldbank.org.

Contents

ABBREVIATIONS AND ACRONYMS	V
ACKNOWLEDGMENTS	VI
OVERVIEW	VII
MANAGEMENT RESPONSE*	IX
CHAIRPERSON’S SUMMARY: COMMITTEE ON DEVELOPMENT EFFECTIVENESS	X
1. INTRODUCTION	1
Background and Context	1
Country Selection	2
Analytical Framework and Work Plan.....	3
Report Structure	4
2. WORLD BANK GROUP STRATEGIC APPROACH	5
References	11
3. MANAGEMENT OF RESOURCES	13
World Bank Group Strategies	14
Outcomes and World Bank Group Contribution	15
Conclusions	26
References	27
4. ECONOMIC DIVERSIFICATION AND NONEXTRACTIVE GROWTH	28
World Bank Group Strategies	31
Outcomes and World Bank Group Contribution	32
Sector-Level Outcomes and World Bank Group Contribution	35
Conclusions	40
5. INCLUSIVE GROWTH	43
Outcomes and World Bank Group Contribution	45
Conclusions	51
6. MAIN FINDINGS	54
Management of Resources.....	55
Economic Diversification and Nonextractive Growth	56
Inclusive Growth	57

CONTENTS

Reference	57
-----------------	----

Boxes

Box 3.1. Consensus Matters: The Evolution of Chile's Fiscal Rule.....	17
Box 3.2. World Bank Group Engagement with the EITI	23
Box 4.1. Chile's Innovation and Entrepreneurial Ecosystem	30

Figures

Figure 3.1. CPIA Rating for the Quality of Public Sector Management and Institutions, Cluster Average, 2006 and 2012.....	22
Figure 3.2. Corruption Perception Index Scores for Selected Resource-Rich Countries, 2006–13	23
Figure 4.1. Price Index of Selected Commodities, 2005–13	28
Figure 4.2. Real Exchange Rates, 2001–13	29
Figure 4.3. Share of Mining and Quarrying in GDP, 2001–13.....	32
Figure 4.4. Average Herfindahl-Hirschman Index for Export Diversification	33
Figure 4.5. Average Herfindahl-Hirschman Index for Domestic Economic Diversification	34
Figure 4.6. Average Annual Growth Rates by Sector, 2004–13	34

Tables

Table 1.1. CCPE Countries: Select Country Data.....	3
Table 3.1. Selected EITI Report Indicators, 2005–11	24
Table 5.1. Select Economic Performance, Poverty, and Human Development Indicators.....	45

**To come.*

Abbreviations and Acronyms

AAA	analytic and advisory activities
CNIC	National Council on Innovation for Competitiveness
CCPE	clustered country program evaluation
CODE	Committee on Development Effectiveness
CPE	country program evaluation
CPI	Corruption Perception Index
CPS	country partnership strategy
CSO	civil society organization
DB	Doing Business
DBM	Development Bank of Mongolia
DPL	Development Policy Loan
EITI	Extractive Industries Transparency Initiative
GDP	gross domestic product
GFMIS	government financial management information systems
HHI	Herfindahl-Hirschman Index
HIPC	Highly-Indebted Poor Countries
IDA	International Development Association
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IMF	International Monetary Fund
JERP	Joint Economic Research Program
MDG	Millennium Development Goal
MDTF	Multi-Donor Trust Fund
MIC	middle-income country
MTEF	Medium-Term Expenditure Framework
NGO	nongovernmental organization
NPL	nonperforming loan
PFM	public financial management
PSD	private sector development
R&D	research and development
RBB	results-based budgeting
RM	resource management
RRDC	resource-rich developing country
SME	small and medium enterprise
SWF	sovereign wealth fund
TA	technical assistance

All dollar amounts are U.S. dollars unless otherwise indicated.

Acknowledgments

The Clustered Country Program Evaluation (Clustered CPE) is a new product prepared by the Independent Evaluation Group (IEG) that includes this synthesis report and four separate country program evaluations of World Bank Group engagement in the Plurinational State of Bolivia, Kazakhstan, Mongolia, and Zambia.

This Clustered CPE was led by Konstantin Atanesyan, and was conducted under the guidance and supervision of Geeta Batra (Manager) and Nick York (Director) and the overall direction of Caroline Heider (Director-General, Evaluation). Country program evaluation teams were led by Konstantin Atanesyan (Kazakhstan), Florence Charlier (Mongolia), Jiro Tominaga (Zambia), and Xiaolun Sun (Bolivia).

Core team members for this synthesis report were Lev Freinkman, Shoghik Hovhannisyan, Takatoshi Kamezawa, Basil Kavalsky, Andres Liebenthal, Marcelo Selowsky, Inder Sud, Steven Webb, and Kendra White. Barbara Balaj edited the report. Corky de Asis and Yasmin Angeles provided administrative support. William Ascher (Claremont McKenna College), Alan Gelb (Center for Global Development), and Andrew Warner (International Monetary Fund) were the peer reviewers for this report.

IEG is grateful to the numerous representatives of the government, private sector entities, and nongovernmental organizations in Bolivia, Botswana, Chile, Kazakhstan, Mongolia, and Zambia as well as World Bank Group management and country teams, who provided valuable time, information, and feedback to the evaluation team.

Overview

This report by the Independent Evaluation Group summarizes the experiences of and draws lessons from the country program evaluations of four natural resource-rich countries: the Plurinational State of Bolivia, Kazakhstan, Mongolia, and Zambia. It concludes that although the challenges identified in these countries are not unique, they manifest themselves with particular intensity in three closely interrelated areas that need to be defined and structured as a coherent strategy: (i) management of revenues from an exhaustible resource; (ii) growth and employment in the nonextractive sectors, and (iii) inclusive growth and reduction of poverty.

Overall, looking at the four resource-rich countries in this evaluation, one does not see the World Bank Group as having a consistent framework for engagement, driven by the defining characteristics of these countries – their rich endowment with non-renewable natural resources and dependence on revenues from their exploitation. Each of the four stories evolved in a unique way that depended on how the country teams decided to react to differing country circumstances. The main challenge for the Bank Group in these countries today is how to stay relevant and competitive, as its value proposition is

no longer its financial resources, but its knowledge and global experience, which may call for a more modest scope of interventions while keeping the focus on key challenges.

The increasingly demand-driven nature of Bank Group programs in these countries and the focus on client-led selectivity imposed certain limitations on fulfilling the Bank Group's mandate as a global development institution, leaving some gaps in important areas. The quality of the Bank Group's outputs, and especially the increasingly intensive analytical and advisory activities, has been consistently high, but its effectiveness has been uneven, if measured by actual follow-up on policy advice. The World Bank's programs often lacked attention to the demand side of reforms, including building partnerships and maintaining communication with stakeholders beyond the executive branch of government.

Overall, summarizing Bank Group engagement in these countries, the report concludes that: (i) the Bank Group is well-positioned and technically equipped to effectively assist in implementing policies and strengthening institutions for prudent management of natural resources and revenues derived from their

OVERVIEW

exploitation; (ii) economic diversification and growth of nonextractive sectors proved to be an elusive target, and Bank Group strategies and analytical products struggled to define diversification as a specific strategic objective; and (iii) a decade of high commodity prices resulted in economic growth and progress on poverty reduction and most social development indicators, but inequality remained a persistent and growing challenge.

Management Response

TK

Chairperson's Summary: Committee on Development Effectiveness

The Subcommittee welcomed the Clustered Country Program Evaluation (CCPE) on Resource-Rich Developing Countries (RRDCs) by the Independent Evaluation Group and broadly concurred with the evaluation's conclusions. Members noted the importance of taking into account the heterogeneity and uniqueness of each individual country's development initiatives. They expressed concern with the conclusion that the demand-driven nature of World Bank Group programs in RRDCs and client-led selectivity can impose limitations to fulfilling the Bank Group's mandate. Members underscored the need for the Bank Group to remain flexible enough to allow for support to be provided based on opportunities, constraints, and changing circumstances of each country. They highlighted the relevance of country ownership and that selectivity should remain country driven. They stressed the need for a well-balanced use of nonlending and lending instruments in these countries as well as targeted interventions based on the countries' capabilities and investment needs in key sectors. Members appreciated IEG's clarification that the report does not undermine the demand-driven approach, but that its purpose is to bring lessons and experiences from other countries, in a more systematic way, into the country engagement process.

Members noted that the CCPE could strengthen and inform individual Systematic Country Diagnostics and Country Partnership Frameworks by providing a different lens and new perspectives through its comparative analysis. They encouraged IEG and Management to maintain close coordination and communication in order to make this new learning exercise more effective. Members stressed that the synthesis report is a useful learning product and could be used for analytical purposes. They noted that it could help the Bank Group develop new products and a more coherent strategy to assist RRDCs improve resource mobilization; revenue management; enhance private sector development; and foster growth and employment in nonextractive sectors. The Committee highlighted the need for the Bank Group to strengthen its partnerships with client countries and for the International Finance Corporation and the Multilateral Investment Guarantee Agency to work closer with the World Bank to achieve a better development impact and improve the Bank Group's data metrics and Results Frameworks. They supported the emphasis on capacity building and sovereign wealth fund creation, but noted that more needed to be done in the area of benefits' sharing, particularly in the context of inclusive growth and poverty reduction and local analytical and negotiating capacity to maximize revenue collection.

CHAIRPERSON'S SUMMARY
COMMITTEE ON DEVELOPMENT EFFECTIVENESS

Speakers acknowledged the challenges the Bank Group faces to stay relevant and competitive in RRDCs since the value proposition is no longer financing but rather knowledge and global experience. They reiterated that if the Bank Group wants to remain engaged in these countries, it has to respect the country's selectivity and ownership. Over time, this may allow the Bank Group to work with client countries to develop projects and programs that can lead to serve the Bank Group's goals, as successfully proven in the case of Kazakhstan. A few observed that for CCPEs to have value, IEG needs to be very careful about the underlying framework, cautioning that different starting points lead to possibly different conclusions and noted that this particular exercise could have benefited from possibly including more than one factor (other than being resource rich) and/or have more countries in the cluster. IEG clarified that each country program evaluation was evaluated individually paying due attention to country specificities and that the framework for the synthesis analysis was spelled out in the approach paper approved by CODE.

Alejandro T. Foxley
CHAIRPERSON

1. Introduction

Background and Context

This synthesis report draws conclusions and summarizes the first Clustered Country Program Evaluation (clustered CPE) undertaken by the Independent Evaluation Group. In addition to this overview report, the clustered CPE includes four individual country program evaluations (CPEs) for Bolivia, Kazakhstan, Mongolia, and Zambia, covering eight to ten years of World Bank Group engagement in these countries. The purpose of the clustered CPE is to exploit the learning potential of looking across a group of countries that have one common characteristic (in this case, rich endowment with and dependence on the extraction of non-renewable natural resources), but that are otherwise a fairly heterogeneous group in terms of geographic location, income levels, and depth of dialogue with the World Bank Group. The synthesis report summarizes the experiences and draws broader lessons across the four countries and the different models of Bank Group engagement therein. The heterogeneity of the group is intentional and aims to maximize the learning value of the evaluation product. This exercise does not intend to compare or benchmark the performance of these four countries against each other.

A clustered CPE is not a thematic evaluation, and there are important differences between the two. Whereas the clustered CPE is designed to draw lessons across countries, it remains an instrument for establishing Bank Group accountability and for learning from its experience by monitoring the impact of its programs within these countries. Each CPE in the cluster is a free-standing product that derives lessons for the coming country strategies, and provides Bank Group shareholders with an independent assessment of the relevance, effectiveness, and efficiency of Bank Group country programs. By contrast, a thematic evaluation would normally look at a larger and more representative sample, and would be intended to illuminate the Bank Group's global impact on a particular theme. For thematic evaluations, the country case studies carried out for this purpose are generally not designed to be independent products.

The effective management and use of natural resources for development has important impacts on a significant group of Bank Group clients. It relates closely to the Bank Group's twin goals of eradicating poverty and boosting shared prosperity. Therefore, the overarching question that all CPEs included in the cluster were designed to answer – "How effective and relevant was Bank assistance in helping the countries take advantage of their endowment with natural resources in a most effective and efficient manner?" – is relevant for a much larger group of Bank clients. In addition, this is an issue of great interest to Bank Group shareholders: for instance, the document on

CHAPTER 1 INTRODUCTION

Special Themes for International Development Association (IDA)-17 stated that: “Natural resource wealth has the potential to be a game-changer for accelerating development in IDA countries, although when not well managed it can be a significant economic stress factor for conflict.”

The World Bank Group does not have a standard definition for resource-richness. Traditional measures included the share of natural resource exports to gross domestic product (GDP) and production flows (mostly, oil and mineral extraction). A distinction is often made between “resource-rich” and “resource-dependent” countries. The term resource-rich normally refers to available deposits of oil, gas, and minerals below the ground, which are finite and can be exhausted; whereas the concept of a resource-dependent country captures the extent to which a country’s economy relies on resource rents – usually measured in proportion to GDP, exports, or government revenues. For the purposes of this evaluation, the term resource-rich developing countries (RRDCs) will refer to the countries that are both endowed with abundant non-renewable natural resources (hydrocarbons and minerals) and are resource-dependent, that is, they derive a significant share of their gross national product, exports, and government revenues from exhaustible resources.

Country Selection

This clustered CPE includes four countries, covering more or less the same period (from 2004–05 to 2012–13), and uses a common analytical framework. The process of country selection included several stages, and began with an analysis of the full set of RRDCs (about 50 countries) included in relevant World Bank Group and International Monetary Fund (IMF) documents. The task team then applied additional criteria,¹ mainly related to the availability of evaluative evidence (presence of a Bank Group program in the last seven to ten years) and potential value for cross-country learning. This analysis led to the selection of Bolivia, Kazakhstan, Mongolia, and Zambia, and included the drawing of lessons from the experience in the widely recognized “good practice” cases of Chile and Botswana.

This selection places a deliberate emphasis on country diversity, aimed at reinforcing the learning value of this cross-country review, and reflecting on how the Bank programs in these countries incorporated the particular needs of the clients and helped them find country-specific solutions to broadly similar challenges. Therefore, additional parameters applied for the final selection included: (a) global coverage – aiming to cover as many Bank regions as possible; (b) type of natural resource – including coverage of mineral-producing countries (Mongolia and Zambia) as well as oil and gas exporters (Bolivia and Kazakhstan); (c) income diversity – including a broad range of

income categories, both lower-middle-income (Bolivia, Mongolia, and Zambia) and upper-middle-income (Kazakhstan) economies; IDA, blend,² and International Bank for Reconstruction and Development borrowers; (d) including a combination of varying degrees of depth of dialogue and engagement modalities with the clients (lending, technical assistance (TA), reimbursable advisory services, and combinations thereof); and (e) availability of evaluative material – including fairly recent Country Partnership Strategy and Completion Reports and project-level evaluations that indicated potential issues for more in-depth assessments as well as ensuring that there are no overlapping CPEs (see table 1.1).

Table 1.1. CCPE Countries: Select Country Data

Country and Region	Country Characteristics				World Bank Portfolio						
	GNI per capita 2012 ^a (US\$)	Type of NR	NR exports (% of total)	NR fiscal revenue (% of total)	Population (% living at \$2/day)	Number of projects	Lending (US\$ millions)	Number of ESW projects	Number of TA projects	Borrower status	Last CPE
Bolivia (LAC)	2,220	Gas, mining	74	32	25	16	490	14	19	Blend	2005
Kazakhstan (ECA)	9,730	Oil, gas	60	40	1	13	4,662	19	121	IBRD	2001
Mongolia (EAP)	3,160	Mining	81	29	49	14	209	36	16	Blend	2002
Zambia (AFR)	1,350	Copper	72	4	82	16	641	28	29	IDA	2003
Botswana (AFR)	7,650	Diamonds	66	63	N/A	3	372	7	12	IBRD	—
Chile (LAC)	14,290	Copper	53	23	2	6	140	15	35	IBRD	2002

Sources: IMF and World Bank.

Note: The table includes projects approved in the FY07–13 period. AAA data refer to deliveries in a given fiscal year. Averages for years 2006–10. Botswana and Chile country cases are used as reference points and are not part of the cluster. — = not applicable; AFR = Africa; CCPE = Clustered Country Program Evaluation; CPE = Country Program Evaluation; EAP = East Asia and Pacific; ECA = Europe and Central Asia; ESW = economic and sector work; GNI = gross national income; IBRD = International Bank for Reconstruction and Development; IDA = International Development Association; LAC = Latin America and the Caribbean; N/A = not available; NR = natural resource; TA = technical assistance.

a. Atlas method.

Analytical Framework and Work Plan

The four CPEs follow a similar organizing framework based on a set of challenges that arise from high dependency on natural resources, and adjusted to particular features of the Bank Group program in each country. This synthesis report follows a similar structure based on this framework and a corresponding set of evaluation questions, grouping them into the following three categories:

CHAPTER 1 INTRODUCTION

- *Management of resources*, including addressing risks to macroeconomic and fiscal sustainability; and improving governance and institutions for the effective use of resources.
- *Economic diversification and nonextractive growth*, including promoting growth, job creation, and the entry of the private sector into nonextractive sectors.
- *Inclusive growth*, including using revenues from natural resources to reduce poverty, build human capital, and address environmental challenges.

The evaluation work was completed in five main phases: (i) concept development, including a literature review; preparation of the approach paper; thematic and country desk reviews; (ii) headquarters-based interviews and discussions with Bank staff and external experts; (iii) field work, including country visits to Bolivia, Botswana, Chile, Kazakhstan, Mongolia, and Zambia; (iv) preparation and internal review of country reports; and (v) preparation of the consolidated synthesis report.

Report Structure

This report has six chapters including this introductory chapter. Chapter 2 reviews the World Bank Group strategic approach based on the experience in the four CPE countries; chapters 3, 4, and 5 summarize the main findings of the evaluative work, organized around the three themes/pillars as described previously. Chapter 6 summarizes the most important findings derived from the four CPEs.

¹ The final selection was done on the basis of the following criteria: (i) high levels of resource dependence for exports or revenues (threshold of 50 percent); (ii) the presence of a diverse Bank Group program of lending, technical assistance, and analytic work; and (iii) regional representation and balance.

² International Development Association-eligible but also creditworthy for some International Bank for Reconstruction and Development borrowing.

2. World Bank Group Strategic Approach

Reflecting resource-dependence in World Bank Group country strategies: All four countries included in this Clustered Country Program Evaluation (clustered CPE) depend heavily on the extraction of nonrenewable natural resources, and extractive sectors play a major role in their economies and public finances. Nevertheless, Bank Group strategies in these countries usually did not focus explicitly on the challenges more typical for resource-rich developing countries (RRDCs), including the role of natural resource revenues as a potential driving force for development and poverty reduction. A notable exception is the country partnership strategy (CPS) for **Mongolia**, which – albeit somewhat belatedly – made the country’s endowment with abundant mining resources the centerpiece of Bank Group strategic engagement. Mongolia also stands out in this cluster evaluation as the only country in which the Bank Group actually maintains direct engagement in the extractive sector through lending, analytic and advisory activities (AAA), and International Finance Corporation (IFC) investments. In the rest of the cluster, the Bank Group has been either effectively cut out of the sector, or was never involved in the first place.¹

At the same time, Bank Group *de facto* engagement in the country program evaluation (CPE) countries, if viewed at the project and AAA levels, did offer solutions to the relevant challenges in the areas where the Bank Group has a comparative advantage, that is, macroeconomic management, infrastructure investment, human development, and so on. Oftentimes, the Bank Group used openings offered through successful AAA to introduce lending and project implementation support.

The country context dictated the prominence of issues related to resource use in the Bank’s strategy. The visibility and prominence of the natural resource factor in country strategy documents generally reflected the quality and depth of overall dialogue with the respective government authorities. For example, **Bolivia’s** policy in the hydrocarbon sector, including the 2005 Hydrocarbon Law and the nationalization in 2006, proceeded independently of Bank Group advice. The 2006 policy notes prepared by the Bank Group argued against the direction in which Bolivia’s natural gas policy had gone and was about to go even more extremely. As a result, since 2006 the government has not sought any help from the World Bank Group on hydrocarbon sector issues. The Bank Group strategy in **Zambia** implicitly recognized the challenge of extremely high dependency on natural resources, and especially the country’s vulnerability to the effects of copper price volatility, which made macroeconomic and fiscal management extremely challenging. However, in the Zambian context many of the questions related to the use of resource revenues had little relevance. Instead, the key question was

CHAPTER 2 WORLD BANK GROUP STRATEGIC APPROACH

whether the Bank could have done more to assist the government in maximizing revenues, specifically: copper accounted for about 80 percent of exports, but only 4 percent of fiscal revenue. The Bank faced a dilemma: whether to support the renegotiation of the mining contracts or maximize revenue collection within the limits of the existing contracts. The issue was highly sensitive as the Bank did share some responsibility for the contracts negotiated with the privatized mines. These contracts did not include a provision for capturing windfall profits in the event of a rise in copper prices. In hindsight, the Bank could have made an earlier start (in a much more favorable country dialogue climate) on the current agenda to strengthen the capacity of the Ministry of Finance to analyze company accounts and to identify inappropriate use of transfer pricing, write-offs, and depreciation allowances.

IFC does not have an explicit strategy for its operations in RRDCs. Instead, it has a sector strategy for engagement with extractive industries. Despite attractive investment returns, IFC considers extractive industry a “high-risk” business. Due to the combination of high risk and fairly intensive staff needs to structure a transaction, IFC also considers the extractive industry a low-volume business in which it should be highly selective and seeks to optimize both development and financial results. Considering the potential reputational risk for IFC, governance is one of the most important risk factors. For higher risk countries that do not have an established track record of regulatory oversight for the sector, IFC’s strategy is to work closely with the World Bank. However, this evaluation found that coordination between the Bank and IFC was ad-hoc and not systematic. CPSs seem to be joint in name only, with weak sector analysis. Both the Bank and IFC generally failed to establish a long-term sector engagement and effective implementation strategy for joint contributions to the CPS and sector objectives. Apart from some pockets of success, IFC struggled to do business in the four CPE countries beyond its main business line of banking and the financial sector. In the four CPE countries, IFC had rather limited engagement in infrastructure, where it has a comparative advantage and global expertise in providing long-term financing and advice on public-private partnerships.² In **Bolivia**, despite a growing economy supported by a booming small and medium enterprise (SME) sector, IFC experienced difficulties in finding long-term investment opportunities in general.

Quality of dialogue: RRDCs have substantial resources to fund government programs, and are therefore less dependent on donor funding. Their willingness to engage in a dialogue is often dependent on the establishment of a shared vision and mutual trust. Bank Group strategies generally aligned with the governments’ development plans. However, very often the overarching objective was to build (or, at times, re-build) a strategic relationship with the authorities. Dramatic positive changes in the macroeconomic situation due to commodity price booms, and the governments’ often critical view of the international financial institutions negatively affected the extent and

form of Bank Group engagement in **Bolivia**, and to a lesser extent in **Zambia**. In this context, the Bank Group often chose to “re-invent itself” and offer unconventional mechanisms of cooperation – albeit with varying success. The Bank Group had more success with this approach in **Kazakhstan** where, after a considerable hiatus in its program, it developed two effective mechanisms of dialogue. These included the regular rounds of cabinet-level “brainstorming sessions” prepared and led by the Bank and chaired by the Prime Minister, and the Joint Economic Research Program (JERP). The JERP was a demand-driven, co-funded program of analytical studies and policy notes on specific sector topics. Implementation of the JERP in Kazakhstan offers some interesting lessons: while it became a powerful tool for strengthening the partnership, advancing the reform agenda and a gradual build-up of the lending program, the fully demand-driven nature of the program imposed limitations on the Bank in defining strategic priorities in its advisory work, disseminating AAA findings, and engaging with local partners.

Tension between the Bank’s mandate and the government’s preferences with regard to the Bank’s assistance program was a common characteristic for resource-rich countries in which the clients did not need the Bank’s financial support. Thus, they could afford to be very selective, including in the use of Bank policy advice. In **Bolivia**, following the transition to the Morales government in 2005–06, the Bank lost its traditional influence on policy, and worked hard to “stay engaged,” exploring entries for dialogue with a publically antagonistic client. The Morales government has been largely uninterested in the Bank’s advice on macroeconomic policy, governance, and resource extraction. In this context, the Bank chose to focus on other areas of engagement. The program became increasingly opportunistic and narrow in scope, reflecting an engagement with areas of support selected by the government, but not necessarily coherent or suitable for achieving the intended results. While possibly appropriate for a transitional period, this strategy may no longer be viable as the Bank could incur reputational risk.

Pro-active engagement with legislatures proved quite useful, especially in countries with growing traditions of parliamentary democracy, such as in **Mongolia**. In Mongolia, the Bank crafted an outreach effort to engage members of parliament in order to build majority support around policy reforms, strengthen the management of the mining sector, and target social welfare reforms. This helped the Bank to stay engaged in dialogue in a society prone to drastic political changes after each electoral cycle that, in turn, led to deep divisions on important issues, thereby imposing challenges to implementing a sustainable reform agenda. Increased country and sector presence was another positive factor: the establishment of a country director-led office in Lusaka, **Zambia** demonstrated the Bank’s commitment to building a robust relationship with Zambian authorities. The placement of a senior mining specialist in Ulan Bator helped to strengthen engagement in this critically important sector for **Mongolia**. In **Zambia**

and **Bolivia**, the lack of dedicated IFC staff resources and presence in the country hindered effective cooperation between the Bank and IFC.

In countries with active electoral politics, and thus frequent and unpredictable changes of government, the interaction of politics and mineral cycles can lead to systematic problems that spill over into country–Bank relations. At times when a country has few mineral revenues coming in – either because world prices are low or the minerals are not yet being exported – then the country is in a weak position vis-à-vis international oil and mining firms. Such firms can drive a hard bargain in contracting for exploration and extraction. Also, at these times the government is likely to depend on the Bank’s blessing to obtain financing, leading to “close collaboration” in policy dialogue. In the next phase of the commodity price cycle, with extraction investments already in place and buoyant world prices, it often looks like the exploration and extraction contracts were bad deals for the country. The Bank can be portrayed as the advisor that led the previous government to give away too much. That happened in **Bolivia** and to a lesser extent in **Zambia** and **Mongolia**.

Political economy analysis: In all of the reviewed countries, a good understanding of the political economy of natural resources was absolutely critical. Governments tend to use mineral resources as tools in promoting their respective political agendas. The discovery of large mineral resources often contributes to more fiercely contested elections and unstable governments, and attendant highly populist decision making aimed at winning constituencies through distribution of the new wealth (World Bank 2012). The Bank’s ability to take a longer view, to maintain a consistent presence, and to exploit the synergies between its various operations is important to be able to mitigate the populism that dominates decision making in many RRDCs. With this perspective, the Bank could be an important contributor if and when economic populism ceases to dominate policy making. In **Mongolia**, Bank-sponsored political economy analysis proved to be a key input in identifying the constraints to adopting policies for the effective management of revenues from the mining boom (World Bank 2009). The findings of the political economy analysis showed the importance of enhancing information and stimulating multi-stakeholder debates about the governance of the mining sector. The analysis helped identify the key actors, notably the powerful political factions that advocated or opposed different facets of the reform program. Because resource cycles can precipitate the decision-making process without sound analysis, the country team devised a comprehensive outreach effort to engage stakeholders in government, the parliament, and civil society. In **Zambia**, the Bank produced a study on revenues from mining (2011) and a political economy analysis that, among other things, warned against industrial policy approaches to diversification and against repeating the experience of creating parastatals in the 1970s and 80s.

Increased role of AAA: Rapidly decreasing demand for Bank Group financing in most RRDCs during the review period accorded a more prominent role to the Bank Group's AAA work. In **Bolivia**, the number of AAA products delivered during the period more than doubled compared to the preceding decade. Analytic work became an increasingly convenient tool to stay current on developments in many areas and to respond to the government's requests for assistance on specific topics. **Kazakhstan's** JERP is a good example of a well-established and effective mechanism in this regard. At the same time, the overall effectiveness of the JERP did suffer from the absence of an explicit results framework and the lack of detailed evidence on how much and what kind of Bank policy recommendations resulted in policy changes. The Bank rarely monitored the results of its recommendations, while the government's own monitoring was sporadic and not regularly shared with the Bank. In **Zambia**, this evaluation found much stronger interest in the Bank's analytic work than had appeared from earlier assessments (2004). A series of semiannual Country Economic Briefs in Zambia were a very useful innovation and an instrument of choice to which officials, academics, think tanks and civil society organizations looked to obtain objective analysis of the current economic situation. The Bank's periodic economic reports in **Mongolia** became a cornerstone of the Bank's communication policy, helping to raise awareness about economic trends and providing the opportunity to discuss frankly the risks posed by countercyclical government policies.

Capacity building: While capacity building is a common and generic "buzzword" across the whole range of Bank clientele, RRDCs have a few special needs in this regard. Negotiating capacity is one of them. **Botswana** is an excellent example of the importance of investing in this function, as the outcomes of its long-term deal with the country's main investor (De Beers) clearly show. By all accounts, the country did not spare efforts and resources to build an equally qualified team on the other side of the negotiating table, and this investment had a high payoff.³ One of the key lessons that emerges from the Bank's support in **Zambia** is the importance of ensuring that the country has the right expertise available at the negotiation stage of mineral contracts and privatization. The failure to look at other fiscal regimes and obtain expertise on appropriate taxation arrangements has had negative consequences for that country. In **Kazakhstan**, building local analytical capacity was a dimension that did not live up to its potential. The JERP very rarely (if at all) engaged local partners in program delivery. As such, the 10-year old program of analytical studies contributed surprisingly little to the build-up of local analytical capacity. In **Bolivia**, the Morales government thought that the Bank had been complicit in the favorable deals that international oil companies had negotiated with previous governments. Consequently, it sought non-Bank expertise to design the new hydrocarbon law, which was less favorable to the international firms.

CHAPTER 2

WORLD BANK GROUP STRATEGIC APPROACH

Partnerships and the demand side of reforms: Experience in all countries proves the importance and crucial role of building and nurturing long-term partnerships and communication with all major stakeholders, also moving beyond the usual and main counterparts of the executive branch of government. This should include the legislature, private sector, civil society, academia, and donor partners. The Bank's early (pre-2005) engagement in **Bolivia** focused on working with the government and overlooked building partnerships with other stakeholders. This later backfired, leading to animosity toward and distrust of the Bank by many Bolivians, including the Morales government. The Bank Group's subsequent and recent approach of not antagonizing the current administration in any way has also been criticized as evading its role as an unbiased source of knowledge and a trusted development partner. By contrast, in **Mongolia**, the Bank used the recommendations of political economy analysis, and came up with a comprehensive program of outreach and capacity building with the media, parliament, and civil society. The effectiveness of the Bank's program in **Kazakhstan** was reduced by the lack of attention to demands from civil society and the private sector. The Bank's policy dialogue focused exclusively on the government at the cost of not communicating with other local stakeholders. Most importantly, limited disclosure kept important policy recommendations out of the general public's reach, thus constraining demand for reforms, and adversely affecting the political economy of governance reforms in the country.

Selectivity: In the context of RRDCs and shrinking demand for Bank services in some sectors, selectivity becomes an obvious strategic imperative in order to stay current and relevant. This refers particularly to the Bank Group's loans and investments. Bank Group strategies do recognize this and, indeed, call for increased selectivity and focus in Bank Group interventions – although in many cases selectivity has been defined by the authorities. While this is generally natural and logical, and all development initiatives should be client-driven and owned, there is one major caveat. In some countries, this client-led selectivity has led to the Bank's *de facto* withdrawal from providing impartial advice on important but politically sensitive areas, such as poverty diagnostics, macro-fiscal management, and governance. In these cases, the Bank should stay cognizant of its mandate as a global development agency and the immediate risks facing many RRDCs, such as the looming deterioration of fiscal balances (already happening in **Zambia** and **Mongolia**) amid falling commodity prices that will create serious risks for countries dependent on mineral exports.

Flexibility: Flexibility is especially important in resource-dependent countries, given the potential for price shocks and the ensuing variability in revenue. Bank strategy was generally flexible in design and practice in all countries. The increasing prominence of technical assistance in the overall program was an important contributing factor in this regard, as it enhanced Bank capacity to adjust to quickly evolving priorities. In

Mongolia, the Bank team reacted promptly to realign the Bank portfolio to help the government cope with the global economic crisis in 2008–09. It did so by shifting the majority of new International Development Association resources to development policy credits, and intensifying the AAA emphasis on real-time policy advice. The Bank Group’s “open-ended” 2004 CPS in **Kazakhstan** was designed as a flexible strategy instrument that would allow for quick mid-course correction – which, indeed, happened at the time of economic and financial crises. However, flexibility of the program should not explain and justify the absence of concrete and measurable performance indicators that limited the ability to measure actual progress and achievements.

Overall, looking at the four resource-rich countries in this evaluation, one does not see the World Bank Group as having a consistent framework or core set of issues to include in the dialogue with resource-rich countries. Each of the four stories evolved in a unique way that depended on how the country team at the time decided to react to differing country circumstances. The Bank’s responses did not seem to derive from any Bank-wide approach to working with RRDCs. The mineral wealth affected country dialogues as the Bank Group adapted its strategy to the situation, but this was usually more in a negative way of limiting the issues that entered into the dialogue. At the same time, this evaluation argues that despite all the differences between the countries included in the cluster, there were common challenges and opportunities where the Bank Group and its clients can learn across countries and Regions, and come up with solutions to some of the toughest development challenges facing this particular group of Bank Group client countries.

References

- World Bank. 2009. *The Political Economy of the Resource Paradox*. Washington, DC: World Bank.
- — —. 2012. *Rents to Riches? The Political Economy of Natural Resource-Led Development*. Washington, DC: World Bank.

¹ Bank Group direct financial engagement with extractive industries is quite low globally, and the total financing volume for the last decade was only \$9 billion – less than \$1 billion annually worldwide (mainly IFC equity investments). In the four reviewed countries, IFC has made one small investment in a junior mine in Zambia and another in Mongolia for the Oyu Tolgoi copper–gold mine in the amount of \$4.5 billion, approved by IFC and the Multilateral Guarantee Agency’s Boards on February 28, 2013. The financing was not yet finalized at the time this report was prepared due to continuing negotiations on key issues between the investors and the government.

² IFC had only one infrastructure investment in the four CPE countries – a \$50 million project in Kazakhstan. This report and the CPEs use the IFC information system classification of infrastructure investments. This will not include telecom, IT, and oil and gas sector investments.

³ Botswana has negotiated an increasing share of the profits from diamond mining, in 2015, about 81 percent. It also reached an agreement with De Beers to move an increasing share of value-added (through polishing and processing) to Botswana, as well as its headquarters from London to Gaborone. Botswana is a 50 percent shareholder in Debswana, the world's leading producer of diamonds by value, and the Diamond Trading Company.

3. Management of Resources

Resource-rich developing countries (RRDCs) have traditionally faced macroeconomic and fiscal management challenges because of the volatility and concentration of their income flows, and the limited linkages from the extractive sectors to the rest of the economy. These problems, if unaddressed, tend to undermine macroeconomic stability and weaken institutions for government accountability. The peculiar nature of resource rent inflows – dubbed the “resource curse” – constitutes a main determinant of the most typical governance failures in RRDCs. Respective development challenges have been well identified in the literature (IMF 2012; World Bank 2012) and could be briefly summarized as follows.

Risks to macroeconomic and fiscal sustainability. Dependence on natural resources with historically volatile prices exposes countries to a risk of revenue disruptions and, hence, adversely affects welfare in the absence of precautionary savings. At the same time, the exhaustibility of non-renewable resources poses difficult choices over the consumption-savings ratio needed to ensure long-term sustainability and intergenerational equity. Moreover, the expansionary fiscal policies during boom periods tend to stimulate domestic demand beyond the existing absorptive capacity in the economy, which often leads to inflationary pressures and real exchange rate appreciation. This, in turn, could adversely affect the non-resource tradable sectors by making domestic production more expensive and non-competitive, a phenomenon known as the “Dutch Disease.” The economic theory has long advocated that to address this challenge, resource-rich countries have to set up special fiscal institutions for saving a portion of their resource revenues over the price cycle, thus buffering their fiscal policies from commodity price fluctuations. Several countries, such as **Chile**, have a positive experience with using such saving mechanisms. Still, many RRDCs continue to follow pro-cyclical fiscal policies that impose costly adjustments in times of revenue busts, as observed during the 2008–09 global financial and economic crises. In this context, the World Bank is expected to support countries in developing robust fiscal policies and institutions that would help turn resource wealth into a steady stream of public revenues, and are capable of supporting longer-term macroeconomic sustainability. The Bank, together with the International Monetary Fund (IMF), can play a role in supporting orderly macroeconomic and fiscal adjustment, including at times of fiscal surpluses accumulated during boom cycles.

Weaknesses in the national systems for public financial management (PFM).

Historically, many RRDCs could not transform their resource revenues into an adequate flow of public goods and services due to capacity constraints and distortive

CHAPTER 3 MANAGEMENT OF RESOURCES

incentive regimes. This failure has often been at the heart of the “resource curse.” Thus, the PFM agenda was expected to be a central part of the Bank’s strategies in the RRDCs. National resource rent management systems have three core PFM blocks and generally one would expect the Bank to support all of them, including: (a) raising resource revenues – advising on an extractives tax regime, capacity building in tax administration, and supporting governments in the course of their negotiations with major private investors; (b) upgrading national PFM institutions and systems – strengthening the legal and regulatory framework for PFM, building capabilities for adequate implementation of national PFM regulations, especially in the areas of budget formulation and planning, accounting, monitoring, reporting, and evaluation; and (c) improving policy advice in defining the public expenditure envelope and providing sector-level support to help improve the expenditure allocation.

Inadequate governance and accountability arrangements. The RRDCs also face two additional governance/political economy risks. First, there is a risk of distributional conflict over the resource rent control and distribution. Second, these countries could be affected by disproportionate and unsustainable expansion of their public sectors, funded by the often temporarily high level of government revenues. The latter instance may lead to an excessive role of the government in the economy (large, ineffective, and interventionist government administration operating in an environment of low institutional capacity). In addition, many RRDCs have been struggling to establish proper accountability systems. In this context, the Bank has a particular expertise in supporting countries to address issues of checks and balances, to improve public administration capacity, and to promote the broader agenda for anticorruption and deregulation. In the context of RRDCs, the Bank is also well-positioned to lead in advancing global initiatives, such as the Extractive Industries Transparency Initiative (EITI).

World Bank Group Strategies

The prominence and design of the resource management (RM) pillar in country partnership strategies (CPSs) varied significantly across the four Country Program Evaluation (CPE) countries. These differences are driven by three interrelated variable factors: (i) the level of economic and institutional development; (ii) dependence on external financing; and (iii) reform priorities. The Bank’s strategies have differed greatly in both their scope (variety of Bank instruments, number of self-standing projects) and depth (intensity and quality of the policy dialogue). In **Mongolia** and **Zambia**, the Bank has had broad programs to support resource management (RM), with significant amounts of lending and advisory services, driven primarily by high financing needs. This was the case especially early in the review period, and by the established tradition

of the high-level policy dialogue with the Bank. The Bank's program in **Kazakhstan** included intensive policy advisory work. There were also opportunities to communicate this advice effectively to senior policymakers. However, until very recently, Kazakhstan has been very selective in borrowing from the Bank. In contrast to Mongolia and Zambia, Kazakhstan did not borrow for capacity building in PFM, which contributed to a gap between the depth of the Bank's policy advice and the pace of actual change in PFM practices. In **Bolivia**, the RM component has mostly dropped out of Bank programs since 2006. Although the new administration of President Evo Morales adopted conservative fiscal policies, it did not express interest in promoting institutional reforms to secure their longer-term sustainability. Issues such as anticorruption were not high on the Bolivian government's priority list. Further, the authorities made it clear that they were not interested in the Bank's assistance in this area.

Outcomes and World Bank Group Contribution

SUPPORT FOR MACROECONOMIC AND FISCAL SUSTAINABILITY

The area of macroeconomic and fiscal sustainability was initially among the top priorities identified within World Bank Group assistance strategies in all four countries, although the intensity of subsequent engagement and progress have varied widely – driven by differences in the respective degree of commitment to fiscal discipline. In **Kazakhstan**, the government's reform effort resulted in the most visible progress in setting up and then strengthening the rules governing the use of oil earnings. Establishing conservative fiscal rules to govern the annual oil revenue transfer from the country's national fund (i.e., National Fund for the Republic of Kazakhstan) to the budget represents a major achievement. Kazakhstan is the only country in the sample that has an established track record of counter-cyclical policy.¹ The Bank contributed to these outcomes through policy dialogue, direct budget support, and a massive amount of analytical work. Two Bank products were especially important. First, the large and ambitious Development Policy Loan (DPL) (2009, \$1 billion) used the window of opportunity during the 2009 crisis to accelerate reforms promoting fiscal sustainability. Apart from specific achievements, such as reduction in budget subsidies to the real sector (while protecting social spending), and rationalization of the use of the National Fund's savings, the DPL helped to cement the government commitment to responsible public resource management, which has continued after the crisis. Second, a Bank report entitled *Oil Rules. Kazakhstan's Policy Options in a Downturn* (2013) contained an assessment of Kazakhstan's current oil rules against possible alternatives (as informed by best international practices) using the results of modeling of various crisis scenarios. It concluded that Kazakhstan's fiscal rules perform well under different types of

CHAPTER 3 MANAGEMENT OF RESOURCES

external shocks, they are simple and practical, and do not need to be replaced by more sophisticated arrangements.

In contrast, in **Mongolia**, fiscal management arrangements failed the test of the commodity boom of 2003–07. The government followed a pro-cyclical policy in 2006–08 when commodity prices hit record levels, which then had unfortunate consequences when the prices collapsed. During the crisis, the government attempted a fiscal adjustment, supported by the Bank’s Development Policy Credits and technical assistance (TA). However, it proved to be unsustainable. After the crisis was over, the government’s reform effort lost momentum, the newly adopted fiscal reform laws were never fully implemented, and actual budgeting rapidly shifted back to pro-cyclical patterns. For the same reason, the Bank’s support to design the Sovereign Wealth Fund (SWF) did not bring any tangible results even though it was technically solid. So far, no consensus exists within the political class of Mongolia around the need for a more responsible fiscal policy. Short-term political priorities have overwhelmed the efforts of Ministry of Finance officials and other reform champions to support prudent fiscal management. According to the recent IMF assessment, budgeting is still pro-cyclical and Mongolia’s fiscal framework remains unsustainable (IMF 2012). By contrast, the experience of **Chile** (see box 3.1) emphasized the critical role of the consensus among the political elites with respect to the importance of saving resource rents.

Compared to Kazakhstan and Mongolia, the macroeconomic and fiscal performance of **Zambia** has been less affected by the latest commodity price cycle. For most of the review period, the budget benefitted only marginally from copper price gains because of the prevailing contractual arrangements with mining companies. Zambia did not enjoy much relaxation of its budget constraints, but instead (in the early part of the last decade) became a beneficiary of debt relief (the Highly-Indebted Poor Countries [HIPC] and the Multilateral Debt Relief Initiative), which introduced a framework for subsequent fiscal adjustment, as well as giving an additional impulse to PFM reforms. Following the HIPC completion, Zambia steadily improved its overall fiscal balance and reduced its domestic borrowing requirements between 2005 and 2012. However, the specific fiscal adjustments targets, supported by the Bank, were only partially achieved. Moreover, after the completion of the series of budget support operations (Poverty Reduction Support Credits, 2008–10), the trend toward a decline in budget arrears has reversed, raising concerns about the sustainability of the earlier adjustment. The expansion of Zambia’s fiscal envelope, driven by the recovery in copper prices and changes to the taxation regime, has been accompanied by signs of weakening fiscal discipline, for example, significant external borrowing on commercial terms; a tripling of the share of public investments in relation to gross domestic product (GDP); and a significant increase in government salaries. Although the Bank shifted the focus of its program away from fiscal sustainability, it still proposed guidelines for the use of

additional resource flows from mining, and advocated the creation of a sovereign wealth fund. This reflected the government's intention at the time to put in place a windfall profit tax and unilaterally abrogate the agreements with the mining companies. The government subsequently reversed its strategy, and revenues from mining expanded only modestly, thus diminishing political support for the establishment of a SWF. Recent growth in mining revenues and the government's plans for budget expansion suggest the need for the Bank to resume its advocacy for a rules-based framework for managing resource flows in Zambia.

Box 3.1. Consensus Matters: The Evolution of Chile's Fiscal Rule

Throughout its history, Chile witnessed significant episodes of macroeconomic instability and high levels of inflation due to its vulnerability to external shocks. These past developments gradually created a consensus for conservative macroeconomic and fiscal policies among the main elements of the political spectrum, and have positioned Chile as a role model for macroeconomic management and sound fiscal discipline.

In the mid-1980s, Chile created the Copper Stabilization Fund to limit public spending at levels determined by what was considered to be the long-term price of copper. The Copper Fund served the country well during the 1997–98 Asian Financial Crisis, when the authorities withdrew \$200 million from the fund to finance some counter-cyclical expenditures. In 2001–02, President Ricardo Lagos put forward a self-imposed fiscal rule (not initially enshrined in law), to demonstrate that a left-center socialist government could be fiscally responsible. The fiscal rule was based on a structural balance rule with the objective of designing a fiscal policy with a medium-term perspective that would also isolate government revenues from copper price fluctuations, from fluctuations in activity due to the business cycle, or any other fluctuation in aggregate demand that would lower the level of activity below potential output. The rule set public expenditures in accordance with the long-term revenue projections based on the expected world prices of copper.

The fiscal rule later incorporated an adjustment to account not only for the price of copper, but also for tax revenues as influenced by fluctuations in overall GDP with respect to a trend GDP (to incorporate non-copper taxes). The fiscal rule was formalized in 2006 through a Fiscal Responsibility Law, creating two independent sovereign wealth funds: the Pension Fund (to cover increased liabilities expected for old-age benefits) and the Stabilization Fund (to accumulate resources when copper prices were above the trend and allow for a counter-cyclical fiscal policy when prices fell below the trend).

Chile's fiscal rule performed an important function during the 2000s. The sharp increase in world copper prices generated an enormous fiscal surplus that accumulated in the sovereign funds (the surplus was 7.5 percent of GDP in both 2007 and 2008). In 2008, the world price of copper hit an all-time high and, at the same time, the popularity of then-President Michele Bachelet hit a low of around 40 percent. The main reason was that she did not spend the income pouring into the country from commodity exports as many Chilean citizens wanted. One year later the global recession arrived and copper prices crashed. However, funds saved during the good times provided the cushion needed to maintain a steady fiscal policy that tempered the downturn. Bachelet's popularity rose to nearly 80 percent. The savings generated during that period allowed the government to implement a strong counter-cyclical fiscal policy at a later point during the global crises of 2009. A large part of the resources drawn from the Stabilization Fund allowed financing of bonuses (direct unconditional transfers) for the bottom 40 percent of the population. It also helped to contain any pressures for an overshooting of the exchange rate during the crisis.

CHAPTER 3

MANAGEMENT OF RESOURCES

Since the global crises, the formula and the system have become more refined in terms of how domestic taxes can influence the rule, as reflected in increased transparency of the governance of the funds (for example, by using both domestic and external advisors), and the eventual establishment of an Advisory Fiscal Council. The primary function of the council is to advise, assess, and evaluate the fiscal stance in both the short- and long term and oversee the execution of the fiscal rule. The legal status of the council is still under discussion.

An interesting finding in relation to the fiscal rule and its utility in other contexts came out in interviews conducted by the Independent Evaluation Group (IEG). In terms of transferring the Chilean experience with its fiscal rule elsewhere, many interviewees believed that for the rule to be credible it is necessary for a country to have had a prior positive track record of good fiscal behavior (several years of sound budget accounts) prior to its legal imposition. A much less successful experience with the fiscal rule in Mongolia (adopted by the Parliament, but never really followed) supports this point.

Sources: World Bank Group; IEG.

The Bank's macroeconomic dialogue with the government of **Bolivia** has been limited. The government of Bolivia managed the latest commodity cycle very successfully by following a conservative and largely counter-cyclical macroeconomic policy, with minimal input from the Bank. Since 2006, the government has followed policies of fiscal restraint and unhurried extraction of mineral wealth. The country achieved solid fiscal and current account surpluses, growing international reserves, and reduced public debt. Growth in budget spending was considerable, but generally well controlled in light of major increases in budget revenues. As a result, as noted by the recent IMF Article IV report, Bolivia's macroeconomic situation has become robust and it is well positioned to withstand short-term economic shocks. From this perspective, Bolivia could be compared to Kazakhstan. The main difference is that Bolivia's policies were designed by the government, with limited advice from international development institutions, including the Bank. Further, its policies were not anchored in formal institutions (such as fiscal rules and a Stabilization Fund) that could help to ensure longer-term sustainability. Recent fiscal restraint seems to depend on the discretion of the top leadership (President and Minister of Finance). Moreover, there has been a concern regarding growing fiscal pressures as the government's traditional allies, including labor and indigenous groups, have been pushing for larger participation in gas proceeds, increases in pensions, fuel subsidies, and so on. In this context, a relevant lesson from the **Botswana** experience is that, absent formal restraints, the discipline in fiscal policy-making tends to soften over time at both the project (costing of projects) and the macro (commitment to fiscal rules) levels (World Bank 2010). Botswana has also experienced the erosion of the Ministry of Finance's authority in coordinating the budget process. Over the longer term, diamond rents have led to an over-expansion of the government. This is particularly apparent in terms of its distortive effect on the labor market. The government's wage bill is high by international standards and, combined with subsidies and transfers, accounts for about 50 percent of total

expenditures, thereby limiting room for fiscal policy flexibility and pushing up labor costs for the private sector.

REFORMING PUBLIC FINANCE MANAGEMENT

Strong macroeconomic and fiscal discipline does not necessarily guarantee efficient use of budget resources at the level of public service delivery. This underlines the need to develop good national systems of expenditure allocation and use. For example, **Botswana's** failure to modernize its PFM system in line with changing country needs has been the primary cause of declining productivity of public investments over the past 20 years, resulting in a disparity between budget spending and development outcomes. While public spending in Botswana is high for a middle-income country (MIC), the country ranks below other MICs in social indicators. Nearly a quarter of Botswana's public spending goes to education – significantly more than in comparator countries, yet with similar, or even worse results.

During the review period, the Bank made a significant and consistent effort to help all four CPE countries to improve their PFM practices. The Bank's strategies consistently emphasized the strengthening of the legal and institutional framework for PFM, improving budget accounting and reporting, introducing a medium-term expenditure framework (MTEF), advancing procurement reforms, rationalizing expenditure allocation, and modernizing debt management and internal control and audit. The Bank's core analytical work (Public Expenditure Review, Public Expenditure Management and Financial Accountability Review, and Public Expenditure and Financial Accountability) was of high quality. However, the actual follow-up on Bank policy recommendations in the PFM area was rather selective, and the reforms initiated with the Bank's assistance often remained incomplete.

There is clearly a positive trend toward strengthening national PFM systems, but more remains to be done. The PFM systems in **Mongolia** and **Zambia** remain weak despite many years of engagement, as is domestic ownership for further reforms. Moreover, in all cases, and especially in **Kazakhstan** and **Mongolia**, progress on the legislative and regulatory side has been stronger than actual policy adjustments. Some of the recent capability improvements remain underused, and those improvements have not yet brought many tangible benefits.

Individual achievements in **Zambia** have not resulted in an effective modernization of the entire PFM system. The government moved selectively, and mainly in the areas that do not challenge strong vested interests. Whenever a change posed a risk to the status quo, the implementation slowed down (Integrated Financial Management and Information System) or stopped completely (decentralization). The absence of commitment to comprehensive PFM reform means that even if there is progress under

CHAPTER 3 MANAGEMENT OF RESOURCES

one PFM component, inefficiency and rent-seeking gravitate to other parts of the government program. It is therefore likely that in the event of a sizeable increase in government revenues in Zambia, their productive use will be hampered by the current institutional arrangements and incentives.

In the area of PFM legislation, the Bank has made a major contribution to a complete overhaul of the legal and regulatory framework for budgeting and expenditure management in **Mongolia**. However, implementation of these laws has lagged in many areas, such as controlling the pace of budget expansion and increasing the transparency of spending.

In the area of revenue management, including tax and customs administration, the Bank's program in **Kazakhstan** has been an important success story. In 2007–09, the government implemented most of the changes recommended by the Bank on both tax policy and administration. This was accompanied by a significant improvement in revenue performance, boosted by higher oil revenues. Kazakhstan's progress on tax administration was even more impressive.² There was an important synergy in this area, where high-quality analytical work was complemented by successful investment projects in tax and custom administration. However, except for **Mongolia**, none of the four CPE countries engaged with the Bank on the core policy choices about commodity taxation (oil, gas, copper). Instead, they sought advisory support elsewhere, including from the private sector.

The Bank remained largely disengaged in the dialogue on tax policy and administration in **Zambia**, where public revenues underperformed during the price boom relative to most other mining exporter countries. The Bank team decided not to advocate adjusting the existing mining agreements that had become increasingly inadequate as copper prices reached record highs after 2004. In retrospect, the Bank could have done more to promote a consensus between the government and industry regarding a coordinated shift towards higher taxation levels and better public services, regulation, and infrastructure for investors. Moreover, the Bank could have started earlier in strengthening the capacity of the Ministry of Finance to analyze mining company accounts and identify the inappropriate use of transfer pricing and depreciation allowances.

In the area of budget formulation and planning, the Bank emphasized relatively advanced concepts such as results-based budgeting (RBB) and a medium-term expenditure framework. Their implementation proved difficult, even in the relatively high-capacity public sector environment of **Kazakhstan**. Despite various improvements in the legal framework for RBB in Kazakhstan, the government budget planning practices remain excessively complex, with too many simultaneous plans required at

each level. In **Mongolia** and **Zambia** there was also only partial progress with MTEF implementation (as could be seen by the drastic expansion of fiscal envelopes in both countries recently), notwithstanding much effort by the Bank and its donor partners.

In the area of budget execution, accounting and reporting progress has been slow and often disappointing in both **Mongolia** and **Zambia**. However, more than a decade of efforts has started to show results. The modern government financial management information systems (GFMIS) have been at the center of their programs. In **Mongolia**, the rollout of the GFMIS to all local governments represented the single most important achievement of PFM reforms to date. In **Zambia**, the GFMIS, supported by the Bank's public sector management projects, also became an institutional platform for strengthening government capacity in budget control and execution, and in public access to information.

In **Kazakhstan**, following Bank advice, the government upgraded its capacity for public debt management, including the development of the Government Debt Management Strategy. At the same time, progress on strengthening the oversight of state-owned enterprise debt in Kazakhstan has been lagging. In **Bolivia**, the Bank also provided advice on the public debt management system when the government made the transition to a blend International Development Association (IDA)/International Bank for Reconstruction and Development status.

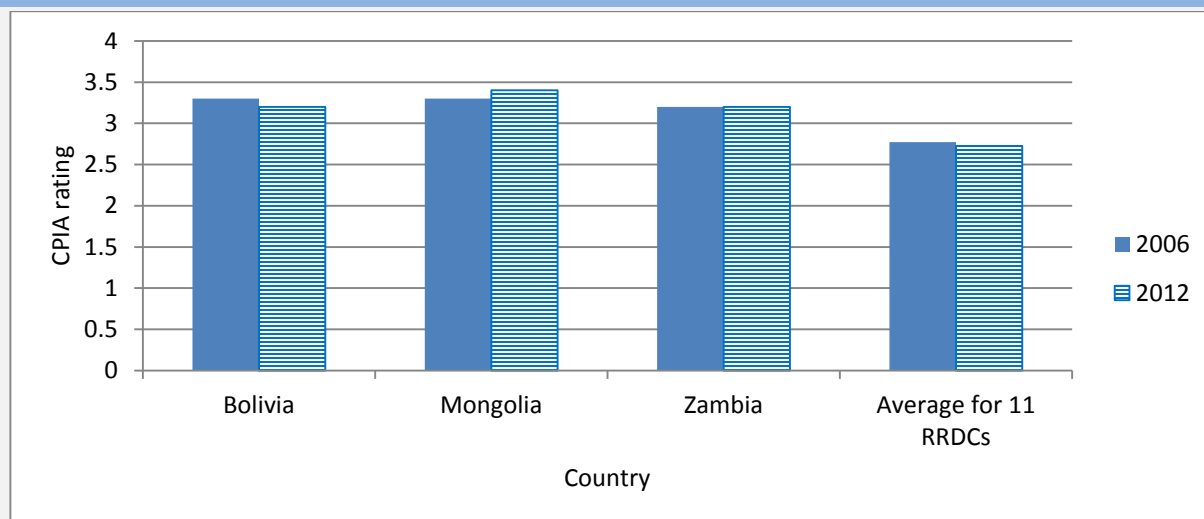
While each individual PFM project in this group was only modestly successful at best, the strategy of long-term engagement has been gradually bearing fruit. IEG project-level reviews questioned the appropriateness of the Bank's approach to PFM-related lending in both **Mongolia** and **Zambia**, arguing that the systems that were supported were too complex and ambitious, and that an alternative strategy of consolidating the "basic" systems first could have been more appropriate in a low-capacity environment (Wescott 2008). When viewed over a decade, however, one can see how the accumulation of small, gradual changes has brought about substantial achievements by greatly expanding the capabilities of respective government agencies. The strategy of long-term sustained engagement has paid off in the end, albeit somewhat later than expected.

STRENGTHENING GOVERNANCE AND ACCOUNTABILITY ARRANGEMENTS

The governance and accountability agenda has been high on the list of Bank program priorities in all four countries. The most popular themes included: (i) support for broad anticorruption initiatives; (ii) strengthening external audit and parliamentary oversight; and (iii) supporting the EITI. Actual progress has been rather limited and slow, compared to the fiscal sustainability and PFM subsectors. Despite regular issuance of high-level statements, none of the four countries has pursued an ambitious program of

governance reforms. Indeed, actual commitment to confront vested interests has been weak.

Figure 3.1. CPIA Rating for the Quality of Public Sector Management and Institutions, Cluster Average, 2006 and 2012

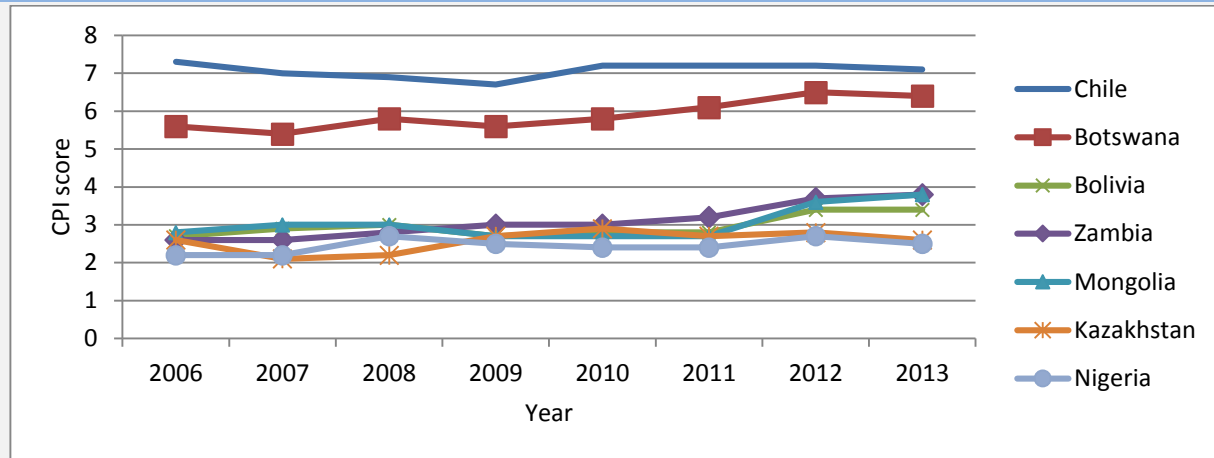


Source: CPIA/World Development Indicators Database.

Note: 1 = low rating; 6 = high rating. CPIA = Country Policy and Institutional Assessment; IDA = International Development Association; RRDCs = resource-rich developing countries. The average is estimated for a sample of 11 low-income RRDCs (IDA recipients) that includes: Angola, Bolivia, Cameroon, Chad, the Democratic Republic of Congo, Mongolia, Nigeria, Papua New Guinea, Sudan, Timor-Leste, and Zambia.

A general measure of institutional quality, the Country Policy and Institutional Assessment rating for the quality of public sector management and institutions, did not show any real improvement between 2006 and 2012 in **Bolivia**, **Mongolia**, and **Zambia** (figure 3.1).³ While their ratings are higher than the average for the peer group of 11 resource-rich IDA recipients, in absolute terms, the ratings remain quite low, that is, below 3.5 on the 6-point scale. These three countries, however, have done better on the Transparency International's Corruption Perception Index (CPI). Their CPI ratings improved over the last decade, especially after 2011 (figure 3.2), albeit from a low level. The "corruption perception gap," relative to countries with stronger institutions, such as **Botswana** and **Chile**, remains significant. According to Transparency International, much of these recent improvements should be attributed to the strengthened legal framework and capabilities to investigate and prosecute corruption cases. Much less progress was recorded with respect to strengthening government accountability institutions. In **Kazakhstan**, in contrast to the other three countries, corruption perceptions did not improve at all between 2006 and 2013, and remain poor – at a position of 140 out of 177 countries rated.

Figure 3.2. Corruption Perception Index Scores for Selected Resource-Rich Countries, 2006–13



Source: Transparency International.

EITI (see box 3.2) has been used by the Bank Group as an important instrument for improving governance and institutions in the extractives sector in three countries – Kazakhstan, Mongolia, and Zambia (see table 3.1).

Box 3.2. World Bank Group Engagement with the EITI

In the late 1990s and early 2000s, there was an increased interest and debate around the “resource curse.” There was recognition that the huge potential benefits of oil, gas, and mining were not being realized in many developing countries, and were instead linked with increased poverty, conflict, and corruption.

The Extractive Industries Transparency Initiative (EITI) was launched in 2002 at the World Summit on Sustainable Development in Johannesburg. It is a multi-stakeholder initiative to encourage governments, companies, international organizations, civil society organizations (CSOs), and others to work together voluntarily to develop a framework to promote the transparency of payments and revenues. The initiative was grounded in a shared belief that the EITI could help address the paradox that two-thirds of the world’s poorest people live in countries that are rich in natural resources, that is, they are impacted by the resource curse.

The World Bank endorsed the EITI and established the Multi-Donor Trust Fund (MDTF) for EITI in 2004 as a global partnership to harness donor resources to develop and broaden the EITI process. The objective of the MDTF–EITI was to increase the transparency of payments made by industry and revenues received by host governments from oil, gas, and mining production. The underlying rationale was that it would help reduce poverty in resource-dependent countries by addressing the resource curse. To date, the MDTF has disbursed around \$60 million in technical and financial assistance to EITI programs in 37 countries.

Source: World Bank Group and EITI.

CHAPTER 3
MANAGEMENT OF RESOURCES

Table 3.1. Selected EITI Report Indicators, 2005–11

Country	2005	2006	2007	2008	2009	2010	2011
Kazakhstan							
Sectors covered	Oil	Oil, gas, mining	Oil, gas, mining	Oil, gas, mining	Oil, gas, mining	Oil, gas, mining	Oil, gas, mining
Number of reporting companies	38	103	108	109	123	164	170
Mongolia							
Sectors covered	NA	Mining	Mining	Mining	Mining	Mining	Mining
Number of reporting companies	NA	35	38	36	76	264	200
Zambia							
Sectors covered	NA	NA	NA	Mining	Mining	Mining	Mining
Number of reporting companies	NA	NA	NA	16	28	20	26

Source: Extractive Industries Transparency Initiative (EITI).

Note: Bolivia is not yet a member of EITI; NA = not available.

Kazakhstan became fully EITI compliant in 2013, Mongolia in 2010, and Zambia in 2012. The EITI process has been quite successful, especially in Kazakhstan and Mongolia, where it has helped to set up new national standards for accountability and disclosure of resource-related revenues, and served as an instrument of empowerment for local civil society groups. In Bolivia the government showed no interest in EITI, despite several overtures from the Bank.

In **Kazakhstan**, the Bank’s technical assistance for EITI was seen as a critical input for building local capacity and enhancing the credibility needed to sustain a multi-stakeholder process. It has begun to broaden citizen participation in governance issues at both the national and local levels. The EITI process may have encouraged the Ministry of Finance to improve the disclosure and accessibility of budget information. Indeed, Kazakhstan’s Open Budget Index has improved from 35 (below average) in 2008 to 48 in 2012, which is higher than the average for the 100 countries surveyed. By many accounts, even prior to Kazakhstan’s achievement of EITI compliance, the EITI process enabled more concrete and practical debates between CSOs, government, and industry around various important hot topics. Similarly in **Mongolia**, the EITI program contributed to revenue management by improving the mining industry’s compliance with applicable taxes. It demonstrated the feasibility of the multi-stakeholder approach to promoting a public policy agenda and facilitated opportunities for CSOs to get

involved in other priority areas, such as budget monitoring and environmental management. In **Zambia**, Bank support to EITI helped to broaden public access to information on mining revenue flows and strengthened the demand side of reforms by building a local nongovernmental organization (NGO) coalition, but the benefits of this have been less than expected. Although the EITI process in Zambia produced considerable evidence of mining companies being systematically under-taxed, the government was slow to act on these findings.

Outside of the EITI, the Bank's efforts to promote accountability and stronger governance were rather fragmented, often explained by insufficient interest from the clients. In **Kazakhstan**, the Bank provided TA in specific technical areas (Accounting Committee, transition to International Public Sector Accounting Standards, and so on). However, there is no evidence of a comprehensive anticorruption program, which was one of the CPS targets. Similarly, in **Bolivia**, supporting governance and public institutions was a key component of Bank Group strategies throughout the evaluation period, but with sharply declining intensity of engagement because of a lack of interest from the authorities. Since 2008, the Bank drastically downsized its involvement in the governance area in Bolivia. In **Mongolia**, the Bank's primary vehicle to pursue accountability objectives was investment lending to strengthen PFM, as discussed in the previous section. Bank projects also supported reforms in public sector accounting, auditing, and budget monitoring – but all remain far from complete. For instance, whereas the timing of external budget audits has improved, the findings are not regularly made public. Moreover, the recent quasi-fiscal programs administered by the newly established Development Bank of Mongolia (DBM) have raised concerns about extra-budgetary spending. The DBM disbursed large amounts of project financing with limited parliamentary oversight, and without being subject to regular government procurement procedures. In **Zambia**, the Bank's strategy was similar to Mongolia, with a significant emphasis on improved functionality and coverage of GFMIS and associated benefits. In addition, the Bank's interventions may have helped empower new constituencies to push for further reforms in budget transparency and accountability, such as the Office of the Auditor General and the NGO community. However, inadequate ownership of reforms is constraining full use of newly upgraded capabilities. For instance, the improved quality of the annual budget audit did not bring tangible accountability benefits, as there was little interest among the political elite to act on the findings of the Auditor General's reports.

Stimulating local demand for stronger government accountability was a particular area of weakness in the Bank's programs under review. This was especially the case in Kazakhstan (outside of the EITI process) and Bolivia, where the Bank has tried to position itself as a trusted advisor to the government, while limiting its engagement with nongovernmental groups. The Zambia program achieved the most traction in this

CHAPTER 3 MANAGEMENT OF RESOURCES

area, but even there the Bank was slow to start supporting demand-side interventions. In Mongolia, the Bank has gradually expanded its efforts to reach out to parliament and civil society organizations to broaden the understanding of risks associated with mineral resource revenues and to support public demand for good governance.

Conclusions

The World Bank is well-positioned to assist RRDCs in implementing policies and institutions that promote macroeconomic and fiscal sustainability, as well as in helping these countries establish a track-record of counter-cyclical policies. Further, it would be important to undertake an analysis to develop realistic contingency plans for dealing with price downturns. Fiscal rules proved to be useful in this regard. However, even in the absence of such rules, the Bank could systematically monitor and analyze performance and provide governments and the public with this information, as well as with information on the performance of key comparator countries.

Policy consensus across the political spectrum, including full recognition of the need to save part of resource rents over the commodity cycle, is a critical ingredient for success in the sustainable management of commodity revenues. When such consensus is lacking (for example, in **Mongolia** and **Zambia**), the countries will remain exposed to the risks of the resource curse, despite efforts by the Bank Group and development partners. Wide dissemination of the Bank's analytical work findings and engagement of local players in their preparation can be powerful tools for strengthening local ownership of reforms. Bank Group support for the EITI process in three of the countries was an effective demand side instrument, and a visible platform for CSOs to discuss and demand transparency and accountability from government and industry officials.

Bank instruments for delivery of PFM support were largely adequate. There has been an important synergy in promoting key program objectives through the simultaneous and complimentary use of budget support and investment lending backed by up by high-quality analytical work. In **Mongolia** and **Zambia** (and to a lesser extent in **Bolivia**), the Bank delivered the core part of its capacity building support through a programmatic approach. Although individual TA projects within these programs have been seen as only modestly successful (largely due to their overambitious design) over the whole period of 10+ years, these programs managed to deliver significant improvements in core RM capabilities. This underlines a clear benefit associated with continuity and consistency of engagement with clients on PFM reform issues. The policy areas that may require further attention include: taxation of resource rents; stimulating local demand for PFM reforms; and country-specific sequencing of

interventions in the core PFM systems so as to reflect more accurately the prevailing capacity constraints.

References

IMF (International Monetary Fund). 2012. *Macroeconomic Policy Framework for Resource-Rich Developing Countries*. Washington, DC: IMF.

Wescott, C. 2008. *World Bank Support for Public Financial Management: Conceptual Roots and Evidence of Impact*. Washington, DC: World Bank.

World Bank. 2010. *Botswana – Public Expenditure Review*. Washington, DC: World Bank.

— — —. 2012. *Rents to Riches? The Political Economy of Natural Resource-Led Development*. Washington, DC: World Bank.

¹ Over the period of 2002–08, Kazakhstan ran budget surpluses averaging 2.5 percent of gross domestic product. During the 2008–09 crises, the government used oil savings to finance a program of fiscal and monetary stimuli estimated at \$17 billion. This helped to smooth the overall effect of the global crisis on the Kazakh economy and supported rapid recovery in 2010–11. The program of budget support was duly downsized as soon as the worst of the crisis was over. As of early 2014, the government has accumulated savings of over \$40 billion in its oil fund.

² Kazakhstan moved from the 66th position in 2007 to 18th in 2014 on the global ranking for Ease of Paying Taxes (a component of the Doing Business rankings).

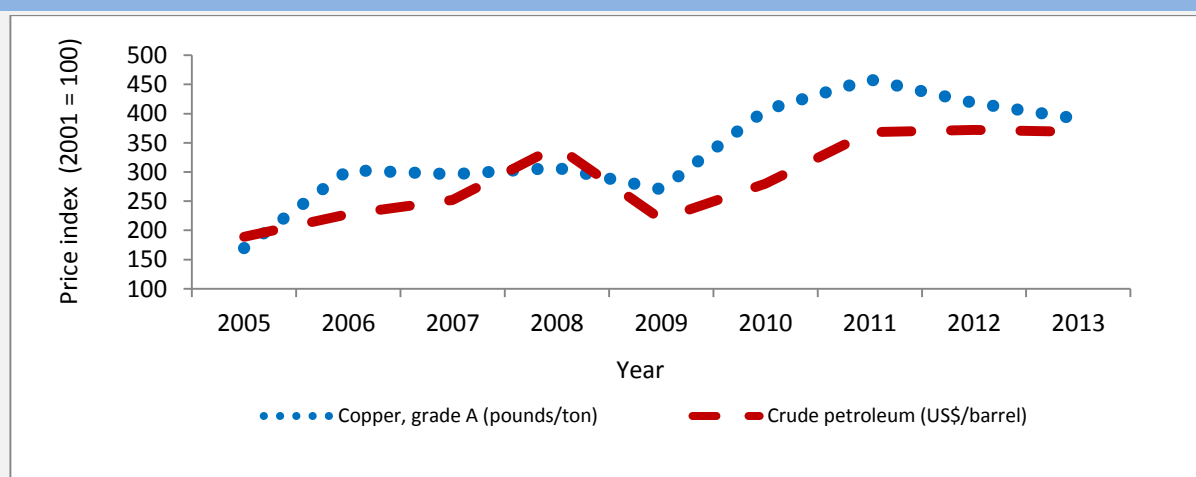
³ Country Policy and Institutional Assessment ratings for non-International Development Association countries, such as Kazakhstan, are not public information.

4. Economic Diversification and Nonextractive Growth

Diversification of the economy and broad-based economic development are critical for the long-term sustainable development in resource-rich developing countries (RRDCs) for two reasons. First, the high level of export concentration makes these economies vulnerable to commodity price fluctuations (figure 4.1) that can result in abrupt contraction of public resources and/or create a negative spillover effect in the rest of the economy. Second, extractive sectors are generally capital intensive, have weak links to the rest of the economy, and, as a rule, do not generate much employment. Therefore, investments in these sectors and their expansion have a low impact on the growth and productivity of other industries leading to a high concentration of gross domestic product (GDP) and a low impact on job creation.

Resource-dependent countries, however, face a number of challenges in achieving economic diversification. Fast growth in export revenues from resource extraction is invariably accompanied by exchange rate appreciation pressures, or the so-called Dutch Disease, that reduces competitiveness of other traded sectors of the economy (figure 4.2). Three of the four case study countries suffered from this phenomenon over the last decade, albeit to a varying degree and with fluctuations linked to resource revenues. To counteract the Dutch Disease, countries need to increase productivity and promote investment in nonextractive sectors to spur their growth.

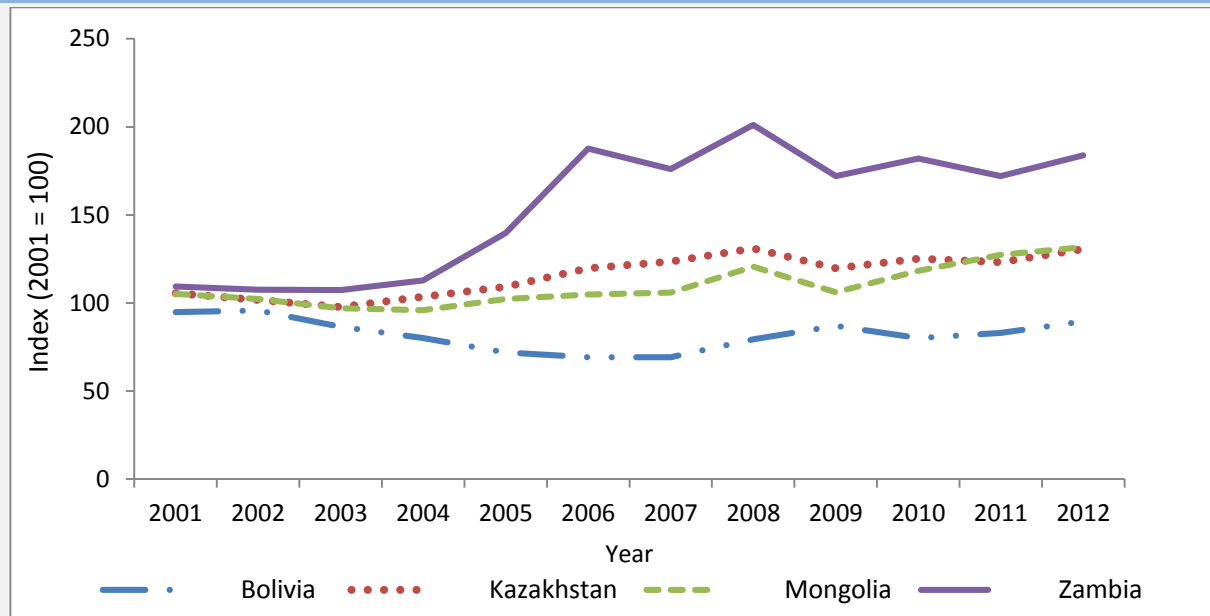
Figure 4.1. Price Index of Selected Commodities, 2005–13



Source: United Nations Conference on Trade and Development Database.

Note: Copper, grade A, electrolytic wire bars/cathodes, London Metal Exchange; crude petroleum average of UK Brent (light)/Dubai (medium)/Texas (heavy) equally weighted.

Figure 4.2. Real Exchange Rates, 2001–13



Source: United Nations Conference on Trade and Development Database.

There is no clear consensus about measures that are necessary to achieve economic diversification, but a few general principles are widely accepted. First, investments in infrastructure—for instance, improving a poor road network and lack of access to power—are often the most critical constraints for growth in many developing countries. These investments are important for reducing the cost of doing business and improving competitiveness. Second, support for agriculture: despite increasing reliance on resource rents, agriculture is often still the sector that employs the largest share of the labor force (32 to 40 percent in **Bolivia**, **Mongolia**, and **Kazakhstan**, and a reported high of 72 percent in **Zambia**). It faces pressures both from the exchange rate appreciation as well as from increasing mechanization as wages are pushed up. Improving agricultural productivity and commercialization, and linking producers to markets are among some of the important measures in this regard. Examples of countries such as Chile and Malaysia confirm the proposition that a healthy rural economy is also important for industrialization because of the linkages between the two. Third, it is important to promote private investment in the nonextractive sectors through improving the business and regulatory environment, providing better access to finance, and supporting entrepreneurship and skill development (see box 4.1). Many governments have also attempted a proactive industrial policy through a system of targeted subsidies and incentives. The efficacy of such measures has generally not proven to be high. Chile provides a good example, whereby the government—while being very particular about the fundamentals (macroeconomic stability, fiscal discipline and business climate conducive for investment)—did not pursue an “industrial policy” approach. Rather, it

encouraged a wide array of small-scale experimentation, with broad participation of nongovernmental organizations (NGOs) and the private sector (box 4.1).

Box 4.1. Chile's Innovation and Entrepreneurial Ecosystem

Background: Although copper remains the main export item (47 percent of total exports amounting to 12 percent of GDP), and an important source of revenue in Chile, non-copper exports have expanded significantly, particularly in renewable natural resources (for example, fisheries, forestry, and agriculture). This expansion is generally attributed to favorable exchange rates in the 1970s and 1980s, and improved policies (open trade, an increased use of Free Trade Agreements, and expansion of public infrastructure). The introduction of the fiscal rule has had a positive influence on these exports by providing a minimal predictability of the exchange rate path, in spite of fluctuations in the price of copper. It has been a critical factor because of the long maturation period for many of these exports (agriculture). Chile has also diversified its export markets to reach East Asia and Europe. Overall, there is an increased awareness of the importance of innovation to growth and a desire to move toward a more diversified and knowledge-based economy.

Chile's National Innovation System: The institutional set up for promoting innovation is rather simple and includes two main government bodies. The National Council on Innovation for Competitiveness (CNIC) advises the President on innovation policies, including the education of specialized human resources and development, and the transfer and diffusion of technology. It produced a strategy entitled "Towards National Innovation" (2007) which identified wide-ranging reforms and initiatives to be financed with the funds from copper royalties. The Ministerial Committee on Innovation is a policy-making body, which further articulates the innovation policies established by the CNIC, and executes and monitors their implementation. The budget of the National Innovation System grew from \$437 million in 2007 to \$1.037 billion in 2013.

Innovation and Entrepreneurship: Chile's success as a hub for innovation and entrepreneurship in South America has been aided by its business-friendly environment, and a large number of schemes and funds made available by the government, universities, foundations, NGOs, and others to encourage innovative and experimental activities in the non-mineral sectors. Many innovation efforts have used a "clustered," sector-specific approach, targeting vertical programs. During the mission to Chile, the evaluation team found that although there is broader support for horizontal programs, a few experts felt that the cluster approach should also be considered, at least at the experimental level, to the extent that such pilots are based on limited fiscal funding and co-financing from the private sector. Interestingly, so far, the most active and promising programs in this area were the ones supporting links to the copper sector, including suppliers (machinery and other technology) and consulting services.

Simultaneously, various other initiatives used horizontal approaches that try to encourage research and development (R&D) and commercialization independently of specific sectors. For example, there is an R&D tax credit for in-house projects. In 2013, the Ministry of Economy launched a portal that allows businesses to incorporate online in just one day. One of the most successful initiatives creating headlines all over the world and promoting awareness of Chile's own "Chilecon Valley" is the Start-Up Chile Program, launched in 2010 to attract e-commerce and information technology software ventures. With this program, the government provides a co-financing grant and a one-year visa to entrepreneurs from all over the world to develop their projects in Chile. Although the program is open to Chileans, most of the start-ups come from abroad. As of 2013, Chile has paid 1,567 entrepreneurs from 65 countries to launch 732 startups. The Chile-California Program was an important example of a successful mechanism for the transfer of "know-how" in agriculture. Through this program, the Ford Foundation funded the training of Chilean agronomists at the University of California-Davis. This led to

a number of successful initiatives, such as the introduction of new varieties of crops (for example, yellow corn) with the participation of university research centers.

Lessons Learned. The Chilean experience with developing nonextractive, export-oriented sectors proves that it can be a very long process that requires a long-term commitment to the fundamentals, such as maintaining a predictable and open trade regime, providing necessary public infrastructure, as well as being open-minded about experimenting, albeit on a small scale. The most visible success stories (wine, fruit, and salmon) are often country-specific and driven by *sui generis* geographic and historical factors, and hence hard, if not impossible, to replicate. At the same time, the Chilean experience shows that horizontal policies for promoting innovation and nonextractive growth – ensuring an even playing field, improving the business environment, providing non-distortionary incentives and complementarities, investing (small scale) in R&D together with the private sector, encouraging and facilitating links between various industries, including the extractives sector – can be quite effective. Such policies also may not require large fiscal commitments. In fact, the key word in Chile seemed to be “innovation” rather than “diversification.” Many initiatives on “innovation” were actually feeding off of the booming mining industry, providing services and technological solutions. Securing co-financing from the private sector was considered critical, and equivalent to passing the “market test.”

Three factors consistently emerge as key to promoting growth and innovation in nonextractives: (i) **getting the fundamentals right** (macroeconomic stability; control of inflation; an open trade policy; transparency and good governance; a conservative and countercyclical fiscal policy; a healthy banking sector; and an independent Central Bank); (ii) **investing in basic infrastructure** – roads, communication, and access to electricity and water; and (iii) **investing in people**, especially in education at all levels.

Sources: World Bank Group; IEG.

World Bank Group Strategies

The Bank Group strategy in two of the four case study countries – **Kazakhstan** and **Zambia** – explicitly had economic diversification as one of the key objectives. Diversification did not feature prominently in any of the country partnership strategies (CPSs) for **Bolivia**, but was implicit in the objective of “productive development and job creation.” In **Mongolia**, given its relatively recent arrival in the group of resource-rich countries, earlier strategies (2004–10) did not emphasize diversification and job creation; rather, the focus was on developing a suitable Bank Group engagement strategy in a rapidly changing macroeconomic situation linked to an envisaged significant increase in mineral revenues. The most recent CPS (World Bank 2012) has building a “sustainable and diversified basis for economic growth and employment in urban and rural areas” as one of its three objectives.

In each of the four countries, the approach to diversification largely followed the three-pronged strategy mentioned above, but with a significant variation in emphasis among the different components. The CPSs for **Kazakhstan** and **Zambia** had the most comprehensive approach in this area, and **Mongolia** the least. In none of the countries, however, was the objective quantified in the results framework, nor were there any mechanisms in place to monitor diversification. In essence, the strategies broke down

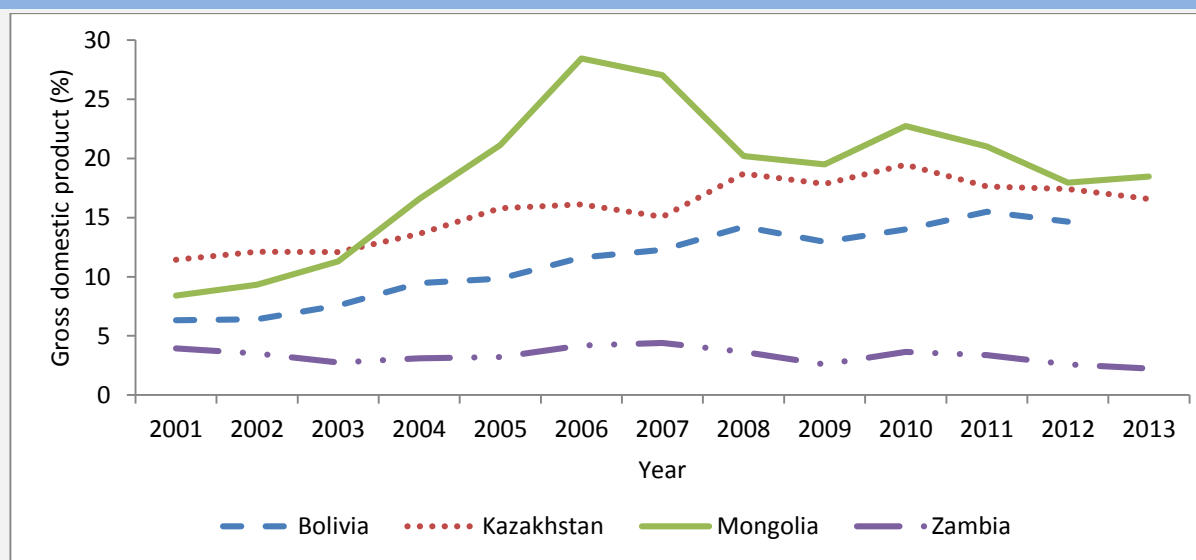
along conventional sector engagements: infrastructure, agriculture, and private sector development.

Outcomes and World Bank Group Contribution

The assessment of Bank Group programs in support of diversification is particularly challenging as none of the CPSs defined diversification beyond general statements or specified any indicators to monitor progress. Most indicators in the results frameworks tended to be at the micro level and had little relevance for measuring progress on the overarching objective.

The individual country program evaluations (CPEs) in this cluster tried (to the extent possible) using various other metrics for diversification – with all of them painting a somewhat negative picture. Using the share of extractives in GDP as the measure, indicates that economies of three out of the four countries are even more concentrated now than they were 10 years ago (figure 4.3). **Zambia** is an exception, but then mining and quarrying is still a much smaller part of its economy compared to the others. However, this measure could be misleading because with favorable price and volume trends, it may be inevitable that the share of extractives in GDP has increased.

Figure 4.3. Share of Mining and Quarrying in GDP, 2001–13

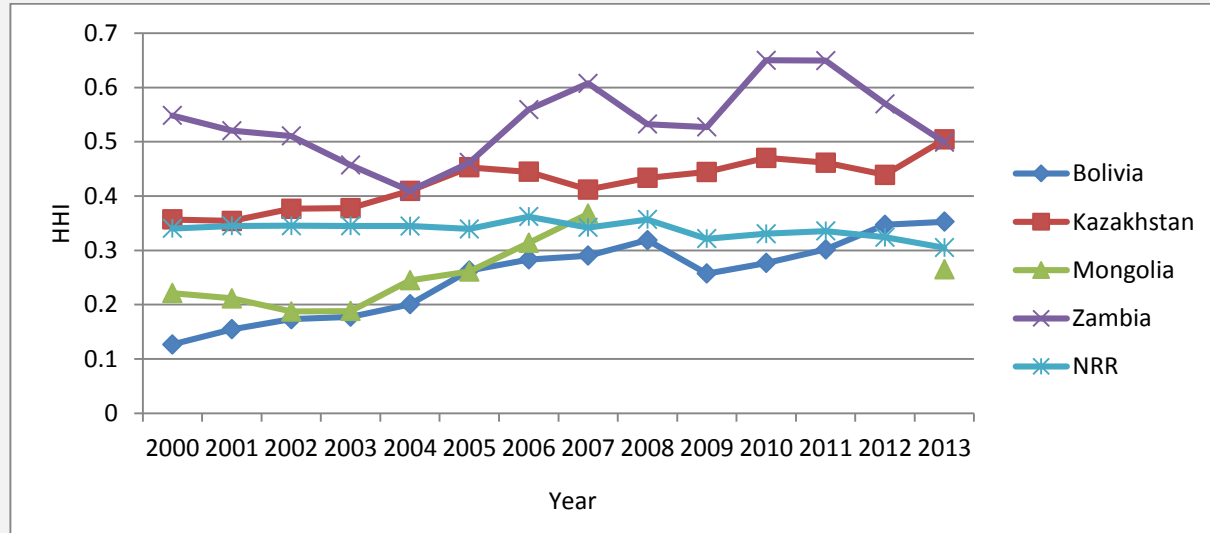


Source: World Development Indicators Database.
Note: GDP = gross domestic product.

Another perspective is provided by using the export diversification index. A commonly used measure is the Herfindahl-Hirschman Index (HHI)¹ that measures the extent of diversification of exports across industries. The lower the number, the less concentrated

the exports. By this measure, the concentration of exports in all four case study countries either remained the same or increased over the last 10 years (figure 4.4).

Figure 4.4. Average Herfindahl-Hirschman Index for Export Diversification

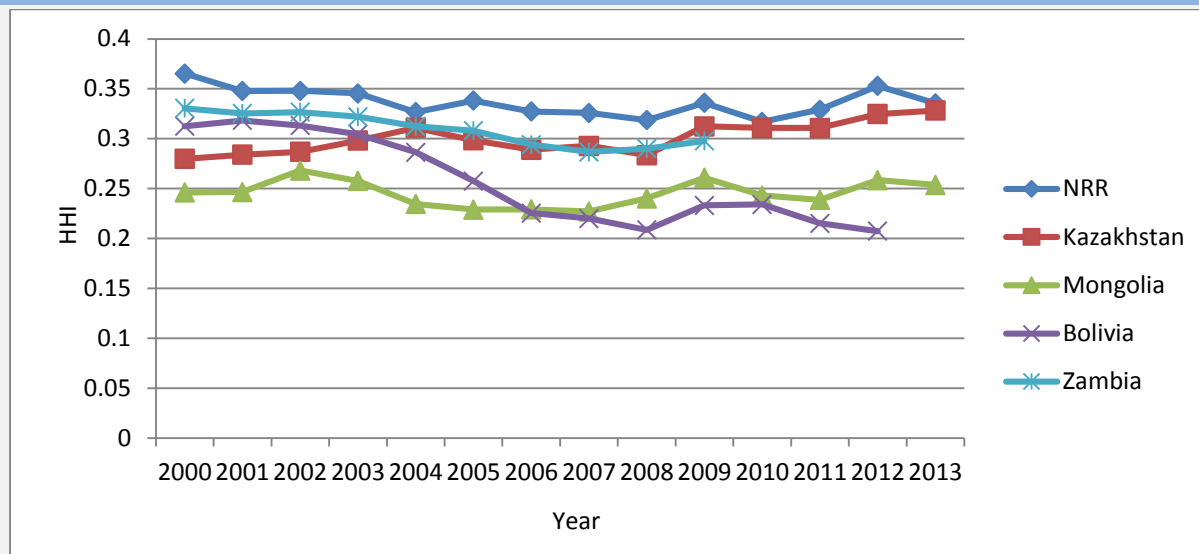


Source: World Development Indicators Database.

Note: HHI = Herfindahl-Hirschman Index; NRR = natural resource-rich countries.

This too could be an incomplete or misleading measure. Export concentration could become higher despite growth in other exports if extractive industries are growing particularly rapidly, or because of growth in other extractive-related industries (**Zambia**) or sectors that are not labor-intensive (all four countries). Therefore, it does not address the issue of job creation outside of the extractive industries that most policy makers prioritize and to which the Bank CPSs give most importance. In this case, it might be useful to look at diversification across the key sectors – mining and quarrying, agriculture, manufacturing, construction, and services. Again using the HHI as the measure, **Bolivia** and **Zambia** showed increased diversification since 2000 (figure 4.5). However, this measure also has a limitation in that there is no presumption that the composition of sectors in GDP is ideal. It could show improvement, for example, if the nontradable sectors are buoyant even while manufacturing and agriculture are stagnant.

Figure 4.5. Average Herfindahl-Hirschman Index for Domestic Economic Diversification

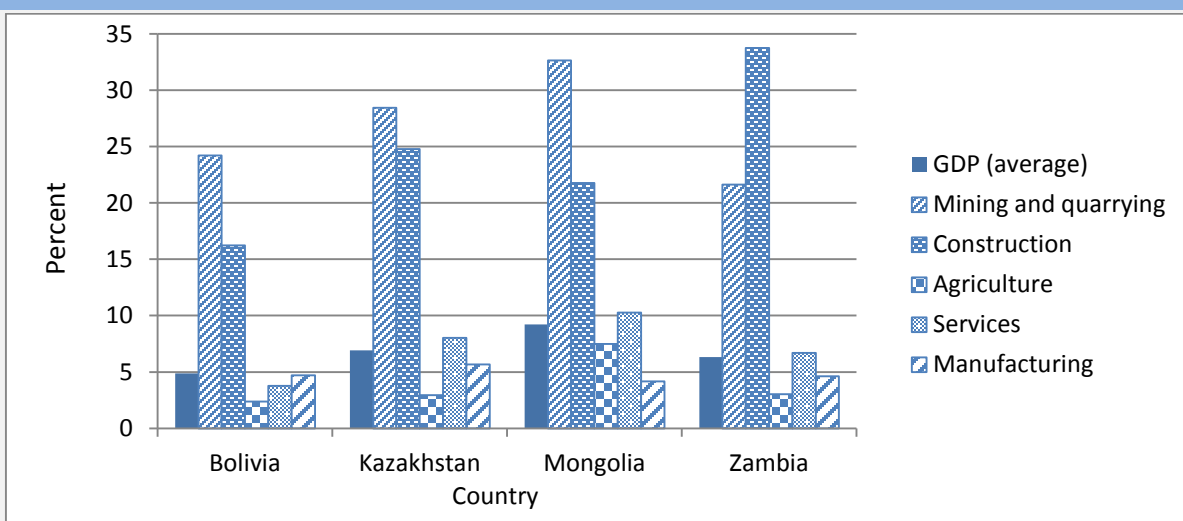


Source: World Development Indicators Database.

Note: HHI = Herfindahl-Hirschman Index; NRR = natural resource-rich countries.

Another possible measure is to look at growth over time in sectors that have the potential for job creation, including agriculture, services, construction, and manufacturing. The objective could be to aim for growth that is not too far below the overall GDP growth. This measure gives a slightly more nuanced picture (figure 4.6). In all four countries, GDP growth is driven largely by the extractives sector. Construction also experienced significant growth, probably linked to increased construction activity resulting from increased public and private investment in real estate. However, growth in manufacturing was anemic in most cases, with a mixed picture in agriculture.

Figure 4.6. Average Annual Growth Rates by Sector, 2004–13



Source: World Development Indicators Database.
Note: GDP = gross domestic product.

Ultimately, whatever the metric used, progress in economic diversification and growth in nonextractive sectors was limited during the review period. This has often spurred policy makers to pursue proactive promotional measures that can be costly, but whose efficacy has not been established.

Although diversification is widely seen as an important objective by the governments of resource-rich countries (and endorsed by the Bank in its country strategies), there is no full consensus on the subject in the literature. A recent Bank study (Gill and others 2014) argues that based on historical evidence from industrialized countries, diversification is neither necessary nor sufficient for economic development. Instead, it notes that the strategy for resource-rich countries should not be to aim for economic diversification, but rather to efficiently convert resource rents into physical, human, and institutional capital. However, in another recent Bank economic report for Kazakhstan (World Bank 2013), a “positive association between rising diversification and rising per capita incomes for countries which have per capita income of up to \$20,000” was noted. Nevertheless, its policy recommendations are consistent with those in the above-mentioned study. The Bank’s de-facto focus on infrastructure, agriculture, and private investments is consistent with this approach, and appears to be generally relevant. However, this review of the four case study countries also provides several nuanced lessons in each of the three areas that could be considered in the future design of country strategies for resource-dependent countries.

Sector-Level Outcomes and World Bank Group Contribution

INFRASTRUCTURE

Infrastructure features as a high priority in the development plans of all four countries. In part, this is because deficiencies in infrastructure were often cited as a major impediment to growth. In addition, infrastructure improvements are also often seen as a way for governments to demonstrate the tangible benefits of resource rents to their people. This approach was evident in Bank Group strategies in all four countries, with the greatest emphasis in **Zambia** and **Kazakhstan** and to a more limited extent in **Bolivia** and **Mongolia**, where infrastructure investments were framed more from equity rather than a growth perspective. Bank Group support was primarily for roads and power, the two infrastructure subsectors that are often the highest priority, with generally satisfactory outcomes (with the exception of the road subsector in **Mongolia**). Bank Group support was primarily in the form of World Bank lending and (limited) non-lending services. Except for some infrastructure-related investments in sectors such

CHAPTER 4 ECONOMIC DIVERSIFICATION AND NONEXTRACTIVE GROWTH

as telecom and gas, and a few aborted attempts to develop public-private partnership projects in **Zambia** and **Kazakhstan**, the role of the International Finance Corporation (IFC) in providing advisory services or offering long-term financing in infrastructure projects was minimal.

Roads. Within infrastructure, roads received the greatest focus, both for upgrading and expanding the network and for ensuring adequate institutional mechanisms for sustainable financing. The road sector was a major and sustained focus of Bank support in **Zambia** and **Kazakhstan**, providing examples of effective Bank interventions. Both countries have ambitious programs of upgrading and expanding their road networks. In **Zambia**, the Bank (jointly with other donors) helped finance road investments and the establishment of new institutions. Today, the sector structure is solid, even from an international perspective, although its efficacy in recent years has come under threat as the government faces increased political pressure to expand the network beyond what is considered to be economical and sustainable. In **Kazakhstan**, with funding of more than \$3 billion since 2009, the Bank is the single largest donor for the government's program to upgrade the Central Asia Regional Economic Cooperation corridors that pass through the country. Although Kazakhstan has ample resources of its own to finance the program, it invited the Bank to ensure sound program planning and execution. Bank involvement helped introduce stronger fiduciary and governance standards, upgrade the capacity of local contractors, and begin the modern maintenance practice of outsource contracting. The Bank also provided significant support for policy and institutional development in the sector.

Power. Increasing access to power was an important goal in all four countries, and all four faced the need for additional investments in power generation with the attendant growth of their economies. Like roads, power was a significant focus of World Bank programs in **Zambia** and **Kazakhstan**, with more limited support in **Bolivia** and **Mongolia**. The Bank promoted the conventional policy and institutional reform agenda: increasing access, improving operational and financial performance of sector entities, establishing tariff-setting mechanisms, and promoting competition. Overall, the CPEs assessed outcomes in all four countries as moderately satisfactory, but the impact of the Bank on the subsector was limited. In none of the countries was the Bank's role central to sector development. Bank support was more opportunistic than based on a medium- to long-term sector strategy.

IFC was largely absent from the sector, in part because of a lack of interest from the governments to promote private power on terms that would be attractive to potential investors. Similar to the road sector, there is a strong rationale for the Bank to support the power sector, given its critical importance. In this context, the Bank also has an established sector policy of promoting commercial operations and private participation.

However, Bank support for the sector was not central in any of the case study countries, indicating the need to find ways to broaden and deepen its support on a sustained basis. Unlike the roads sector, the power sector appears to elicit significant interest from other donors and private players.

AGRICULTURE

All four reviewed countries had an established tradition of and an untapped potential for agricultural development. The sector received significant support in all four countries through projects designed to improve rural farm and non-farm incomes, promote value added through agro-processing, and the creation of non-farm employment. However, the Bank's impact in agriculture was limited because it lacked a strategic approach based on sector policy dialogue, and it missed opportunities for scaling up individual project interventions. The outcomes of Bank programs were rated unsatisfactory in **Zambia** and **Kazakhstan** and satisfactory in **Bolivia** and **Mongolia**. However, the Bank's main focus in both **Bolivia** and **Mongolia** was much more on livelihoods and rural poverty alleviation rather than on commercialization and export agriculture – areas most relevant to diversification. In **Zambia**, despite significant potential in agriculture, the Bank initially did not give priority to the sector, although the pace of Bank support picked up in the second half of the evaluation period. IFC has only one investment – in the country's largest agro-processing company (Zambeef), and it did not pursue an active policy of promoting agribusiness more generally. Bank experience in **Mongolia** and **Bolivia** points to the complementarity of rural poverty alleviation and diversification, although a more explicit consideration of these two goals could have provided alternative designs for the interventions. IFC's work in **Bolivia** stands out as one of the few examples of a proactive IFC role in agriculture.

Overall, Bank support for agriculture did not have much impact in the sector for several reasons, including: complex project designs; insufficient sector work; and disparate projects in different areas that lacked synergies. Most importantly, individual projects reflected opportunistic financing rather than being based on a well-considered and agreed sector strategy.

PRIVATE SECTOR DEVELOPMENT

In all RRDCs, the primary target of private investors quite naturally is the extractives sector. However, the extractive sectors rarely generate much employment. Dutch Disease, combined with the typical obstacles to doing business act as barriers to attracting investments in nonextractive sectors. In addition, there are often insufficient linkages by extractive sectors with domestic industry in terms of supply chains and subcontracting. Thus, making nonextractive sectors attractive to private investors has been an important part of the Bank Group strategy in all four countries.

CHAPTER 4 ECONOMIC DIVERSIFICATION AND NONEXTRACTIVE GROWTH

Private sector development (PSD) was a specific area of Bank Group programs in all CPE countries, but with significant variation in emphasis with regard to the components. The Bank Group approach to PSD in all four countries can be divided into three components: (i) improving the business environment; (ii) promoting access to finance, particularly for small and medium enterprises (SMEs); and (iii) directing investments in sectors with greater employment potential. Within this broad framework, this was an area of shared responsibility between the Bank and IFC, with the Bank generally focusing on the business environment and IFC on investments. Regarding access to finance, the Bank generally focused on the broader financial sector issues, and IFC on making finance accessible to SMEs.

All four CPEs rated outcomes for PSD negatively. Two common reasons stand out in all countries: limited strategic thinking on PSD in general, and insufficient collaboration between the Bank and IFC, with often parallel and uncoordinated efforts, lacking consideration of relative comparative advantage and synergies. Instruments such as risk-sharing, guarantees, credit information, and so on, did not receive the attention necessary when the credit risk seemed to have been a bigger constraint than the availability of finance. IFC had a rather limited net effect in promoting investments in the nonextractive industries even though it made relevant efforts.

Business environment. Improving the business environment was a specific area of Bank focus in **Bolivia** and **Zambia**. In both countries, the Bank carried out significant analytic and advisory activities (AAA) work to influence government policies, but with little impact. In **Zambia**, the Bank funded a number of studies dealing with competitiveness issues. Based on extensive consultations with the public and private sectors, the studies identified the critical policy and institutional constraints to attracting private investments in specific subsectors. The studies, however, did not find much traction in the government, in part because each had a long list of similar recommendations without adequate assessment of sequencing and implementation. They also lacked ownership within the government. Further, there are questions about the utility of subsector analysis without addressing the broader issues of competitiveness affecting the entire economy. IFC's limited involvement in the sector studies was a missed opportunity: its experience in dealing with potential investors could have provided valuable inputs, and the Bank's work could have been exploited by IFC in its investment promotion efforts. IFC's work on the business environment was primarily related to regular updates of the Doing Business (DB) indicators. Despite formal improvement in DB indicators in three of the four case study countries, the Independent Evaluation Group observed a clear disconnect between the rankings and the actual perceptions of main participants and observers on the ground, including IFC staff, about the state of the business environment.

Access to finance by SMEs is often a challenge, and the four CPE countries were no exception. However, the financial sector in RRDCs did not have a liquidity problem, given the growing revenues from extractive industries. The main constraint to SME finance was not availability of financing, but access. The Bank's role, as noted, was to ensure the soundness of the financial sector, and the joint Bank-IMF Financial Sector Assessment Program proved to be a valuable instrument in this regard in all four countries. In **Kazakhstan** and **Mongolia**, the financial sector faced serious issues of significant non-performing loans (NPLs),² mainly caused by the construction and real estate bubbles generated during the commodity price boom years. In both countries, the Bank supported reforms in the financial sector through development policy loans that allowed the government to restructure and capitalize the troubled banks. It also provided technical assistance and policy advice to design and implement the reform programs. Bank policy advice was sound, but the problem of NPLs continues to linger.

In **Kazakhstan**, IFC supported the financial sector during the financial crisis in 2008 through the re-capitalization of the systemic banks, providing higher risk financial instruments of equity and subordinated loans to improve the capital adequacy of client banks. In other CPE countries, IFC focused on loans or short-term trade finance guarantees to commercial banks for on-lending to SMEs and agribusiness, as well as support for leasing. Experience with these IFC loans, however, was mixed. In some cases, there was insufficient demand for IFC funds, often because the participating banks had access to other sources of funds at more favorable terms (**Zambia**), or because there was little impact beyond the benefits of the IFC financing itself (**Mongolia**). The banks in **Zambia** cited the issue of SME creditworthiness as the constraint, something IFC's financing alone does not address. To complement its loan operations, IFC also proactively supported various advisory services to SMEs, including some innovative pilot programs to work with grassroots organizations. Most of these programs, however, have remained at the pilot level, and have not been scaled up.

The episodes of financial crises in **Kazakhstan** and **Mongolia** point to broader financial sector issues in resource-rich countries. Increasing liquidity in the banking sector because of growing resource rents often carries the risk of questionable investments (for example, in real estate). This raises the question of whether the financial sector should have been an area of Bank focus from the outset.

Promoting private investment in nonextractive sectors. IFC's investments in nonextractive sectors in all four countries were limited, and were generally concentrated in the financial sector. In **Bolivia**, IFC made several efforts at engagement, but the business environment was not conducive to foreign investment. The nationalization of several IFC-financed companies in the last few years has no-doubt left a negative perception of country risk both in the markets and within IFC. In

CHAPTER 4 ECONOMIC DIVERSIFICATION AND NONEXTRACTIVE GROWTH

Zambia, IFC accomplished little beyond its investment in Zambeef and a few lines of credit. More recently, IFC issued a Kwacha bond (\$28.4 million) to deepen Zambia's capital market. While it has no short-term impact on private investment, it could prove to be an important instrument in developing Zambia's domestic capital market. Similarly, in **Kazakhstan**, during the whole period reviewed, IFC made only 10 investments in non-financial sectors (including cement, tourism, furniture, health insurance, transport, and agribusiness).

Conclusions

Economic diversification and growth of nonextractive sectors has been, and is likely to be, an important developmental objective in resource-dependent countries and the Bank Group strategies therein. At the same time, Bank Group strategies and studies do not have a common definition of diversification, as well metrics to measure it. There is, nevertheless, a common understanding that the basic policy tenet is that of using resource rents to build up other diversified assets. The most compelling conclusion based on recent studies, and confirmed by the practical experience of most successful countries such as Chile, is that the most important step a government can take is to focus on the fundamentals, that is: maintain macroeconomic stability, invest in infrastructure, improve the business climate, encourage private investment and invest in people.³ In this regard, the Bank Group's broad implicit strategy of focusing on infrastructure, agriculture, and private sector development is relevant – although this evaluation observed a wide variation in performance and results in each area. In this context, the Bank Group could also help clients define a realistic diversification strategy, taking into account constraints and opportunities in each of the three component parts, and advised by analytical work. This review highlights a few lessons that could provide future guidance for Bank Group support in resource-dependent countries in specific areas.

Moving forward, it is important that the Bank define some suitable metrics that can help guide policy discussions on the effectiveness of these interventions. As discussed, various measures that have traditionally been used to measure diversification have limitations. Therefore, it may be useful to have a combination of various metrics that, taken together, can shed light on the effectiveness of the programs. These may also need to be combined with broad measures of sector-level performance.

Infrastructure is a sector in which the Bank Group needs to maintain and expand its presence. Most countries have growing needs in this area, and the Bank has an advantage in providing a combined approach to both the physical and institutional dimensions of sector development. Bank experience in infrastructure was generally

positive in all four countries reviewed. Transport (roads) and power are the most important subsectors that have a direct bearing on private investment. However, there is a risk of countries pursuing sub-optimal investments in response to political and popular pressures. Thus, the focus of the Bank should continue to be on ensuring the economic efficiency of investments and on institutional development. Other subsectors (water and sanitation, urban services, and so on) are unlikely to feature prominently in investor perceptions. Bank support in these areas could be primarily viewed from the lens of social development.

Agriculture is an important sector that needs to be supported by significantly more analytical work. Despite the well-recognized importance of the sector and its high potential in all four CPE countries, the outcomes of Bank programs have been generally poor. The Bank has often lacked a coherent strategic approach to the sector around which different interventions could then be designed. In most cases, there was little synergy between the Bank's individual projects, thus severely diminishing their sustainability. Agriculture is a sector in which the economic diversification objective overlaps with rural poverty alleviation. In RRDCs, both perspectives need to be kept in mind in the design of strategies and interventions.

The PSD strategies of the Bank and IFC need to be joint not only in their titles. The Bank and IFC will have to formulate a coherent and actionable approach to PSD. All four observed country strategies did not present much evidence of any real coordination or cooperation between the two institutions. This has often meant missed opportunities, possibly a waste of resources, and, at times, inappropriate interventions. IFC could become more proactive in seeking out potential investors in nonextractive sectors, and particularly in labor-intensive sectors.

References

- Gill, Indermit S., Ivailo Izvorski, Willem van Eeghen, and Donato De Rosa. 2014. *Diversified Development: Making the Most of Natural Resources in Eurasia*. Washington, DC: World Bank. doi:10.1596/978-1-4648-0119-8. License: Creative Commons Attribution CC BY 3.0.
- World Bank. 2012. *Mongolia – Country Partnership Strategy for the Period FY2013–2017*. Washington, DC: World Bank. <http://documents.worldbank.org/curated/en/2012/01/16244913/mongolia-country-partnership-strategy-period-fy2013-2017>.
- — —. 2013. *Beyond Oil: Kazakhstan's Path to Greater Prosperity through Diversifying*. Kazakhstan Country Economic Memorandum No. 78206. Washington, DC: World Bank.

¹ The Herfindahl-Hirschman Index shows whether exports are concentrated on some products or distributed in a more homogeneous manner among a series of products.

CHAPTER 4
ECONOMIC DIVERSIFICATION AND NONEXTRACTIVE GROWTH

² According to the most conservative estimates, nonperforming loans amount to 30 to 35 percent of the total number of loans in Kazakhstan, thus making it the global “leader” in this respect.

³ This aspect (e.g., skills) is discussed in chapter 5.

5. Inclusive Growth

Inclusive growth encompasses both the Bank's focus on its twin goals of poverty reduction and sharing the benefits of growth, as well as the set of program interventions that contribute to achieving these goals in a sustainable fashion. These include: (i) the provision of social welfare and social safety nets that protect the poor and vulnerable; (ii) human development through education to raise the productivity of the poor and middle-income groups and health services; (iii) spatial programs of rural and urban development that focus on enhancing the quality of life and providing livelihoods opportunities for those who live in rural areas and urban slums; and (iv) the promotion of environmental sustainability.

The strategies adopted in the four review countries vary in the extent to which they have clearly internalized this set of challenges and made an informed choice about where to focus the Bank's efforts. The Bank program in **Mongolia** would seem to be a good practice example, with a strategic approach that is targeted to poverty reduction and shared growth; it very explicitly selects areas that will have the maximum impact. In other countries, Bank selectivity seems more arbitrary. In **Bolivia** and **Kazakhstan**, this seems to reflect the lack of interest of the government in Bank support in particular areas, whereas in **Zambia** it is mainly the lack of traction of particular programs that the Bank has supported in the past. In these countries however, there is a need to put the Bank program in this pillar into a clearer strategic framework to demonstrate the likely impact of the Bank's interventions on the achievement of the twin goals.

The implications of resource revenues for poverty reduction and social development in resource-rich developing countries (RRDCs) are not qualitatively different than the challenges that all developing countries face in promoting inclusive growth. However, the analysis of the four cluster Country Program Evaluations (CPEs) suggests the following five areas where the Bank needs to focus more intensively in RRDCs than in many other borrowing countries. The first area relates to the setting of the objectives, while the others are the four key program areas needed to address the objectives in RRDCs.

(a) **Poverty focus.** In the upward swing of the resource cycle, RRDC governments can become complacent about whether the benefits of growth are reaching the poor. Vested interests in sectors such as contracting and commercial transport become powerful and pressure the governments to undertake the kind of public construction works (airports, major highways, public buildings, and so on) which may have limited impact on poverty reduction over the medium- and even the long term. In this context, the Bank

CHAPTER 5 INCLUSIVE GROWTH

needs to build on its diagnostic work to monitor progress and to advocate for a continued focus on poverty reduction and shared prosperity.

(b) **Social transfers.** RRDC governments are likely to be under more pressure than others to support cash transfers that allow the public at large to feel that they are deriving their share of the benefits that flow from resource exploitation. The risk is that these transfers are often poorly designed and do not meet their objectives. The Bank has an important role to play in helping governments design and implement cash transfer programs that are fiscally sustainable and that address the most urgent needs of the poor. This becomes particularly important during the downward part of the resource cycle when budgetary expenditures come under pressure. At such times, the Bank needs to advocate, and may need to provide direct support, for ensuring that the safety net for the most vulnerable is adequately funded and reaching those who are most in need.

(c) **Education and skills development.** Sustained poverty reduction requires investment in human development to build the skills and capacity needed to raise productivity and stay competitive. The availability of substantial revenues from mineral, oil, and gas resources in RRDCs has helped many of their governments achieve the Millennium Development Goal (MDG) of universal education coverage. Although the importance of this should not be underestimated, there needs to be more emphasis on enhanced education quality and skills development if the investment in human development is to have a significant impact on productivity, competitiveness, and poverty reduction. In this situation, the Bank needs to focus on and support improvement in the quality of the education system and put into place an effective monitoring system to assess quality issues.

(d) **Reaching the rural poor.** In many RRDCs, one sees the evolution of two different economies – a relatively prosperous, rapidly-growing urban economy with an expanding population, infrastructure, and large amounts of both public and private investment on the one hand, and a rural economy that is a backwater with stagnant productivity and little investment (other than for a primary school classroom) on the other. Most of the poverty is concentrated in the rural sector, where governments often lack the structures and instruments for reaching the rural poor. To support inclusive growth, the Bank needs to provide a focus on rural poverty, including piloting approaches for reaching the rural poor, and supporting the scaling up of successful approaches.

(e) **Environmental impact.** In many RRDCs, the extractive sectors are often a direct cause of environmental degradation, which needs to be addressed through effective regulations and monitoring. The Bank therefore needs to supplement its regular

program of environmental support in these countries with a special focus on the environmental implications of extractive industries.

Outcomes and World Bank Group Contribution

POVERTY FOCUS

The evaluation period covers the upswing of the price cycle between 2004 and 2013 (except for the global crises in the years 2008–09), when buoyant prices for oil, gas, and minerals not only led to increased production, but also to exploration and development of new sources. Rapid expansion and growth in the extractive sectors contributed to relatively fast rates of growth in all four CPE countries, which led to significant poverty reduction and improvement in most human development indicators (table 5.1). The only area in which there was limited progress was made was inequality.

Table 5.1. Select Economic Performance, Poverty, and Human Development Indicators

Indicator	Bolivia		Kazakhstan		Mongolia		Zambia	
	2004	Latest ^a	2004	Latest ^a	2004	Latest ^a	2004	Latest ^a
GDP per capita (US\$)	955	3,151	2,874	12,276	798	4,170	557	1,802
Poverty headcount ratio at national poverty lines (% of population)	63	45	34	3	34	27	N/A	61
Urban poverty headcount ratio at national poverty lines (% of urban population)	54	37	23	1	29	23	N/A	28
Rural poverty headcount ratio at national poverty lines (% of rural population)	78	61	47	5	43	36	N/A	78
Primary enrollment (% gross)	107	91	105	106	109	109	106	108
Life expectancy	64	67	66	70	65	68	46	58
Infant mortality (per 1,000 live births)	46	31	30	15	39	26	81	56
Gini coefficient	55	47	30	29	33 ^b	37 ^c	51	57

Source: World Development Indicators Database.

Note: GDP = gross domestic product; N/A = not available.

a. Latest data available.

b. Figure from 2002.

c. Figure from 2007.

Kazakhstan made steady progress on all key indicators, including an increase in life expectancy; a reduction in maternal and infant mortality rates; and achievement of

CHAPTER 5 INCLUSIVE GROWTH

three of the MDGs (reduction of poverty by half; universal primary education; and gender equality in education). Poverty data show a very impressive decline from 34 to 3 percent,¹ although the numbers are hard to confirm as the Bank's last poverty assessment in the country was conducted in 2004. In **Mongolia**, the decline in poverty was most impressive between 2010 and 2012, falling by an average of 5 percentage points per year. Whereas poverty has declined, the gap between rich and poor in Mongolia has widened, with the gains in income for the better-off outstripping the impact of rapid growth on the poor. **Bolivia** has seen the most impressive reduction in extreme poverty, despite slightly lower growth rates compared to the other three countries. This could be explained by the expansion of small businesses; growing employment in the services sector; direct transfers to the poor from an increased share of rents from natural gas; and shifts in the terms of trade in favor of agricultural products from which many of the rural poor derive their income. The outlier in this group is **Zambia**, where despite growth, poverty incidence remains very high. Rural poverty, at 74 percent, is more than double the level in urban areas. There was a steady increase in inequality over the review period, reflecting a high concentration of growth in urban areas and among the large commercial farmers and entrepreneurial and professional groups.

In **Bolivia**, **Mongolia**, and **Kazakhstan**, a number of factors contributed to poverty reduction, including a combination of: cash transfers; growth of employment in the services sector (urban poverty); and a sustained program of outreach to rural areas with the promotion of education, health, infrastructure, and support for livelihoods. Productivity improvements did not seem to have played a significant role. The story in **Zambia** is a complex one. Although the government did not derive much in the way of revenues from copper mines, a great deal of additional fiscal space was created through the country's Highly-Indebted Poor Countries completion in 2005, as well as higher revenues through the growth of the urban economy and commercial agriculture. While initially there was a major expansion of expenditures on health and education, in more recent years, resources have been used for a substantial increase in public sector salaries and for expanding the country's physical infrastructure. Very little growth has reached the small farmers in rural Zambia as government expenditures have targeted mainly the urban core of the country. As a consequence, the rural poverty headcount has increased with population growth.

As experience in the four CPE countries shows, the direct impact of growth in extractive industries through employment generation (directly, or indirectly, through demand for inputs, or development of downstream processing) could be rather limited: for example, the Oyu Tolgoi copper mine in **Mongolia**, one of the largest in the world, is expected to cost about \$20 billion to develop (until 2019). It is expected to account for about 30 percent of the country's gross domestic product (GDP) at full production, but

will have only 3,000 to 4,000 employees at that point. In addition, in most RRDCs, the extractive industries have made little use of tradable domestic inputs, or led to the development of downstream processing.² The multinational companies that develop these resources generally have facilities elsewhere that they use for the sourcing of inputs or processing of outputs.

The limited spill-over from extractive industries puts most of the weight on governments to meet the expectations of the public at large. During periods of new oil, gas, or mining development, there is increasing buildup of political pressure on governments to meet expectations that the resources will translate rapidly into higher incomes and provision of more and better public services. In **Mongolia** and **Zambia**, this has made it difficult to resist populist calls for the pro-cyclical use of resources. In both countries, governments have amplified the impact of the resource boom by running up sizeable budget deficits, using expansionary monetary policies, and borrowing abroad. The Bank's role in this situation is to ensure that government revenues derived from natural resources are used in ways that maximize their impact for achieving sustainable poverty reduction.

Effective advocacy requires both analytic work and policy dialogue on poverty reduction. Yet these have not been a prominent feature of the Bank program in most reviewed countries. In **Zambia**, where the issue is most urgent, the Bank's analytic work on poverty culminated in the 2012 Poverty Assessment entitled *Stagnant Poverty and Inequality in a Natural Resource-Based Economy*. In spite of wide dissemination, the report seems to have had little traction. In the other three countries, some work was done at the beginning of the evaluation period. However, there has been no subsequent poverty analysis. The last two strategies of the Bank Group in **Kazakhstan** do not mention poverty reduction as an explicit objective, nor do they track poverty indicators.

Effective poverty analysis requires reliable data on poverty, and this, in turn, implies arrangements for monitoring through regular surveys. The Bank has been active in both **Zambia** and **Mongolia** on supporting arrangements for collecting better poverty data, and aligning the surveys supported by the Bank with those of the national statistics bureaus. In Mongolia, this led to the adoption of a new methodology in 2012 to make a quantitative assessment of poverty rates and assess poverty dynamics. This is a noteworthy achievement compared to the mid-2000s, when the official poverty numbers were estimated using inconsistent poverty lines – and drawing erroneous conclusions on poverty trends over time.

SOCIAL TRANSFERS

Developing country governments provide cash transfers in several ways, among them: (i) the pension system to the elderly; (ii) unconditional cash transfers (which can be

CHAPTER 5 INCLUSIVE GROWTH

universal, but are usually social welfare payments to vulnerable groups); and (iii) conditional cash transfers that promote the achievement of various educational- or health-related goals.

The Bank has been actively engaged in policy advice and analysis on pensions in three of the four countries reviewed. Advice on pension reform was an important part of the Bank's policy dialogue in **Kazakhstan**, driven by strong demand from the government.³ The Bank also conducted timely analytical work at the request of the **Mongolian** government to evaluate the pension scheme and propose policy reforms.

In addition to pensions, countries need to put into place comprehensive social safety nets. This is becoming an increasingly urgent issue in many RRDCs, where governments are under growing pressure to spread the natural resource wealth in the most direct and efficient manner. A key element in the Bank approach has been to advocate for programs targeted to the poor. This reflects the evidence that universal programs have substantial leakages of funds to the non-poor and are likely to be fiscally unsustainable. Moreover, targeted programs are difficult to administer, require information on incomes, and are subject to elite capture and diversion of resources. In addition to policy advice, this has meant that governments would need to put in place the administrative capacity for effective implementation.

The difficulty of moving in this direction is evidenced by the Bank's engagement with the **Mongolian** government over its universal Child Money Program (CMP). In 2005, the CMP was introduced on a targeted basis, and in 2006, it was expanded to universal coverage. The Bank's analytical work clarified for policy makers the limited impact of the universal program on poverty reduction – and its fiscally high and unsustainable cost. As a result, the government adopted the Social Welfare Law (SWL) in 2012 to overhaul the system through the introduction of the Poverty Targeted Benefit (based on a proxy means test), and a substantial consolidation of benefit programs. However, this became a contentious issue in the subsequent election and, to date, the law has still not been implemented.

Given its importance for both fiscal stability and poverty reduction, the Bank needs to be involved in supporting the design of appropriately scaled and efficient cash transfers in RRDCs. Politically, it is often difficult to withdraw a benefit once it has been given. Therefore, it is important that the Bank engage with governments during the early phases of resource exploitation when significant revenues begin to flow into the budget. In this way, it can help governments design a modular approach that can be expanded over time in relation to fiscal affordability. In addition, the Bank needs to assist governments in carrying out periodic monitoring and evaluation regarding the poverty impact of fiscal transfers. Bank engagement in this area with RRDCs is especially

important given the inherent instability of mineral and oil resource revenues, and the likelihood that when price or production shocks occur, poorly designed transfer programs will not be sustainable.⁴

EDUCATION AND SKILLS DEVELOPMENT

All of the CPE countries were making substantial progress toward achieving the access to education objectives of the MDGs. The growing concern (especially in the poorer countries) was that the system was not meeting the needs of the labor market (producing the new skills that a rapidly growing and diversifying economy was likely to require) and achieving the productivity gains necessary to escape poverty and reduce vulnerability. Bank programs in all countries concentrated on improving education quality, mainly primary and secondary. However, there were very few attempts to address skills development and vocational training.⁵

In spite of a relatively limited role for the Bank in **Kazakhstan**, it has had a visible impact in basic education, where it focused on supporting the government's efforts to improve quality. The Bank's contribution is widely credited by the Independent Evaluation Group's interlocutors in introducing universal pre-school education. The Bank has made a major contribution to enhancing the quality of primary education in **Mongolia** through policy dialogue and its lending program. Bank projects introduced reforms in rural primary schools that are now being scaled up at the national level through government policies. In **Bolivia**, the Bank had traditionally successfully supported primary education reform, as well as education decentralization. During the evaluation period, the Bank shifted its support from national reforms to smaller scale municipal pilots, as the then new government showed little interest in policy reform and Bank assistance. The possibility of the pilot programs to serve as a testing ground for broader reforms has not materialized, as the government has not been interested in sectorwide reforms.

The Bank's involvement in improving the quality of education has achieved an important first step of building awareness, but it now needs to move to a second stage. The Bank is playing an important role in keeping the focus on quality and on helping governments develop programs in this area. This would seem to be a major comparative advantage of the Bank. However, to move beyond advocacy, the Bank needs to strengthen its analytic work to identify the steps needed for better quality and curriculum reform, help put monitoring systems in place, and evaluate the structure of secondary and tertiary educational institutions and the policy framework for skills development.

CHAPTER 5 INCLUSIVE GROWTH

REACHING THE RURAL POOR

In most of the reviewed countries, poverty is becoming more and more concentrated in the rural areas. The key cities and mining towns benefit more directly from the earnings from natural resources. Their incomes rise with the demand for labor in construction and services. The traditional farming population is often poorly placed to meet the additional demand for more and better quality foodstuffs and other crops. As a consequence, they benefit little from this growth, except through labor migration and remittances. The evidence suggests that an active program of rural development and the promotion of agricultural value chains is needed to achieve a significant impact on rural poverty.

The most striking example of Bank support for rural development comes from **Mongolia**, where rural living conditions have dramatically changed for the better since the mid-2000s. The Bank's program covers several activities that seem well coordinated on the ground and have jointly produced important learning and synergies. Mission evidence suggests that the rural program as a whole merits recognition as best practice. Bank-supported projects created synergies that reinforced support for higher living standards for herder households, and the adaptation of the traditional nomadic way of life in a modern, growing economy.⁶

Some important lessons for future livelihood support can be derived from these country studies. The **Mongolia** experience shows the impact that the Bank can have through a holistic approach to rural development, capturing the synergies from a number of separate programs focused on rural development. The Bank is following a similar approach in its program in **Bolivia**. The poverty assessment in **Zambia** takes the opposite line, arguing that: "marginal improvements in economic and social indicators can be accomplished through targeted interventions in the rural economy, but enduring, structural income growth and the widespread reduction of poverty will only be achievable through broad-based employment creation in the urban industrial and service sectors." The cross-country view which this cluster CPE enables, would strongly support the argument that this is not an either/or proposition. An entirely urban-focused program would leave a large reservoir of rural poverty in countries such as **Zambia**, and some of the newly-emerging RRDCs for many years into the future.

ENVIRONMENTAL IMPACT

The four countries in the cluster have all been richly endowed with natural resources, including land, forests, water, and biodiversity. In every case, their rich natural endowment has been gradually degrading under a variety of pressures arising from their unregulated economic development, ranging from overgrazing and the expansion of the agricultural frontier, to the growth of air and water pollution from industrial and

extractive activities. Some of these pressures have been aggravated by the countries' vulnerability to climate change, with the attendant increase in the frequency of extreme weather events. In every case, the countries' response had been limited by inadequate policy frameworks and weak institutional capacity to enforce the applicable environmental laws and regulations. Underlying these common elements, each country was facing a set of very specific challenges.

The mitigation of extractive industry environmental impacts was a major focus in Zambia and Mongolia, and was addressed through safeguards in Kazakhstan. In **Zambia**, the Copperbelt Environment Project mitigated environmental liabilities to facilitate the privatization of the copper industry. However, continuing reports about mining sector chemical spills have raised concerns about the long-term sustainability of the benefits. In **Mongolia**, a wide array of complementary components in various projects have helped to deepen the understanding of the potential impacts of mining development, strengthen the policy and institutional framework, and prepare the infrastructure for managing the environmental and social impacts of mining. In addition, the International Finance Corporation's (IFC) involvement with Mongolia's two largest mining projects provides comfort that their environmental and social management provisions are in line with international norms. In **Kazakhstan**, the Bank and IFC's early petroleum projects helped to: successfully update enterprise environmental and social policies and procedures; introduced sophisticated pollution abatement technologies; and cleaned up past damage.

The strengthening of the institutional and policy framework for the environment was part of every Bank intervention. In **Bolivia**, the Bank helped create institutions and organizations needed to manage and conserve biodiversity. In **Zambia**, Bank projects helped strengthen national park management and environmental control capacity. Nevertheless, the long-term sustainability of these projects' achievements has been affected by a lack of general support from the government for policy, legal, and institutional reforms. In **Mongolia**, the Bank directly contributed to the expansion of the Ministry of Environment's mandate and power, and helped promote the development of a vibrant civil society constituency. In **Kazakhstan**, the successful remediation of past legacy issues⁷ helped strengthen the capacity of key environmental agencies. Indeed, their continuing sustainability appears assured by their very visible success and continuing government support.

Conclusions

In all four RRDCs, the commodity price boom and economic growth led to broad improvements in poverty and human development indicators, but also led to a

CHAPTER 5 INCLUSIVE GROWTH

widening income gap and rising inequality. The outcomes of Bank Group activities aimed at helping countries share the benefits of growth with the wider population and improve human development outcomes were generally positive (with the exception of Bolivia, because of a fundamental mismatch with the interests of the line ministries). This occurred despite the generally small (and declining) size of Bank programs in these areas and the diminishing interest of the authorities. The reasons for a given country's lack of enthusiasm varied from general skepticism about the utility of Bank advice on poverty and education to the unwillingness to acknowledge the persistent poverty problem for political reasons. However, the high impact of Bank activities in these areas relative to their size serves as proof of the Bank's comparative advantage and global expertise. Further, it also underlines the importance of this aspect of the Bank's mandate as a global development institution. The following findings emerge from the experience in the four countries reviewed:

- There is a need to design a program of advocacy for poverty reduction and better sharing of the benefits of growth. It should be based on poverty analysis, support for improved data collection, and poverty monitoring.
- Early and sustained engagement in the design of targeted cash transfers is necessary. The Bank has sometimes been reluctant to intervene in this area because it tends to be highly politicized. Subsequently, when the fiscal situation deteriorates, the International Monetary Fund and the Bank have little choice except to condition support on a government's agreement to change the system of poorly-designed transfers.
- There is a need to emphasize education quality and skills development as a key factor in raising the productivity of the poor. Although governments in all of the reviewed countries are putting substantial resources into the education sector, the benefits are less clear at this stage.⁸ The Bank's focus on quality is well founded. An effective start has been made through creating a consensus around the need for quality improvements. These efforts need to be taken to the next stage through broad-based programs that start with good analytic work and better monitoring of education outcomes. Good practice interventions such as the Rural Education and Development (READ) project in Mongolia should be widely disseminated.
- A well-designed rural development program should be a key feature of Bank involvement in RRDCs. Whereas the growth generated by extractive industries development generally reaches the urban areas through demand for construction workers and the services sector, it does not trickle down to the rural economy at a pace that is likely to impact poverty and living standards. Bank programs can help steer government expenditures and focus toward the rural economy. What is particularly encouraging is how successful many of the Bank rural

development interventions have been. The Mongolian rural program is a major achievement and merits wider dissemination in the Bank and other countries.

- Continued support for the mitigating environmental impacts of extractive industries and dealing with past legacy issues is important. This has been an area of satisfactory Bank Group interventions, as it had successfully brought both the public and private sectors to a realization of the costs of neglect – as well as the impact of a better environment on the population’s quality of life.

¹ The poverty line in Kazakhstan is set at \$2.25 per day, which is considered very low for an upper-middle-income country (approaching a high-income country threshold).

² An exception is Botswana, where the government has required De Beers to move its headquarters, and a significant proportion of diamond cutting and polishing, to the capital of Gaborone.

³ A report of the World Bank offered guidance on tackling the issue of income adequacy for future pensioners in a sustainable way. It was used by the Bank and the government to inform a high-level brainstorming session in 2012 on the topic of pension reform.

⁴ Chile is an example of a resource-rich country that has set aside funds generated by the sale of natural resources to act as a hedge against the fluctuations of global commodity prices and provide a buffer to economic crises. During the global crises of 2008–09, a large part of the resources drawn from the Stabilization Fund allowed financing of bonus (direct unconditional transfers) for the bottom 40 percent of the population.

⁵ There was only one Bank project on technical and vocational training and it was in Kazakhstan. The Technical and Vocational Education Modernization Project (FY10: ongoing, expected to close in 2015) was too early to evaluate.

⁶ The Bank’s projects have changed the way herders provide for livestock pasture and fodder needs; have access to the closest source of water; receive warnings about bad weather; buy livestock insurance; benefit from improved primary education for their children; receive better medical services; participate in local planning and investment decisions; and use energy to watch television, store food, and communicate with their families by mobile telephones.

⁷ The most famous one is the partial restoration of the Northern Aral Sea that transformed a massive region that had become uninhabitable into one where people are returning and restoring their livelihoods.

⁸ In Botswana, the Finance Ministry has become increasingly frustrated by the lack of improvement in education quality outcomes despite steady increases in expenditures in the sector. It has decided to stop increasing outlays until the Ministry of Education can demonstrate better quality outcomes.

6. Main Findings

This review concludes that although the challenges identified in resource-rich developing countries (RRDCs) are not unique, they manifest themselves with particular intensity in three closely interrelated areas: (i) management of revenues from an exhaustible resource; (ii) growth and employment in the nonextractive sectors; and (iii) inclusive growth and reduction of poverty. The close links between these areas need to be defined and structured as a coherent strategy, emphasizing the areas important in a particular country context, with a set of measurable progress indicators.¹

The over-arching strategic role of the Bank Group in RRDCs is to assist them in using the revenues generated from natural resources efficiently, effectively, and sustainably in support of poverty reduction and shared growth. In the four countries reviewed in this clustered Country Program Evaluation (CPE), the Bank Group did not use a consistent basis for choosing the issues to include in the dialogue with resource rich countries. Each of the four stories played out in a unique way that depended on how the country team at the time decided to react to differing country circumstances. They did not seem to derive from any Bank-wide approach to working with RRDCs. The mineral wealth affected country dialogues as the Bank Group adapted its strategy to the situation. However, this was usually more in a negative way of limiting the issues that entered into the dialogue.

The main challenge for the Bank Group in most RRDCs today is how to stay relevant and competitive. As all of these countries are now able to raise funds from alternative sources, including from private capital markets, the Bank Group may not have the same ability to influence as many sectors as before. As their incomes rise, all RRDCs tend to become more demanding clients, requiring the Bank to be prepared to develop highly selective and flexible programs, follow strategies with a long-term horizon, and act decisively when there is a window of opportunity. There needs to be recognition that the Bank Group's value proposition is no longer just its financial resources, but the knowledge and global experience it can share with the authorities and private sector clients, whether provided through lending, investment, or analytic and advisory work. This may call for a more modest scope of interventions, keeping the focus on the key challenges.

The Bank Group dialogue in RRDCs has seen intense highs and lows, yielding lessons for a more mature relationship in the future. In some countries, there is the legacy of a difficult past relationship and the Bank needs to overcome a residual lack of trust. As all four countries advance on most of the development indicators and rely less on external resources to meet their financing needs, there is an opportunity for the Bank to

construct a new type of partnership based on shared goals and mutual commitment. This partnership, however, should still allow for a collegial and candid discussion of areas where views on policy priorities may differ.

The increasingly demand-driven nature of Bank Group programs in RRDCs and client-led selectivity can impose limitations on fulfilling the Bank's mandate as a global development institution, leaving some gaps, including an insufficient amount of attention to poverty analysis. The Bank's programs often lacked attention to the demand side of reforms for the sake of pleasing the client. In the future, the Bank could be more proactive in engaging local partners to advance transparency and accountability, as well as in contributing to the building of local capacity.

The quality of the Bank's increasingly intensive analytic and advisory activities (AAA) work has been consistently high, but its effectiveness has been uneven, if measured by actual follow-up on policy advice, which was sporadic. Demand-driven, knowledge-based programs can be useful instruments for strengthening partnerships. However, their effectiveness can be limited by an inadequate monitoring and evaluation framework, a lack of disclosure of policy recommendations, and insufficient engagement by local partners.

Management of Resources

The Bank Group is well-positioned and technically equipped to effectively assist the RRDCs in implementing policies and strengthening institutions that promote the prudent management of natural resources. The Bank, jointly with the International Monetary Fund (IMF), should maintain a dialogue on macroeconomic and fiscal policies and help countries build fiscal buffers during the upswing phase of commodity prices. It should be prepared to step in with exceptional budget support in case of an abrupt downturn in prices. Further, it would be important to undertake analysis to develop realistic contingency plans for dealing with price downturns. Fiscal rules proved to be useful in this regard. However, even in the absence of such rules, the Bank could systematically monitor and analyze performance and provide governments and the public with this information, as well as information on the performance of key comparator countries.

Policy consensus across the political spectrum is a critical ingredient for success in the sustainable management of natural resource revenues. The Bank can contribute to promoting this consensus by building relationships of personal trust and capacity building at key government agencies. It also can encourage public demand for reforms

CHAPTER 6 MAIN FINDINGS

through the engagement of local stakeholders and a wide dissemination of policy advice.

Bank Group support for the Extractive Industries Transparency Initiative (EITI) process was an effective demand-side instrument, and a visible platform for civil society to discuss and demand more transparency and accountability. Experience with the EITI confirms its usefulness as an effective instrument for promoting transparency and accountability, even beyond the extractives sector.

Economic Diversification and Nonextractive Growth

Economic diversification and the growth of nonextractive, labor-intensive sectors proved to be an elusive target in all of the countries reviewed. Bank Group strategies and analytical products acknowledged the importance of economic diversification away from extractive industries, but struggled to define diversification as a specific objective, as well as to specify any outcome measures/indicators for it in results frameworks. Based on the experience in these CPE countries, as well as more successful cases such as Chile, the most important steps a government can take are focusing on the fundamentals: maintaining macroeconomic stability, investing in infrastructure, improving the business climate, and encouraging private investment. The Bank Group's implicit strategy of focusing on infrastructure, agriculture, and private sector development was relevant. However, the effectiveness of separate elements of the Bank Group program in these areas was highly uneven, and the impact of these interventions in terms of achieving diversification was not evident.

All observed Bank Group country strategies did not present much evidence of any real coordination or cooperation between the Bank and the International Finance Corporation (IFC) on promoting economic diversification in RRDCs. This has often meant missed opportunities for taking advantage of synergies. IFC has generally struggled to structure investment transactions, except for the financial sector. In most RRDCs, IFC is now one of the many funding sources available, and its value proposition was not always clearly articulated to private companies. In the future, IFC should take a longer-term view for its engagement in RRDCs, working with the Bank. It should consider originating new investment transactions and advisory service projects, in particular for infrastructure and agribusiness, where IFC has a comparative advantage and global expertise.

Inclusive Growth

All countries included in this cluster CPE were able to benefit from the commodity boom of the last decade. High rates of economic growth were accompanied by significant progress on poverty reduction and most social development indicators. At the same time, all countries continued to grapple with growing inequality and an increasing gap between urban and rural incomes.

To help RRDCs in promoting more inclusive growth by sharing the wealth generated from natural resource extraction, the Bank would need to stay actively engaged in advocacy for poverty reduction and the monitoring of its outcomes, consistent with its mandate as a global development institution. In terms of operational engagement and areas of advisory work, the Bank's support to RRDCs should focus on: the design of social transfers that are fiscally sustainable and targeted to the poor; support for better quality education to raise productivity of the poor and develop skills; rural development programs designed to reach those left out by extractive industry growth; and mitigation of any adverse environmental impact of extractive industries.

Reference

OED (Operations Evaluation Department). 2005. *Extractive Industries and Sustainable Development*. Washington, DC: World Bank.

¹ This conclusion reinforces a similar finding of an earlier report by the Operations Evaluation Department (2005), the precursor to the Independent Evaluation Group.