

Professional Development Programs for Parliamentarians and their Staff

Parliament and Extractive Industries

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Introduction

Countries with natural resource wealth can be blessed or cursed: if used well, these resources can create long-term economic growth and development; if used poorly, they can cause conflict, economic instability and a deterioration of human development.

In practice, oil, gas and mineral resources have had a perverse effect on many resource-rich nations. Instead of contributing to poverty alleviation and economic growth, resource revenues often lead to large-scale corruption, less development, and wars.

In the absence of strong government institutions that are transparent and accountable to citizens, resource revenues are often managed ineffectively. Large and unregulated inflows of funds to government can create incentives for those in power to corrupt, and policy makers are easily tempted to provide short-term solutions to long-term social and economic problems. The relationship between citizens and governments is undermined as the government depends less on revenues from taxes and non-extractive sectors. In order for natural resources to be used effectively and for development purposes, more accountable and transparent mechanisms must be adopted and supported by a wide range of stakeholders such as governments, multinational corporations, legislative bodies, political parties, civil society organizations and the media.

Current efforts to increase transparency and accountability in natural resource management mainly emphasize the roles of the government and civil society organizations. Much less attention has been paid to the potential contribution of legislators. The three core functions of Parliament—representing constituent interests, legislating, and overseeing the executive branch—are crucial along the entire extractive industries value chain. Legislators are responsible for ensuring that policy and regulatory frameworks regarding extractive industries benefit the population, and they can make sure that government agencies appropriately allocate and account for revenues.

The National Democratic Institute (2007) has identified that legislators often face constraints in fulfilling their roles and responsibilities, including weak individual and institutional capacity, little independence from more powerful executives and ruling political parties, and limited political will. Because of capacity constraints, and a lack of strong analytical backgrounds, high quality policy analysis is sometimes difficult. NDI finds that faced with proposals from well-informed or connected executive branch agencies or officials, legislators often lack both the information and the confidence to influence legislation, policy or management of the extractive industries. Legislators often operate in a system with weak institutional checks and balances and low levels of accountability.

Natural resources should be exploited to help a country reach its social and economic goals. The exploitation should not take place as a goal in itself. In practice, this means the country has to have a clear vision of where and what it wants to be in the future, and how the resource sector can contribute to this. Natural resource rents should be used to serve the benefit of all citizens, within the framework of a country's long-term development goals (The Natural Resource Charter, 2009).

It is a huge challenge to turn natural resource wealth into a blessing and make the sector contribute to sustainable development. Policy makers have many choices to make, from the speed of the extraction path, ways to deal with the volatility and uncertainty of revenues, prevention of environmental damage, to avoiding social conflict. Decisions with inter-generational consequences have to be made in great uncertainty. Luckily there are several practical guiding principles that can help boost transparency, accountability and social and economic development in a resource-rich setting.

This course will explain the elements of the resource curse, what measures can be taken to combat it, and how parliamentarians can play an important role in doing so. The course will address the link between extractive industries and economic and financial management, revenues, expenditures and the budget, environmental and sustainable

development, poverty reduction and community development, including transparency and accountability mechanisms.

At the end of this course participants will be able to identify strengths and weaknesses in government's extractive industries policy and how to make the extractive industries sector more developmentally oriented. By reviewing good practices in the extractive industries sector, participants will be able to better understand and analyze the costs and benefits of mining policy outcomes, their effect on stability, growth and on the budget. Participants will know how to enhance benefits and mitigate the risks related to the extractive industries sector, and can therefore oversee the executive more effectively. Participants can have a more informed debate about extractive industries issues. Participants will know how to enhance transparency and accountability related to the use of revenue and licensing, and they will know how to effectively participate in the Extractive Industries Transparency Initiative (EITI). Vertical accountability mechanisms will be strengthened, as legislators will know how to disseminate information and open proceedings for dialogue and debate.

Unit 1 of this course will give an introduction to the extractive industries sector and the resource curse. It will also describe how Parliament can relate to the sector. In Unit 2 we will discuss which institutions will contribute to counter the resource curse. Unit 3 will describe the importance of sound economic policy and planning, including the four stages of the budget cycle and medium term frameworks. Unit 4 will describe the first stage of the resource chain: the decision to extract. Unit 5 covers the contracting stage, followed by Unit 6 (revenue collection) and Unit 7 (revenue management and sustainable development)

Each Unit will list learning objectives and review questions can be found at the end of each unit. Throughout, words will be underlined that appear in the Glossary on page 96.

Unit 1: Introduction to Extractive Industries - The Resource Curse Revealed

Learning Objectives

What is the Resource Curse?

After studying this unit, you should be able to:

- Be able to explain what the 'resource curse' is
- Be able to explain the mechanisms of the resource curse
- Be able to tell whether or not your country is suffering from the resource curse
- Know what 'Dutch Disease' is
- Be able to link the three functions of parliament to the extractive industries sector

Introduction and Overview

This Unit will give an introduction to the resource curse and the extractive industries sector. It will describe the resource curse and the mechanisms behind it. The Unit outlines how conflict and war are related to extractive industries, and how trade openness and democracy are linked to the oil and mining sector. It will give a short description of how commodity prices can affect government finances and how economic diversification is related to the extractive industries sector. The Unit will then sketch how the institution of parliament can use its constitutional rights to influence the resource curse.

The Symptoms of the Resource Curse

Extractive Industries refer to the industry or sector that involves (non-regenerative) natural resources, such as minerals, oil and gas. Extractive industries can contribute significantly to a country's economic development and often offers the first opportunities for foreign direct investment and private sector development. They generate government revenues, foreign exchange earnings, and employment. If managed well, revenues from oil, gas and mining could stimulate economic growth and social development.

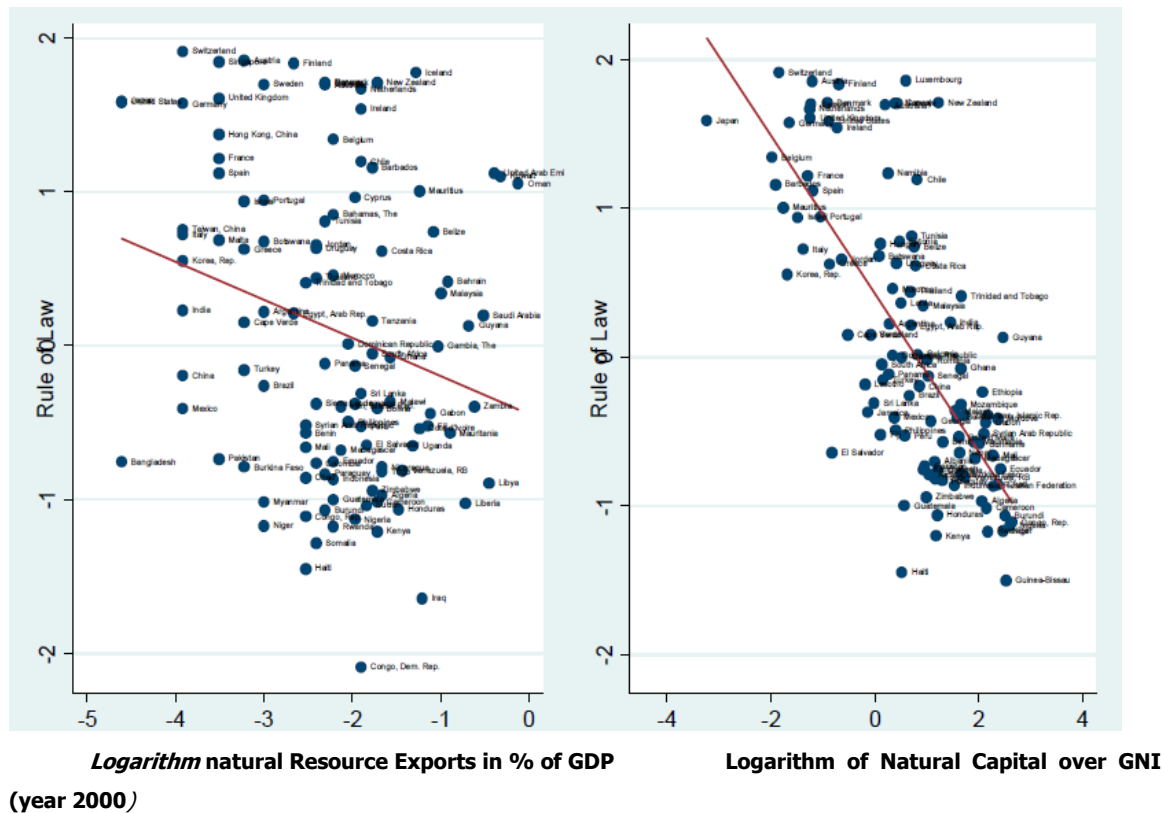
However, many resource-rich countries are currently near the bottom of international human development indicator rankings and perform worse than resource-poor countries in economic, social, and environmental development and governance. This is what we call the '*resource curse*'.

High levels of corruption are associated with extractive industries, as well as conflict and war (see Table 1 for an overview of civil wars linked to resource wealth). Natural resources' extraction increase chances of civil conflicts through weakening of the state. The negative spiral of corruption, crime and war significantly hinders economic growth. Economies that are significantly dependent on oil and mineral wealth often have authoritarian rather than democratic forms of governance, and weak legal or regulatory frameworks. See for example figures 1 and 2. Figure 1 suggests that rule of law and the ration of natural resource exports (or natural capital) to national income (GNI) are highly negatively correlated. This means that on average, if natural resource exports in a country are high, the rule of law is likely to be of relatively bad quality. The reverse is also true: if natural resource wealth in a country is low, then the quality of the rule of law tends to be better. Figure 2 shows a strong correlation between expropriation risk/corruption and natural capita. This suggests that natural resources have an adverse effect on income per capital through a worsening of institutional quality.

Resource rich countries have little international trade, few incentives for the development of capital, a weak connection between the natural resource and other

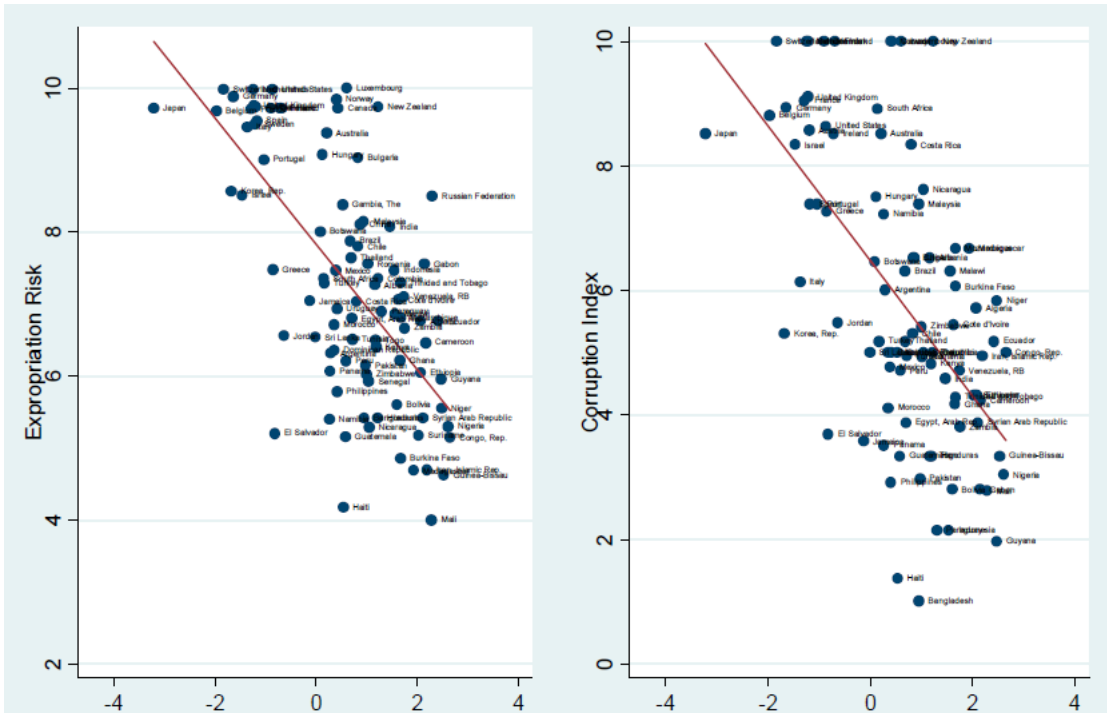
sectors of the economy, and limited economic diversification into competitive manufacturing industries. They also have very low investment rates, and low saving rates. Other economic symptoms of the curse are a decline in the competitiveness of non-resource economic sectors, macroeconomic vulnerability to fluctuations in world commodity prices and deteriorating government finances because of excessive government borrowing during 'boom' years.

Figure 1: Correlation between Rule of Law and Natural Resource Exports



Source: IMF (2007), "Can the Natural Resource Curse Be Turned into a Blessing? The role of Trade Policies and Institutions"

Figure 2: Corruption/Expropriation Risk and Natural Capital



Logarithm Natural Capital over GNI (year 2000)

Logarithm Natural Capital over GNI (year 2000)

Source: "Natural Resources and Development Strategy after the Crisis", World Bank PREM note, January 2010 number 147

Table 2.1 Civil Wars Linked to Resource Wealth, 1990–2002

<i>Country</i>	<i>Duration</i>	<i>Resources</i>
Afghanistan	1978–2001	Gems, opium
Angola	1975–2002?	Oil, diamonds
<i>Angola (Cabiinda)</i>	1975–	Oil
Cambodia	1978–97	Timber, gems
Colombia	1984–	Oil, gold, coca
Congo, Rep. of	1997	Oil
Congo, Dem. Rep. of	1996–97, 1998–	Copper, coltan, diamonds, gold, cobalt
<i>Indonesia (Aceh)</i>	1975–	Natural gas
<i>Indonesia (West Papua)</i>	1969–	Copper, gold
Liberia	1989–96	Timber, diamonds, iron, palm oil, cocoa, coffee, marijuana, rubber, gold
<i>Morocco</i>	1975–	Phosphates, oil
<i>Myanmar</i>	1949–	Timber, tin, gems, opium
<i>Papua New Guinea</i>	1988–	Copper, gold
Peru	1980–95	Coca
Sierra Leone	1991–2000	Diamonds
<i>Sudan</i>	1983–	Oil

Source: M. Ross "The Natural Resource Curse: How Wealth Can Make You Poor" (in Natural Resources and Violent Conflict: Options and Actions, Ian Bannon and Paul Collier eds., World Bank, 2003)

The Mechanisms behind the Resource Curse

The mechanisms at work behind the resource curse are both economic and political, with multiple causal factors. These factors can be broken down into four mechanisms: "The Dutch disease" (see Box 1); economic diversification and fiscal discipline; centralized political economy models; and rent-seeking models.

1. Centralized political economy/Political elite

Although part of the explanation for the resource curse is purely economic, the key issues are institutional and political as well. Centralized political economy models focus on the political elite. They assume that the presence of natural resources increases the value of staying in power and increases the likelihood that others will challenge the government for power. This can result in those in power spending more resources to keep their power (for instance through patronage).

Significant capital investments are required to extract or develop natural resources and only the political elite have the authority to grant access to those resources. Because all this power is in the hands of a few, it can create opportunities for corruption.

In the absence of transparency and mechanism for accountability, resource profits are easily used by the political elite to consolidate power through corruption and patronage. The resource profits provide opportunities for rebels and can finance conflict, motivated by the desire to capture the rents and power.

Resource wealth has an adverse effect on institutions, since excessive resource revenues are an easy way for the government to avoid accountability and resist institutional reforms. It is in the interest of political elites to block technological and institutional improvements, since it might result in a weakening of their power. Resource monies are often used by politicians to bribe voters by offering them well paid, but unproductive jobs in the public sector, or inefficient subsidies and tax cuts. In the absence of a well-functioning tax system, relationships between governments and citizens are undermined.

Over time, political elites become increasingly dependent on resource revenues and patronage systems to maintain their authority. Other sources of revenue and the relationship between government and citizens are neglected by the political elite and seen as unimportant.

2. Dutch Disease

The Dutch Disease refers to the crowding out of the manufacturing and agricultural sectors of the economy by the extractive sector. This is caused by two factors: a sudden increase in the income from natural resource exports causes an appreciation in the real exchange rate, which makes non-natural resource export products uncompetitive on the international market. This then leads to a collapse of the domestic non-natural resource export sector. The second factor for the Dutch Disease is the shift away from the non-resource export sector to the booming natural resource sector, causing the non-resource

sector to shrink. Thus, natural resources revenues can lead to neglecting and crowding out of potentially dynamic non-resource sectors that can make a difference for economic development and employment creation.

3. Economic diversification/Fiscal discipline

Resource-rich countries often rely solely on the export revenues of their natural resources. More than half of the developing countries still have commodity export dependence of over 70 percent (see Figure 4). Among the least developed countries, commodities consist of over 75 percent of exports. Viewed by region, Africa, Latin America and the Caribbean, and the Middle East and North Africa are most dependent.

Commodity prices go through huge swings, and resource-dependent countries experience more frequent and more aggregate shocks and fluctuations. Volatile and unpredictable commodity prices imply volatile natural resource revenues, and during a resource boom the temptation exists to act in a short-sighted fashion and spend or borrow too much.

One way to reduce the dependence of governments on resource revenues is to help them to diversify economically. States with more diverse export products are better protected against international market fluctuations like oil and minerals prices and are therefore less prone to the resource curse. For oil and minerals exporters, an option for diversification is to develop downstream industries, which can process and add value to raw materials that have just come out of the ground. Many downstream enterprises use large numbers of low-wage workers and thus offer special opportunities to the poor.

When fiscal discipline and checks and balances are absent, governments often fall prey to unsustainable budgetary policies, thinking their resource income will last forever. Increases in budget expenditures lead to debt, deficits and rising inflation that undermine longer term development priorities. Policy makers embark on unsustainable social programs, and have high levels of public consumption, combined with low levels of national savings and investment, which leads to a slowdown in long-term growth. The natural resource curse is particularly severe for economic performance in countries with

a low degree of trade openness (Arezki and van der Ploeg, 2007). Adopting policies directed toward more trade openness can thus soften the impact of the resource curse.

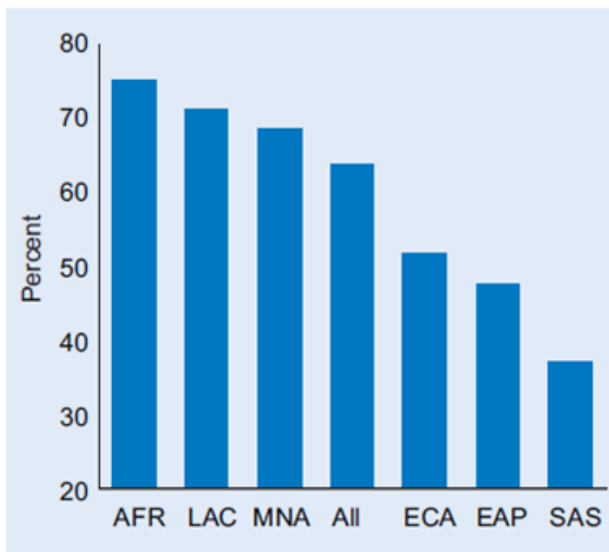
BOX 1
Gas in the Netherlands – “Dutch Disease”

The phenomenon ‘Dutch Disease’ stems from the economic outcomes after the discovery of a massive gas field in the north of the Netherlands in the 1970s. The term Dutch Disease mainly refers to the exchange rate appreciation and the crowding out effect exporting resources has had on other sectors of the Dutch economy during the first resource-boom. However, it also refers to the fact that the Dutch government adopted several unsustainable budgetary policies, thinking that the high gas revenues would last forever. They increased public employment and public spending, raised the level of unemployment and disability benefits, weakened eligibility conditions for benefits, raised the minimum wage, and implemented protective labor market legislation. Government expenditures increased from 44% of GDP in 1970 to 61% in 1983. Although the gas revenues showed an increasing trend, they could not keep up with the increasing level of government expenditures. Tax increases were necessary as a stabilizing factor while government debt increased from 38% of GDP in 1977 to almost 70% in 1984.

The problem before 1994 was that all gas revenues flowed directly into the national budget. In 1994 Parliament approved not only the Law on the Fund for Economic Stabilization, but also much stricter fiscal and budgetary rules to stabilize government finances. The Law made 41.5% of the gas revenues flow directly into the Stabilization Fund. The accumulated money in the Fund is only to be used for long-term, sustainable, national investment projects falling under the following categories: Infrastructure, Environment, and Knowledge & Innovation.

It has taken more than twenty years to put the Dutch welfare state on a financially sustainable footing again.

Figure 3: Developing countries commodity exports share in % in 2003-2007



Source: World Development Indicators, World Bank.
*As % of merchandise exports. Simple averages for country groups.

Source: World Bank (2010) "Natural Resources and Development Strategy after the Crisis", World Bank PREM note, number 147

4. Rent-seeking models

Rent seeking is cutting you a bigger slice of the cake rather than making the cake bigger, or trying to make more money without improved productivity. This can manifest itself in many different ways. It is the process by which an individual, organization, or firm seeks to profit by manipulating the economic environment, rather than improving and expanding economic activity. Often times rent-seeking behavior is considered corrupt because it implies that money, or potential earnings, are reallocated in a manner that is not beneficial to or approved by all stakeholders. Whether legal or illegal, as they do not create any value, rent-seeking activities can impose large costs on an economy. In a country with high resource rents people choose to become rent-seekers. This diverts talent away from productive entrepreneurship, and in the long run the economy is worse off.

Box 1

Early Warning Indicators

Is your country suffering from the resource curse?

Is there a centralized political economy/political elite?

- *Those in power spend more resources to keep their power*
- *Ranking on corruption indexes is high*
- *Low accountability relationship between government and citizens*
- *High level and/or increase in untargeted social transfers*
- *No institutional modernization*
- *High level and/or increase in public sector wages and/or minimum wage*

Are there signs of the Dutch Disease?

- *Currency appreciation*
- *Decrease of exports*
- *Decrease of local production*
- *Increase foreign imports*

Is there Economic diversification / Fiscal discipline?

- *High level of and/or increase in the extractive industries as percentage of export*
- *High level of and/or increase in the extractive industries as percentage of GDP*
- *Economy is extremely vulnerable to fluctuations in commodity prices*
- *High level of and/or increase in public spending*
- *Low level of and/or decrease in public saving*
- *Government doesn't respect laws for fiscal discipline*
- *High level of and/or increase in government debt*
- *High level of and/or increase in government deficit*

Is there Decentralized political economy / Rent seeking?

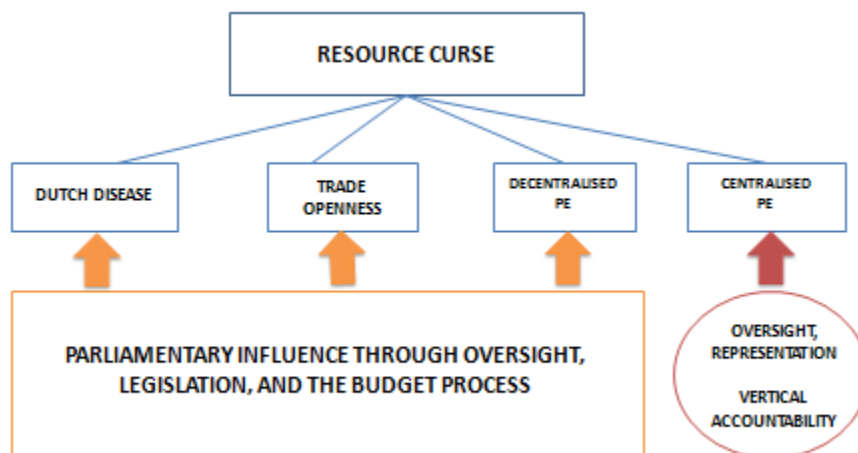
- *Low ranking and/or decrease in "doing business indicators"*
- *Low level of / decrease in level of foreign direct investment*
- *Increase in number of businesses*
- *Increase in number of lobbyists*
- *Competitive extractive industries effective tax rates?*

Parliament and the Resource Curse

The resource curse can be avoided with the right institutions and policies. Research shows that a democracy in combination with strong checks and balances can overcome the resource curse (A. Wiig, 2008). Vertical accountability mechanisms and transparency are needed to control corruption and patronage. Electoral competition also significantly reduces some of the negative political aspects of the curse. In reality, resource-rich countries are more likely to be autocratic.

Research shows that resource-rich countries with a parliamentary democracy perform better economically and socially than countries with a presidential democracy (R. Torvik, 2009). The institution of parliament can use its constitutional rights to influence and counter the resource curse. A legislature effectively carrying out its three core functions – oversight, representation and lawmaking – is critical to the success of natural resource management. The theory of the mechanisms responsible for the resource curse and their management can be linked to functions of parliament as shown in Figure 1 below.

Figure 4: Parliament and the Resource Curse



Parliament holds the '*power of the purse*' (see Box 2 on the next page) with respect to the review and passing of annual country budgets. Given the need to link extractive industries profits to the national budget and national revenues and expenditures, an

understanding of natural resources linkages to the national budget process is necessary for development of national strategies. Using its influence on the budget process and medium and long term economic strategies, parliament can guide economic policy towards countering Dutch Disease, economic diversification, and trade openness.

BOX 2
The Power of the Purse

Parliaments have historically struggled for a role in the budget process. The House of Commons was at the forefront of claiming the 'power of the purse'; parliamentary involvement in public finance and budgetary matters.

"The finance of the country is ultimately associated with the liberties of the country... If the House of Commons by any possibility lose the power of the control of the grants of public money, depend upon it, your very liberty will be worth very little in comparison. That powerful leverage has been what is commonly known as the power of the purse – the control of the House of Commons over public expenditure."

William Ewart Gladstone, 1891

Parliaments Oversight Function & Extractive Industries

Parliamentary oversight refers to checks on the implementation of the law by the executive. One of the main functions of parliament is its work in scrutinizing the operations of the executive, that is, exercising the oversight of the implementation of the law from the angle of performance and accountability and, especially, the use of the finances granted to the executive for its work. Perhaps most important for natural resources management, parliament is a key institution of accountability: through their oversight function parliaments and their committees can investigate natural resource-related issues. They can engage in the monitoring and evaluation of government policies, thereby reducing possibilities for patronage and other forms of corruption. Legislatures are mandated to scrutinize government activities, and their task is to make

sure that programs are implemented effectively and legally, and funds are accounted for properly. By effectively using oversight tools such as the question period, conducting public hearings, and inviting people to testify before committees, legislators can help to make sure that the extractive sector is managed well.

Parliaments Legislative Function & Extractive Industries

Through its *legislative* function, parliament is responsible for reviewing bills and enacting legislation and regulation needed for effective natural resources' management and reform. It can adopt strategies and laws to open up trade and encourage or create incentives for private sector development. Also, several countries have run into legal obstacles for EI implementation, tax competition, freedom of information and contract transparency, and a revision to the laws has been required (NDI, 2007). Legislators can ensure these laws are changed. In addition, some countries have strengthened the Extractive Industries Transparency Initiative (EITI) by turning it into law.

Regulatory frameworks regarding the management of natural resources are often spread across different pieces of legislation and government policies (NDI, 2007). Usually constitutions state that natural resources belong to the people but the government is granted the authority to manage the resources on behalf of its citizens. Mining or oil codes specify procedures and rules for granting concessions, conditions for exploitation, royalties, and taxes. Corporate tax structures and laws regarding employment and the environment have implications for extractive industry management as well. Through their lawmaking functions, legislators can support the passage of these regulations in order to create an enabling environment for sustainable and accountable management of extractive industries. Moreover, given the multidisciplinary nature of the sector, a close coordination among different government entities is necessary to avoid regulatory gaps. Parliament can oversee this.

Parliaments Representative Function & Extractive Industries

Through its *representative* function parliament can make sure the voices, preferences and interests of the public are heard, respected and articulated. Parliamentarians' outreach to their constituents in general and on natural resources management in particular is relevant in this context. Parliament can ensure effective public participation in the political process. Where the legislator represents constituents that have extractive industries resources, there is a direct interest. Parliaments are uniquely positioned to understand and monitor the effects of extractive industries on the citizens and act as a bridge among the government, private sector and civil society. Through public hearings, interviews with the media, constituent outreach, and other methods, legislators can build public awareness about extractive industries and the problems it identifies. Parliaments provide the potential to serve as a forum for multiparty consensus on extractive industries' policies, and thus for countrywide support and ownership.

The country's elected government is ultimately responsible for the way in which natural resources wealth is managed. But legislators can scrutinize government activities, ask the right questions, and promote transparency and accountability in the extractives sector. In many resource-rich countries around the world, legislative engagement and oversight plays an important role in strengthening accountability and transparency in the extractive industry sector (NDI, 2007), and legislators engage regularly with civil society and the media to provide a platform for discussion on the topic.

BOX 3 – Norway’s Legislature Plays an Important Role in Oversight of the Gas and Oil Industry

When oilfields were discovered in the North Sea off Norway in the late 1960s, the country was already one of the world’s wealthiest and most open societies. Norway’s highly efficient and professional civil service offered better career prospects than the private sector, though societal norms and the threat of heavy criticism by the legislature and the media discouraged political leaders and other interests from trying to influence their work. Strong institutions of accountability, in place since the eighteenth century also guarded against political interference.

During Norway’s national debate over the exploitation of the country’s oil resources, farmers, fishermen and environmental activists were among the groups who expressed concerns over the possible risks of becoming an oil-dependent economy. Their concerns were taken into account in the recommendations made by the Norwegian Parliament in 1974 favoring moderation and long-term planning in oil sector development.

Decades later, Norway’s legislature plays an important role in overseeing management of the oil and gas industry. For instance, the legislature creates the framework for the oil and gas sector by: passing legislation and other instruments; debating white papers outlining executive branch proposals; and revising and approving major development projects.

An independent Auditor General’s Office that reports to the legislature conducts regular financial and performance audits of all government accounts and state-owned enterprises and monitors management of state interests in companies.

Source: Transparency and Accountability in Africa’s Extractive Industries: the role of the legislature (2007)

The Committee System

Parliamentary committees as units of organization within legislatures, provide greater freedom for in-depth analysis making it possible for Members of Parliament, and ultimately the parliament itself, to perform the core functions of law making, oversight and representation. A well-functioning committee system is the framework for effective legislative involvement in lawmaking and executive oversight, as well as a platform for citizen engagement. A committee on extractive industries is an effective way for

legislators to organize and coordinate their involvement in the extractive industries sector. Coordination between existing committees can also be useful: often several committees—budget, oil or mining, anti-corruption, public accounts—have been mandated to look at a certain aspect of the extractive industries sector. Effective oversight requires that the activities of these committees be coordinated and that information be shared between them. Legislatures can also establish ad-hoc, select, or investigative committees to study or to deal with specific issues. Legislators should use the committee system to monitor and oversee the extractive industries sector. Public committee hearings are also a useful way to raise public awareness about extractive industries.

The *effectiveness* of a parliamentary committee depends on a number of factors, these include:

- A clear mandate, roles and responsibilities for the committee;
- The size of the committee – if a committee is too large or too small it renders it ineffective; large committees become unwieldy and small numbers limit the quality of ideas needed for effective work;
- The skills of the chairperson of the committee. The following are qualities of an effective committee leader: competence; flexibility and adaptability; firmness and decisiveness; honesty and dependability; openness; fairness; tolerance; patience; and humility;
- The quality of support staff and resources available to the committee: skilled personnel, access to relevant and accurate analysis and information, and adequate logistical support;
- Consensus-building – The multiparty nature of parliaments often translates into multiparty committees. Effective consensus-building techniques and a nonpartisan approach to committee work becomes critical in promoting committee effectiveness (Stapenhurst et al. 2005).

BOX 4 – Successful Resource-Rich Countries- A Closer Look at Botswana

Examples of resource rich countries with strong institutions and a commitment to good governance, transparency and accountability are Australia, Canada, the US, New Zealand, Iceland and Norway. Countries such as Botswana and Chile have leveraged their natural resource wealth into sustainable growth through investment-friendly policies, fiscal discipline and long-term planning.

Botswana is widely perceived as a model of the successful management of natural resources for development. Since the discovery of diamonds in 1967, diamond revenues have helped fund investments in infrastructure, education, health and other development programs. The diamonds are mined by private companies in which the government has significant shareholding. The largest operator is Debswana, in which De Beers and the Government of Botswana are equal partners. Although the revenue sharing agreement between the two partners is confidential, some analysts estimate that the government takes approximately 75 percent of the profits through taxes, royalties and dividends. According to one study, Botswana's success can be attributed to:

- A stable political system that values honesty, transparency, accountability and commitment to citizen welfare;
- A stable socio-political environment enabling properly regulated extraction, processing and marketing of national resources;
- A fiscal environment whose monetary laws, taxes, inflation levels and financial management attract foreign and local investment; and
- Sound partnerships between government and the private sector, underpinned by a mutual commitment to the sustainable utilization of resources.

Traditional concepts of dialogue, as embodied in the use of *kgotla* (village councils) and commitment to consensus or *kogisano* (social harmony) continue to have an important influence on political processes. Through various economic policies, Botswana has been able to limit external debt, stabilize growth and encourage economic diversification. In 2006, De Beers and the government of Botswana signed an agreement to establish a new company – Botswana Diamond Trading Company – that will sort, value and market diamonds. These functions were previously carried out in London. Diamonds will also be cut and polished in Botswana in the future. These initiatives are expected to create new jobs and increase the diamond industry's contribution to the country's economy.

Unit 1 Questions

Please answer each of the following questions. If you are taking this course in a group you may then meet to discuss your answers.

1. How does Parliament conduct its legislative function regarding the extractive industries sector in your country? Is it active? What are the most important pieces of legislation regarding the extractive industries sector?
2. How does Parliament conduct its representative function regarding the extractive industries sector in your country? Are there MPs that represent areas with extractive industries?
3. How does Parliament conduct its oversight function regarding the extractive industries sector in your country? Is there a committee that focuses on natural resources or extractive industries? If so, what has that committee accomplished so far and how? What about a Public Accounts Committee? Which oversight tools are being used?

Relevant Internet Resources

The Natural Resource Charter: <http://www.naturalresourcecharter.org/>

Parliamentary Strengthening: <http://www.parliamentarystrengthening.org/>

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Unit 2: Countering the Resource Curse with Good Institutions

Learning Objectives

Institutions, Laws, Good Governance and Extractive Industries

After studying this unit, you should be able to:

- Be able to explain what the concept 'institutions' means
- Be able to explain how transparency and a Freedom of Information Law can influence the resource curse
- Be able to outline the relationship between accountability and corruption
- Be able to outline the relationship between corruption and the resource curse
- Know how parliament can increase horizontal and vertical accountability
- Understand in which way parliament can use its representation function to improve participation in the extractive industries sector
- Recognize the importance of cooperating with civil society and the media in order counter the resource curse

Introduction and Overview

This Unit will show the relationship between institutions and the resource curse. Good governance concepts such as transparency, accountability and checks and balances are mechanisms to counter corruption and the resource curse. The Unit will give a detailed outline of the concept of transparency, the merits of a Freedom of Information law and it will be explained how parliament and other government agencies can play a role in assuring that information is disseminated and accessible to the community. Regarding corruption and accountability, the unit will explain how a code of ethics and/or code of conduct can help give guidelines that outline expected behavior of public officials.

Institutions

Research shows that the resource curse is less severe with good institutions (See Box 5). 'Good institutions' with good governance practices are typically more successful with extractive industries practices.

Creating an environment of good governance is at the heart of the institutional and policy changes needed to sustain sound fiscal management, sustainable and equitable development and extractive industries. Good governance concepts such as transparency, accountability and checks and balances are mechanisms to counter corruption.

BOX 5: Institutions

Institutions are defined as structures and mechanisms of social order and cooperation governing the behavior of a set of individuals. Institutions are identified with a social purpose and permanence, transcending individual human lives and intentions, and with the making and enforcing of rules governing cooperative human behavior. The term, institution, is commonly applied to customs and behavior patterns important to a society, as well as to particular formal organizations of government and public service. As structures and mechanisms of social order among humans, institutions are one of the principal objects of study in the social sciences, including sociology, political science and economics. Institutions are a central concern for law, the formal regime for political rule-making and enforcement.

Transparency

Because, according to most constitutions (for examples please refer to Unit 5, Contracts), extractive resources belong to the public, decisions regarding their management and exploitation should be subject to public oversight. A necessary prerequisite for effective oversight and good governance is transparency. Transparency requires openness in government systems. It means that information is available in a timely and accurate fashion and that information provided to the public is useful.

Because of transparency, citizens and MPs know what they can expect from their government. Without it, they are unaware of opportunities, regulations or procedures established by the government, and therefore, they cannot use them for their benefit. Transparency in governance is crucial because it enables citizens and MPs to control their government's actions and builds trust among politicians.

When the rules, procedures, and objectives of the government are not available to the public, there is not budgetary and administrative oversight to balance the power of government officials, transparency is lacking, incentivizing corruption. Without oversight and transparency of budget and rules, national resources may be plundered and power may be abused. Lack of transparency creates opportunities for public officials to abuse their office for private gain (www.parliamentarystrengthening.org / Corruption Module).

Transparency is important at all stages of the extractive industries chain. For instance, the rules and terms for bids or concessions should be clear and publicly available. Concession-holders should be known, the allocation of resource rights should be transparent. National resource companies must be well governed and transparent: their revenues, expenditures and investments should be openly available to the public through annual reports that are punctually produced. The government should also publish and state clearly how the revenues generated from extractive industries are allocated and how citizens will profit from them (The Natural Resource Charter, 2009).

In order to create maximum transparency, accountability, and ultimately welfare, citizens should know about the resource extraction. Governments should adopt transparent processes along the whole extractive industries chain: for establishing and implementing resource policies, for awarding contracts, for taking spending decisions, and for managing revenues (see also The Natural Resource Charter, 2009). Citizens need to be informed of the basic policy framework regarding natural resources and their contribution to the country's welfare. If citizens know about the government's intentions on resource extraction and their relation to economic growth and social development, they will be more able to understand and support the government's intentions, mitigating potential sources of conflict.

TIP 1 – Initiate information availability on the budget

TIP 2 – Initiate information availability on public investments

TIP 3 – Initiate information availability on procurement

**TIPS
for Legislators**

Freedom of Information Law

In order to avoid some of the common complications inflicted on media, some governments have passed laws on access to information that give citizens and journalists the right to request and receive a wide range of information from the government, which make it possible for journalists to obtain the facts they need to do their job and citizens to be informed on policy measures. This also protects the media as they can then have evidence of the statements they are publishing. The parliament works with the media so the media can work to inform the people. In order for parliament to be effective at its job, the government and the media must work together to allow for information to be brought to and empower the community. (For more, please visit www.parliamentarystrengthening.org for the Parliaments in Promoting an Information Rich Society Module)

Access to information represents the basic tools for development and good governance. It empowers citizens through access to and use of information and knowledge and engages citizens and citizen organizations in public policy debates, public services delivery, and the monitoring and management of public goods. Effective public participation in decision-making requires information to be publicly available in an accessible form. Most countries establish ***Freedom of Information Laws*** (FOI) to officially legislate this basic professional and human rights. In addition to the basic rights already mentioned and the desire to make government information more open, FOI also allows citizens to request that access be provided for information held by the

government that is not otherwise made routinely available. This can have important consequences for contract transparency in the extractive industries sector.

The process for obtaining public information through FOI laws is not simple. Exceptions when this is not possible include national security restrictions, the protection of personal privacy, and the protection of trade secrets. Such laws typically involve a bureaucratic, cumbersome, and relatively expensive process that the citizen must undertake in order to obtain information that is legally in the public domain (www.parliamentarystrengthening.org / Promoting an Information Rich Society Module).

The countries that currently have a FOI law are Albania, Angola, Antigua and Barbuda, Armenia, Australia, Austria, Azerbaijan, Belgium, Belize, Bosnia and Herzegovina, Bulgaria, Canada, Colombia, Croatia, Czech Republic, Denmark, Dominican Republic, Ecuador, Estonia, Finland, France, Georgia, Germany, Greece, Honduras, Hungary, Iceland, India, Ireland, Israel, Italy, Jamaica, Japan, South Korea, Kosovo, Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Macedonia, Mexico, Moldova, Montenegro, Netherlands, new Zealand, Norway, Panama, Peru, Poland, Portugal, Romania, St. Vincent and the Grenadines, Serbia, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Tajikistan, Thailand, Trinidad & Tobago, Turkey, Uganda, Ukraine, United Kingdom, United States, Uzbekistan, and Zimbabwe.

Box 5 - Early Warning Indicators

Transparency

- *Documents related to extractive industries such as the budget, contracts, procurement systems, data on revenues and expenditures, etc. are not available to the public, to journalists, or to financial analysts*
- *There is no Freedom Of Information Law in place*
- *There are often confidentiality clauses in contracts between the government and extractive industry companies*
- *The government does not actively communicate with the public about its policies*
- *Low ranking on and/or decrease in Transparency International indicators*

Accountability

Transparency closely relates to accountability, as weak accountability mechanisms tend to facilitate corruption. Where there is a lack of transparency and accountability corruption will flourish.

There are two relationships of accountability: government workers to elected officials, and elected officials to the citizens who elect them. When accountability occurs between elected officials and the citizenry government officials have to explain or justify what they have done or failed to do for their people. Only then can we guarantee that leaders will actually act according to their citizens' wishes.

Accountability involves reporting actions and being held to standards. Because of the power of accountability, citizens not only have a say in official decisions, but also have the right to hold their rules to account. It is the obligation of parliamentarians and other power holders to account for or take responsibility for their actions (www.parliamentarystrengthening.org / Governance Module).

Corruption

Effective governments should also be able to contribute to the quality of governance in a country by ensuring that the rule of law is administered fairly. The government should conduct sound policies that improve the lives of its people. The lack of rule of law leads to an inefficient, unfair and corrupt system, which is inconsistent with an environment for good governance. Parliaments have the authority to create the legal framework needed to prevent and curb corruption, for example laws against inappropriate behavior. In addition, parliaments can bolster integrity in governance by establishing incentives to public officials and transparency and accountability. In order to be effective, laws must follow a key set of principles in clear language to minimize areas of discretion, and adapt them to the local circumstances and should address some issues such as conflicts of interest, nepotism, and statutes of limitation – not only to provide for the necessary punitive measures but also to promote an administrative and social environments adverse to corruption. Parliaments can curb corruption by holding the government accountable. This can be achieved through effective participation in the budgetary process, the exercise of parliamentary oversight through anticorruption commissions, cooperation with supreme audit institutions, and promoting a media-friendly environment (www.parliamentarystrengthening.org / Corruption Module).

BOX 6 – Networking & international legislative organizations

Legislators may be able to strengthen their knowledge and engagement on extractive industry transparency by networking with their peers through international legislative organizations. For example, Global Parliamentarians Against Corruption (GOPAC) is a network of legislators dedicated to combating corruption. See also www.gopacnetwork.org.

Corruption also occurs when there is a known conflict of interest between a decision-maker's policy duties and his or her personal self-interest. Even if there is no evidence of improper actions, a conflict of interest can create an appearance of impropriety that can undermine confidence in the ability of that person to act properly in his/her position.

In countries with weak ethical standards, legislators are just as likely as members of the executive branch to maintain business or personal ties perceived to be conflicts of interest. In Ghana, for instance, elected representatives and government ministers may serve on the boards of corporations over which they have direct or indirect oversight. In Tanzania, the 1998 Mining Act drops the provision that forbids that the Ministry of Mines officials cannot own shares in mining companies, creating a window for conflict of interest and corruption (NDI, 2007). In countries where oversight activities are conducted, legislative committees have turned to extractive industry companies to help finance extractive industry site visits, creating the impression of a conflict of interest (NDI, 2007).

When there is a case of great public outcry to improve ethics standards and eliminate ethics violations, ethics regimes are created. A common method for addressing potential misconduct on the part of parliamentarians is through a code of conduct, which is enforced horizontally, by a specific commission acting on behalf of the public. They are created in order to generate more ethical behavior among politicians and to rebuild public trust in political institutions. These regimes have been adopted by several legislatures and generally take on one of the following two forms:

1. Ethics codes – These are general documents that formulate broad principles of behavior, but do not define what is appropriate and what is inappropriate behavior, nor do they establish sanctions for violations of the code. For example

2. Conduct codes – These tend to include very specific terms with clear sanctions for those who violate the arrangements of the code.

The success of ethics regimes is dependent on whether the people that are regulated by the code actually share the same ethical standards, have a common understanding of what is appropriate behavior, and a common understanding of what constitutes misconduct. Unless all members of a society share the same beliefs, their understanding of what is appropriate and inappropriate in power positions, and their understanding of what constitutes democratic governance run the risk of being different. Ethics Regimes

help create an equal playing field. When misconduct, corruption and other forms of unethical behavior occur, ethics regimes can help eliminate them through legislative training, sanctions, and public pressure (for more information please visit www.parliamentarystrenghtening.org / Legislative Ethics and Codes of Conduct Module).

The government should have effective institutional arrangements to promote public sector values, and a code of ethics or guidelines for the appropriate conduct of public officials, which should be clear, accessible, and publicly available. This is often supported by arrangements to enlist public servants in support of these ethical standards in their departments or ministries. Officials handling or making decisions about the receipt or use of public funds, and otherwise exercising their official powers, should be subject to a code of conduct that precludes unethical behavior. Some aspects of such a code could be included in the budget and tax legislation; other aspects may need separate policy, legislation, or regulations.

BOX 7 – The UN International Code of Conduct for Public Officials

The *International Code of Conduct for Public Officials*, adopted by the United Nations on December 12, 1996, takes as its starting point that a public official is in a position of trust, implying a duty to act in the public interest. It includes the following provisions:

- public officials shall avoid conflicts of interest;
- public officials shall comply with any applicable requirements to disclose their personal assets and liabilities;
- public officials shall not solicit or accept any gift or favor that may influence the performance of their duties;
- public officials shall respect the confidentiality of any information in their possession; and
- public officials shall not engage in political activity outside the scope of their office such that it impairs public confidence in the impartial performance of their duties.

Participation

Accountability and transparency refer largely to the people in positions of power, but for corruption to truly be avoided, the other part of the equation, citizens, must also be considered. Participation is the process through which citizen's influence and share control over government's priority setting, policymaking, resource allocation, and access to public goods and services. Participation is important because it allows engagement of citizens and organization in public policy. Parliament is in a position to play a leadership role in promoting greater participation by opening up its practices and procedures to the public. For example, parliamentary debates could be televised and records of these debates could be made publicly available, including through the Internet. Constituency offices as well as elected officials at all levels can also help foster greater participation. Furthermore, committee meetings should be open to the public. When citizens are well-informed about their government's spending priorities, and can monitor the use of revenues, it forces government officials to act more responsibly. In the short run, public criticism may be unpleasant, but in the long run it will produce a more efficient and effective government.

It is harder for citizens to monitor their government when the government is funded by resource revenues: the revenues typically arrive through non-transparent channels, and contracts are often kept secret. Parts of the revenues may be channeled through state-owned enterprises, which are hard for citizens to monitor. At the same time, the need for citizen monitoring is especially strong: resource-rich governments tend to be unusually large, and for the reasons discussed above, they play an unusually central role in the nation's economy (NDI, 2007).

Parliament and other government agencies can play a role in assuring that information is disseminated and accessible to the community. Communities may develop communication networks that allow members of the community to develop a unified voice and make demands for services and information relevant to them.

Through its *representative* function parliament can make sure the voices, preferences and interests of the public are heard, respected and articulated. Parliamentarians' outreach to their constituents in general and on natural resources management in particular is relevant in this context. Parliament can ensure effective public participation in the political process. Where the legislator represents constituents that have minerals or oil reserves, there is a direct interest. Through public hearings, interviews with the media, constituent outreach, and other methods, legislators can build public awareness about extractive industries and the problems it identifies. Parliaments provide the potential to serve as a forum for multiparty consensus on extractive industries' policies, and thus for countrywide support and ownership.

BOX 8: Bringing information to the people

Once information is made accessible, the public will need to have the skills to properly utilize access, and interpret information in order for it to truly be empowering. For information to empower people it must bring into focus the need to improve their capacity to analyze information and to act on that information by communicating views through:

- a.) Public hearings,
- b.) Public meetings,
- c.) Participatory planning committees,
- d.) Focus groups,
- e.) Surveys,
- f.) Citizen advisory groups, etc.

Source: www.parliamentarystrengthening.org / *Promoting an Information Rich Society Module*)

Civil Society Organizations and the Media

Reaching out includes not just communicating with, but also listening to society. In many nations civil society organizations (CSOs) and think tanks are a good source of policy expertise, but relations between CSOs and parliaments in many nations are very poor. In others, however, parliaments have learned to tap the experts within CSOs in order to build up their own expertise.

Likewise, community stakeholders learn the opinions, decisions and actions from policymakers through the media. The media can be a platform for all stakeholders by communicating rights to the people, informing people about political candidates' items up for vote, communicating the needs of the people, and the demands of CSOs. In short, the media allows for a space for political negotiations to occur. It tells us about when elections are going to be held, what political parties are running and what promises the candidates are making. The media will inform the public of important announcements regarding extractive industries and may also research how parliament and other public officials are doing their constituents justice and where they are falling short (www.parliamentarystrengthening.org /Promoting an Information Rich Society Module).

TIP 1 - Incorporate EI into constituent communication

Citizens often care very deeply about whether the natural resources in their country are benefitting them, but know little about what the government receives from extractive industries, or how it spends the revenue. Legislators can transmit this information through their regular contact with constituents.

TIP 2 - Work through the media to build public awareness

Legislators can raise awareness on EI issues by conducting press conferences and other media activities. In some countries, legislators often write opinion editorials or newspaper columns.

See also: Transparency and Accountability in Africa's Extractive Industries: the role of the legislature (National Democratic Institute, 2007)



**TIPS
for Legislators**

Unit 2 Questions

Please answer each of the following questions. If you are taking this course in a group you may then meet to discuss your answers.

1. Is there a Freedom of Information Law in place in your country? Is/Would such a law be useful?
2. Does the legal framework in your country succeed in preventing corruption? What are the strengths of the legal framework? Where are the weak points? In the extractive industries sector in your country, are there conflicts of interest that occur? Does legal framework have specific regulations against conflicts of interest?
3. How does parliament open up to the public and ensure greater participation in its practices and procedures, especially regarding extractive industries?
4. How can the public reach out to parliament? Are there constituency offices? Does parliament disseminate information to communities? How does parliament, and especially the committees dealing with extractive industries issues, know about the demands from citizens on EI?
5. Which civil society organizations and think tanks are involved in EI issues in your country? What can MPs learn from them? What can they learn from MPs? Is there regular contact and exchange of information between these parties?

Relevant Internet Resources

The Natural Resource Charter: <http://www.naturalresourcecharter.org/>

Parliamentary Strengthening: <http://www.parliamentarystrengthening.org/>

Global Organization of Parliamentarians Against Corruption (GOPAC):

www.gopacnetwork.org

Select Bibliography

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Unit 3: Countering the Resource Curse with Economic Policy and Planning

Learning Objectives

Strength through funds, policies and framework

After studying this unit, you should be able to:

- Be able to explain the extractive industries governance framework;
- Be able to recognize the stages of the resource chain;
- Be able to articulate the relationship between the economic, legal and social framework, the stages of the resource chain and transparency and accountability;
- Recognize the necessity of having a strategic plan for the extractive industries sector;
- Be able to explain the elements of a good strategic plan;
- Know how to get information and stay up to date on the policies and pieces of legislation regarding the extractive industries sector;
- Know how to use the budget process to influence the allocation of revenues in ways that alleviate poverty and promote social and economic development;
- Know which policy measures will diminish the negative effects of the resource curse
- Know what a Stabilization Fund is.

Introduction and Overview

How can extractive industries contribute to long-term national debt? How can they help reduce poverty? How much should they be taxed? This unit outlines the requirements of the strategic framework for the extractive industries sector, as well as the macro-economic and legal framework. In this unit, parliamentarians will be provided with practical information on budgeting, consumption and investment choices, spreading out

expenditures over time (expenditure smoothing), ways to counter the Dutch Disease, and rules for fiscal discipline. Practical tools to influence and monitor these policies are provided as well.

The Extractive Industries Governance Framework

Together with an open system of transparency and accountability, the right social and economic policy choices can counter the resource curse. The figure below shows how economic and social policy interrelate, the relationship between the economic, legal and social framework, and how these frameworks relate to the natural resource chain. Transparency and accountability are important in all stages of the policy decision-making process, including the monitoring and evaluation of progress and policy outcomes.

The ultimate goal is to make resource revenues contribute to long-term sustainable development. Effective use of resources requires a plan or vision of what the country wants to do and how resources can help the country in getting there. These larger goals should guide all of the individual decisions along the entire value chain. All decisions that have to be made throughout the value chain, such as the decision to extract, the awarding of contracts, the laws and regulations regarding environmental issues, fiscal regimes, and the spending of resource revenues should be set so as to provide maximum benefit for the citizens. Citizens benefit from extractive industries if the sector's revenues are used or invested by the government in such a way that results in economic and social welfare for all of its citizens and future generations (for example through job creation, infrastructure improvements, improved healthcare facilities, access to education, etc.)

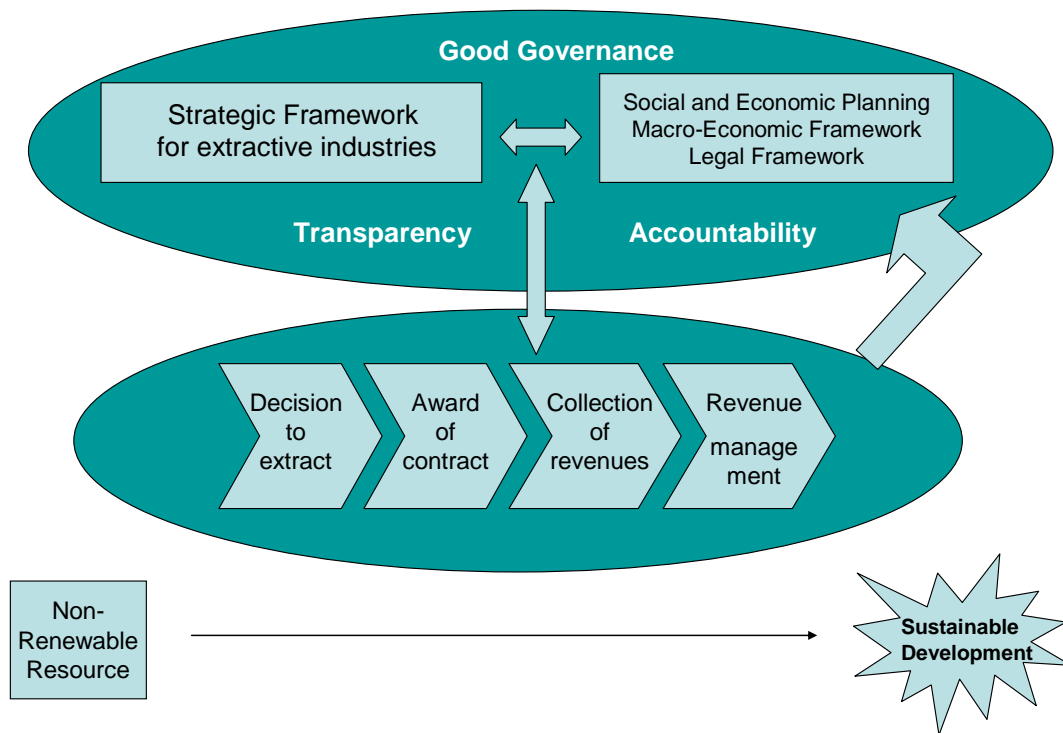
The management of natural resources along the value chain should fit into the country's long term economic and social development goals and poverty reduction strategies (the Natural Resource Charter, 2009). The development of natural resources should be designed to facilitate the maximum benefit to the citizens of the country within the framework of its long-term development goals.

This requires a vision and a plan for natural resources management.

A country's long term economic and social development goals should be clearly outlined in a strategic framework that uses social and economic planning scenarios to reach the country's long term goal. A strategic framework should reach beyond the annual budget and include a medium-term budget, strategies for consumption, investment and expenditure smoothing, and it should include ways to let resource-revenues contribute to the country's economic and social development and poverty reduction.

The strategic framework is related to and operates within the country's existing (or desired) macro-economic and legal framework. The macro-economic framework should include mechanism to counter the Dutch Disease, strategies to diversify the economy, to stimulate and develop the private sector. The strategic and macro-economic frameworks operate within an enabling legal framework that includes rules for fiscal discipline.

Figure 5: The Extractive Industries Governance Framework



Based on: Revenue Watch (2008), E. Alba (2009)

The process of depleting a non-renewable resource and using its revenues for development can be projected into a so-called 'resource chain' (see the figure above). The resource chain includes the steps from the decision to extract, to the awarding of contracts, to the collection of revenues and finally revenue management. All steps should take place in an environment that is transparent, accountable and participatory (the principles of good governance), and under a clear strategic framework as well as a clear and carefully planned macro-economic and legal framework.

Before depletion of the resource begins, policy makers have to think through why depletion is the right decision to make, and value the costs and benefits of depleting, and not depleting. Then, contracts have to be awarded to companies that will execute the extraction. Operations of these companies have to be constantly monitored, and the state has to start collecting revenues in the form of taxes and royalties from the

companies. Finally, when revenues are collected, they have to be spent in ways to conform the strategic framework. Meanwhile, the effects of the revenue extraction on the macro-economy have to be monitored, and policies have to be put in place to counter negative side-effects such as the Dutch Disease and deteriorating government finances.

The country's legal framework should incentivize the prevention of environmental damage; make public the awarded contracts; ensure the proper health and safety requirements, etc. Because of the multidisciplinary nature of the regulatory process and legal framework, close coordination among different government entities is necessary to avoid regulatory gaps.

Transparency and accountability are important in all stages of the extraction chain. Governments should adopt transparent processes for establishing and implementing resource policies, for awarding contracts, for taking spending decisions, and for managing revenues. Citizens should be properly informed on the extractive policy framework.

Being Informed and Up-to-Date

Being informed on the government's strategic framework, where and how resource revenues can be found in the budget and medium term strategy, and knowing the important pieces of legislation and regulations regarding extractive industries is essential. Other than that, MPs in countries with extractive industries have to be up-to-date on recent developments in the sector, they have to know what goes on in places where resource are extracted from the ground, how communities are affected, whether or not revenues make their way back to those communities, etc. This is not an easy task and it is a time-consuming activity and one for which representatives must be sensitive to many different needs.

There are a number of ways by which legislators can acquire this information. For instance, local and international civil society, academic institutions, international organizations, companies and government representatives that are experts on the issue

can be helpful in providing information and explanations when requested. International donors such as the World Bank, the African Development Bank, Revenue Watch, Publish What You Pay, etc. may also be able to provide information on request.

The following is a list of 10 tips from the EITI Guide for Parliamentarians (NDI and Revenue Watch, 2009) to help legislators to require the necessary information on the extractive industries sector.

TIP 3.A _ *Conduct site visits*

Legislators visiting an oil, gas or mining operation educate themselves about how the natural resource is extracted. Meetings with company employees and representatives of the ministry responsible for the industry can shed additional light on industry operations and finances.

TIP 3.B _ *Hold briefings or informational hearings*

Legislators might invite oil and mining ministry officials, company representatives, civil society, and other experts to brief members during a committee meeting or an informational hearing. In many countries, civil society groups knowledgeable about technical, legal or financial aspects of extractive industries hold similar briefings for their colleagues, and legislators should take advantage of their expertise.

TIP 3.C _ *Organize a study tour to a successful resource-rich country*

Exchange visits can provide tangible, comparative information about how the extractive industries sector works and how it can benefit a country. By meeting with another country's actors, legislators can gain insight into how certain decisions were made and why, which can inform a legislator's view of his or her country's own extractive industries policies.

TIP 3.D _ *Commission a study*

Legislative committees can take advantage of local or international expertise on extractive industries by consulting with experts from universities or civil society

organizations to conduct research on key issues. Such studies could examine fiscal, legal or operational aspects of the industry and highlight key concerns that may be relevant.

TIP 3.E _ Produce a committee report

Committees can also produce a public report explaining findings of a commissioned study or other committee activities. Committee reports are often used in developing legislation or to encourage the government to act on an issue.

TIP 3.F _ Use the internet and other publicly available information sources

If parliaments are to expand their representation, lawmaking and oversight performance, they generally need to upgrade their infrastructure. Modern parliaments need effective information systems, both intranet systems for internal communication and high-speed connections to the Internet to enable MPs and staff to connect quickly and efficiently with the world. A number of parliaments now broadcast parliamentary sessions over radio and television, and a growing number now open committee meetings to the public.

TIP 3.G _ Participate in a conference or workshop on extractive industries

Legislators can participate in workshops or conferences, and discuss their views on extractive industries as well as how they would like to see the legislature participate. International donors and local or international CSOs may be able to help facilitate these events.

TIP 3.H _ Request regularly scheduled extractive industries briefings

Committees can request that senior government officials provide briefings on a regular schedule. Committee members will need to determine how often these briefings should take place to ensure effective information exchange.

TIP 3.I _ *Coordinate efforts with local civil society organizations and local think tanks*

Some CSOs are very active on extractive industry issues. They may have links with international organizations that provide them with financial support and information about the extractive industries. These organizations can provide legislators with useful information on the extractive industries, be helpful advocates in encouraging the government improve, provide informed ideas for developing a policy related to extractive industries, or help to hold the government accountable for missing or mismanaged revenues. Legislators can reach out to civil society groups, think tanks, sector experts, representatives of the private sector and others with particular extractive industry expertise. However, not all civil society organizations are capable and effective. It is necessary to select and engage with those CSOs that seem organized, have sufficient capacity, and knowledge about the topic.

TIP 3.J _ *Establish contact with peers from other resource-rich countries*

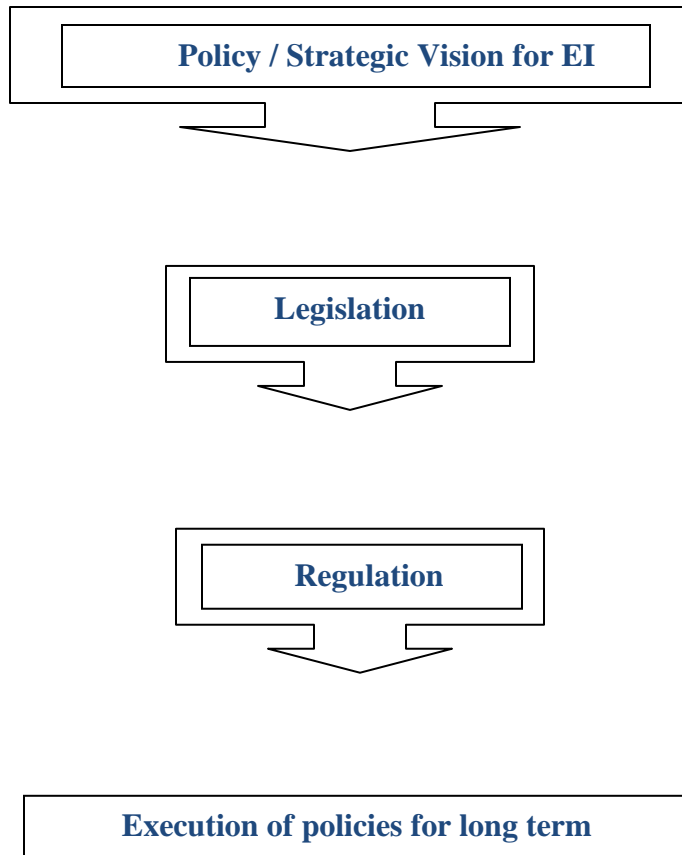
Establish contact with peers from other resource-rich countries who confront similar challenges or have played a role in addressing them. It is useful to share information, best practices and lessons learned on a variety of policy issues. Legislators can become better informed and more effective overseers by working with their peers in other resource-rich countries and in regional networks, international legislative networks and with international donors.

The Strategic Framework and Resource Management

National investment opportunities should not simply bubble up from within each sector ministry, but should be coordinated within an agreed framework. A strategic framework involves the development vision for the country, clarifying the role of the extractives sector within it and establishing the legal framework to serve it. The overall aim must be to maximize the benefits to the citizens of the country, now and for future generations. Parliamentarians have a key role to play in long-term social and economic planning that clarifies the contribution that extractive industries are expected to make to long-term development. Economic mechanisms to counter the resource curse, such as policies to prevent the Dutch Disease, to diversify the economy, to increase the competitiveness of the private sector, and the use of a stabilization fund or other investment decisions should be incorporated into the country's strategic framework.

Policy and laws regarding extractive industries must then be reflected in legal and regulatory frameworks that govern minerals and revenue management. Therefore the legal framework and regulations should be fixed to a clear vision for development and poverty alleviation (See Figure 6).

Figure 6: Relationship between the strategic vision, legislation, regulations and long-term development



Governments must create a business climate that attracts private investment, a necessary precondition to the development of the extractive industries. They must also address domestic policy issues regarding extractive industries, such as the environmental impact on communities, and ensure an equitable distribution of revenues to all citizens.

The role of parliament should oversee and assist the government in achieving these goals, by opting for those policies that are likely to bring the greatest benefit to all people. Policy and investment decisions should be reviewed against their costs, their benefits, whether or not costs outweigh benefits, and alternative decisions.

The strategic framework should address the following issues:

Ensure Economic Diversification - Resource-rich countries must diversify their economy in order to be less vulnerable to volatility in resource prices and revenue. The problem is that many developing economies are very poorly diversified and specialize mostly in agriculture and other primary commodities. An advantage is that these countries have abundant and relatively cheap labor and should develop a labor-intensive manufacturing base to diversify their exports (The Natural Resource Charter, 2009). This will make their economies less dependent on global commodity markets and thus less volatile and vulnerable. In order to stimulate the manufacturing sector, well targeted subsidies or tax reliefs can be an effective policy response. Opening up for trade to foreign countries, and creating better access to foreign markets to create export opportunities can also stimulate the manufacturing sector.

Private Sector Incentives - In most countries experiencing a resource boom, private banks tend to lend excessively and inefficiently. The expansion in commercial credit is often financed by foreign borrowing. This irresponsible lending behavior can lead to negative money flows in downturns, and commercial bank restructuring might be necessary. A possible solution is a curb on commercial bank's borrowing abroad (The Natural Resource Charter, 2009).

The private sector can stimulate efficient investment, especially for the growth of the non-resource economy. Also, the private sector also supplies the capital goods that investors need. Since, due to patronage, public sector investments will often crowd out private sector investment in resource-rich countries, there is a special need for policies that foster private investment. Fiscal incentives and other stimuli can be used to help the private sector develop (The Natural Resource Charter, 2009).

Ways to counter Dutch Disease - Natural resources revenues can lead to a crowding out of potentially dynamic non-resource sectors such as the manufacturing and agricultural sectors. As mentioned before, this is known as 'Dutch disease'. First of all,

trade liberalization is needed to depreciate the exchange rate and reduce the effects of Dutch Disease. Other than that, one of the remedies to Dutch disease is to install policies that will lower the costs of manufacturing and agricultural products, so that their export becomes attractive again.

The way to do this on a sustainable basis is not through subsidies, but through targeting infrastructure spending towards their particular needs, such as power, water, roads and ports (The Natural Resource Charter, 2009). Additionally, the problem of Dutch disease can be reduced by smoothing fluctuations in commodity prices, for instance through Stabilization Funds (see also page 45 and Box11 and 12). Another option would be for the independent central bank to influence the exchange rate by adjusting the interest rate, although this is not possible when exchange rates are pegged to a foreign currency. Depending on a country's monetary policy, coordination with fiscal policy makers is necessary.

The Budget, Medium-Term Frameworks and Fiscal Discipline

Ways to counter Dutch Disease, to diversify the economy, to increase the competitiveness of the private sector, and the use of a stability fund or other investment decisions should not only be incorporated into the country's strategic framework, but should be reflected, explained and safeguarded in the country's annual budget, medium term economic framework and mechanisms for fiscal discipline.

The Budget

By getting involved in the budget process legislatures can direct the allocation of revenues in ways that alleviate poverty and promote social and economic development. In many countries the power to amend or change budgetary line items is severely limited. Furthermore, legislators are often under pressure to pass budgets within timeframes that do not allow for thorough review.

Expected and realized government revenues and expenditures are documented in a country's annual budget. The budget should also explain how expected and realized revenues fit into the long term strategic vision. The government also must explain how it is going to cope with increases in the world price of natural resources, avoid boom-bust cycles, and coordinate the spending of natural resource revenues.

Budgets should be comprehensive and transparent and ensure funding predictability for government departments. The budget process is used to assess competing claims on the budget and to facilitate difficult tradeoffs. Meeting this challenge successfully requires that budgeting maintains fiscal discipline and prioritize strategic public funds. Fighting the resource curse requires a public financial management system in which budgetary allocations are open and transparent. This requires *ex ante* transparency, current monitoring and *ex post* evaluation of expenditures. Fiscal discipline requires that budget totals are the result of explicit and enforced decisions. Aggregate fiscal discipline refers to the control of the key measures of fiscal performance, including total spending, total revenue, the financial balance and the public debt (IMF, 2007).

Many factors are important for determining the appropriate total level of aggregate spending, including available revenues, access to borrowing and the acceptable level of the deficit. Given these constraints, fiscal discipline calls for affordability of total spending, including in the medium to long term. Some countries have adopted formal rules to ensure fiscal discipline, for example by allowing borrowing for capital purposes only (the so-called 'golden rule') (IMF, 2007). A strong treasury or finance ministry can check that spending departments do not make exaggerated claims on the budget and that they stick to their budgets once they have been approved. A hard budget constraint on departmental spending exists when the treasury is successful in enforcing approved budgets. This requires comprehensive and reliable information to monitor compliance of government departments with spending plans. To maintain fiscal discipline, parliament has to resist the temptation to add new spending without cutting back elsewhere in the budget.

BOX 9 – Basic elements of public expenditure management

Aggregate fiscal discipline – Budget totals should be the result of explicit, enforced decisions; they should not merely accommodate spending demands. These totals should be set before individual spending decisions are made, and should be sustainable over the medium term and beyond.

Allocative efficiency – Expenditures should be based on government priorities and on effectiveness of public programs. The budget system should spur reallocation from lesser to higher priorities and from less to more effective programs.

Operational efficiency – Agencies should produce goods and services at a cost that achieves ongoing efficiency gains and (to the extent appropriate) is competitive with market prices.

See also: www.parliamentarystrengthening.org

Because resources are limited, budgeting forces us to consider the merit of competing claims on the public purse and to negotiate tradeoffs between them. The achievement of allocative efficiency or strategic prioritization requires government capacity to allocate resources and select programs and projects in conformity with its objectives. This process is supported where the policy basis of the budget is stated clearly on the basis of a strategic framework. Allocative efficiency is threatened where spending departments are bailed out when they overspend, because poor budget execution can introduce substantial ad hoc realignments that distort stated priorities. Such distortions often divert resources away from the poorest and most vulnerable groups in society to cater for the interests of bureaucracies and strong interest groups. Parliament can provide an important platform for public debate on the nation's priorities (www.parliamentarystrengthening.org / Budget Module).

A description of major expenditure and revenue measures and their contribution to policy objectives should be provided, as well as estimates of their current and future

budgetary impact and their broader economic implications (IMF, 2007). Budget discipline requires clear descriptions and costing of both continuing government programs and new policy proposals. As part of the budget documentation, countries should always include a statement describing any important fiscal policy changes and their expected effects. This will allow an overview and understanding of the factors that may cause budget outcomes to diverge from planned spending (IMF, 2007).

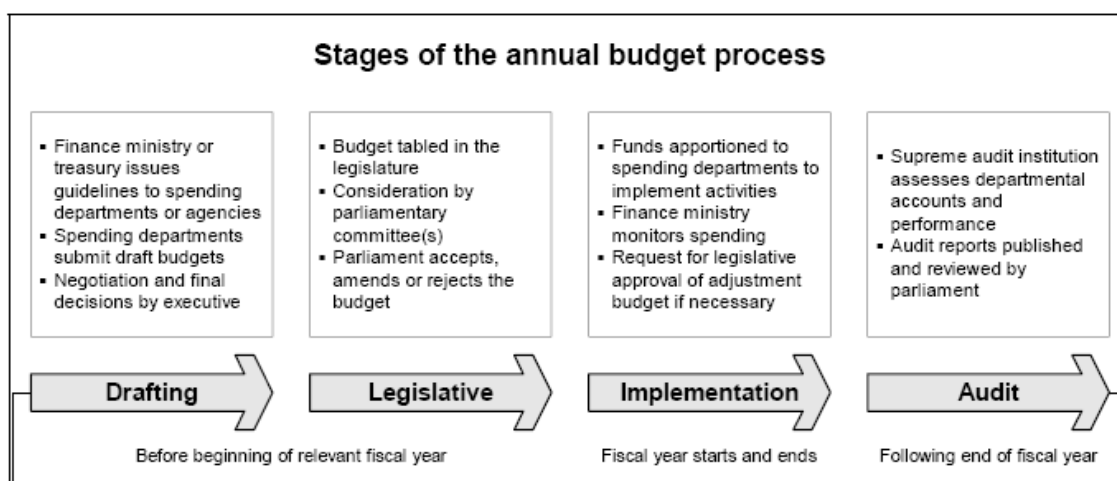
The Budget Process

Budgeting is a process rather than an event, and budget cycles are ongoing and interconnected. Parliament plays a key role in the budgetary cycle; financial integrity is central to anti-corruption efforts. In most countries, the ultimate control over the national budget rests with parliament. This power of the purse constrains governments to tax and spend in only specific ways and seeks to ensure management of funds, disciplined reporting and transparency. It also provides a means for parliamentarians to be heard on how money is to be obtained and spent. The role of parliament should not be restricted to budget approval and the review of audit findings. For instance, in a number of countries parliamentary committees ask the government to report on the process of drafting an upcoming budget yet to be tabled, and legislators might request certain documentation that is used in the drafting process.

The budget process is governed by a timeline that typically can be separated into four different stages:

- Drafting
- Legislative
- Implementation
- Audit and evaluation

Figure 7: The stages of the budget process



Drafting

The drafting stage is concerned with compiling a draft budget that can be submitted to the legislature. This stage is mostly internal to the executive, but it does not have to be a secretive affair. The first step is to set fiscal policy and estimate available revenues in order to establish the total resource envelope that will be available for spending. Based on the policy framework of the government the finance ministry issues indicative expenditure ceilings for each department. This leads up to negotiations between spending departments and the finance ministry about the allocation of funds across different functions. A consolidated draft budget has to be reviewed and approved at the highest political level, such as the president or cabinet, which will also make final decisions on especially contentious issues that could not be resolved before.

Overly optimistic revenue forecasts are politically tempting because they create an imaginary space for promises of more money on services. In the case of the extractive industries sector the difficulty of budgeting is dealing with both extremely unpredictable and extremely volatile revenue streams. To avoid overly optimistic forecasts, best practices is to take an overly cautious prediction of oil, gas, or minerals prices, and construct the annual and medium term budget with those precautious revenues. In case prices turn out to be higher than expected, there have to be clear rules for spending the windfall revenues. In case prices turn out to be even lower than expected, losses are limited and not as extreme as in overly optimistic scenarios.

BOX 10 – Principles of good budgeting

Comprehensiveness: The budget must cover all the fiscal operations of government, encompassing all public expenditure and revenues, to enable full and informed debate of the tradeoffs between different policy options.

Predictability: Spending agencies should have certainty about their allocations in the medium term to enable them to plan ahead. Stable funding flows support departmental planning and efficient and effective delivery.

Contestability: No item in the budget should have an automatic claim to funding. All policy and attached funding should be regularly reviewed and evaluated in order to ensure prioritization and optimal performance of spending agencies.

Transparency: All relevant information inquired for sound budgetary decision making should be available in an accessible format, and in a timely and systematic fashion. Budget information needs to be accurate, reliable and comprehensive.

Periodicity: The budget should cover a fixed period of time, typically one year, and the process of compiling the budget should follow a clear and reliable schedule that is agreed upon and published in advance.

The inevitable revenue 'shortfalls' result in higher deficits or necessitate expenditure cuts that distort spending priorities so that allocative efficiency is undermined. To be transparent government should publish the macroeconomic assumptions and projections upon which the budget is predicated. It is a good test of government's budgetary foundation to consider whether its growth forecasts are substantially more optimistic than those produced by the private sector and international organizations. If this is the case, it is rather likely that the budget is unsound. Unrealistic assumptions about improvements in revenue collection are another symptom of escapist fiscal planning. Such tactics threaten to undermine the objectives of budgeting.

The realism of the assumptions underlying the macroeconomic framework is critical for the realism of the budget as a whole. The assumptions must therefore be accurately

presented in the budget documentation and available for scrutiny by outside experts. ***Assumptions regarding natural resource prices and production should be made transparent.*** This will reduce the risk of overly optimistic assumptions being chosen for projected growth or inflation that will undermine the integrity of the budget process. In this context, it is important for transparency that the assumptions and data used for the medium term framework and development of the budget be reflected to the extent possible in any development plan or policy framework paper set out by government. Moreover, there should be a transparency relationship between the two types of documents, with any differences clearly explained (www.parliamentarystrengthening.org / Budget Module).

Legislative/Approval

Once a comprehensive budget has been drafted, it has to be approved by the legislature to become effective. During the legislative stage, parliament scrutinizes the expenditure and revenue proposals of the executive. Its options are to approve or reject the budget, to amend it, or, in a few cases, to substitute the draft tabled by the executive with its own budget. In some countries, the legislature passes separate legislation for appropriations and changes to the tax code; in others it considers a unified budget bill. The exact form of legislative approval is less important than the fact that it must be comprehensive. The duration of the legislative stage is an important element of variation between budget processes of different countries. Budget scrutiny takes time. A good rule of thumb, therefore, is that the more time the legislature has to review the draft budget, the greater its overall potential influence. A national legislature requires a minimum of three months for effective consideration of the annual state budget (www.parliamentarystrengthening.org / Budget Module).

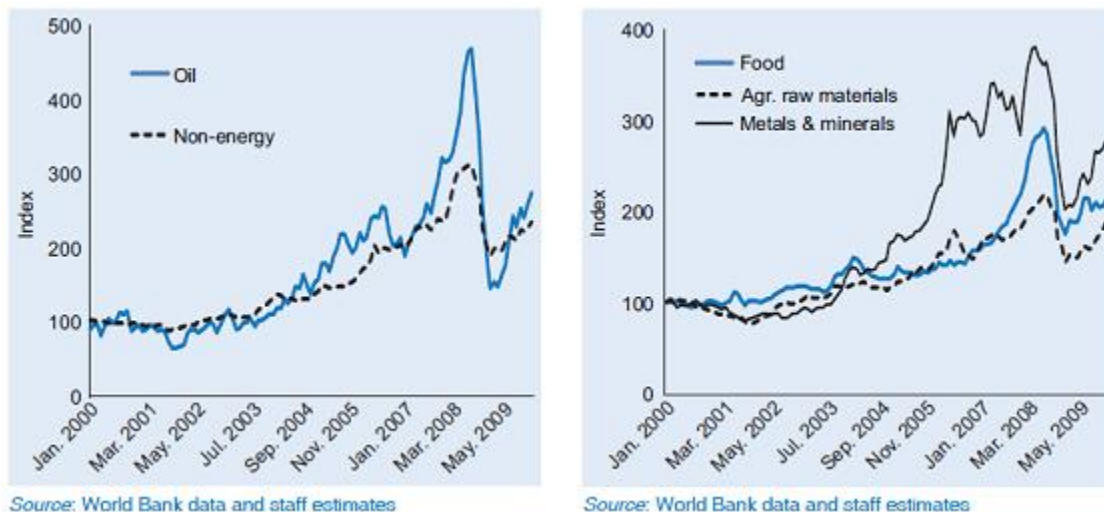
All countries, and especially resource-rich countries, are exposed to fiscal risks inherent in a continuously changing economic environment and even with high quality forecasting many new and urgent pressures on public spending are impossible to anticipate and can emerge suddenly. To ensure that the budget remains authoritative even during difficult economic times, a budgeting system needs to cope with uncertainty. This is the function of contingency reserves, which set aside an amount for adapting the budget to changing

circumstances or emergencies. However, contingency reserves need to be clearly accounted, decisions about their use should be a transparent and approved by the legislature, and they should not be excessive in size. Otherwise, they can easily deteriorate into 'slush funds' (www.parliamentarystrengthening.org / Budget Module).

There are several policies that can counter the resource-curse by either better managing revenues, and/or better managing expenditures. These policies should be clearly reflected in a country's annual, and medium-term budgetary framework. The revenues from natural resources are distinctive in two key respects from other sources of government revenue: since they are derived from depleting a resource they are intrinsically temporary, and since commodity prices are highly volatile and unpredictable they are unreliable. Based on econometric studies commodity prices do not display any permanent trend over time. This means that commodity prices follow a random walk and are thus unpredictable. Based on statistical research, there is very little reason to expect commodity prices to trend either upwards or downwards.

Part of the paradox of plenty arises from the very high volatility of commodity prices (Collier, van der Ploeg, Venables, 2009).

Figure 8: Commodity Price Indexes (US\$2000 = 100)



Source: "Natural Resources and Development Strategy after the Crisis", World Bank PREM note, January 2010 number 147

Natural resource discoveries can induce governments to engage in excessive public spending based on the incorrect assumption that windfall natural resource revenues are permanent. This gives rise to unsustainable spending levels. For instance, we have just seen the end of one of the biggest commodities booms ever. During the boom, countries have not taken advantage of it to boost economic development, save money, and improve government finances, and find themselves in trouble now the boom has come to an end. Successful management of public investment thus needs to accommodate volatility, both by smoothing out expenditures, and by using periods in which investment is relatively low to prepare projects to be implemented when revenues become available. This requires that domestic expenditure is built up gradually and spread out over time to take account of revenue volatility (The Natural Resource Charter, 2009).

Policy measures that will diminish the negative effects of the resource curse, and that need to be considered before approving the annual and medium term budget, are:

1. Improve government finances

'Debt overhang' is a phenomenon often seen in resource rich countries. Debt overhang refers to the circumstances where the debt level is so high that investment incentives are distorted. When resource flows dry up, the returns on new projects are used to pay off outstanding debt. However, with high levels of debt at high interest rates, this pay off is often not sufficient, and debt keeps accumulating. To prevent debt overhang from occurring, countries with high debt levels that are experiencing a commodity boom can use the revenue windfalls to pay off outstanding (foreign) debt. Debt reduction enhances the country's credit standing and appeal to investors, and most importantly, will reduce the cost of capital for the domestic private sector (The Natural Resource Charter, 2009).

2. Sovereign and Stabilization Funds

In budgeting it is critical to take account of commodity price volatility and the potential effect on revenues. Sufficient investment has to take place for when resources run out or revenues decrease. To deal with this, some countries accumulate assets during periods of high prices so that spending can be smoothed during downturns. This can be done by saving a portion of revenues during high price periods, holding the savings in a "stabilization fund", and then using the saved revenues during low price periods. Resource revenues are to put the revenues in a Stabilization Fund when commodity prices are high and draw from this Fund when commodity prices are low. This way the country can spread the benefits of its natural resource wealth over a long time. Sovereign Wealth Funds and Sovereign Liquidity Funds are examples of stabilization funds. Although quite similar, they differ in purpose, scale and composition of assets. The amounts paid into the stabilization fund should be held in international financial assets to avoid the effect of Dutch Disease. Depending on the purpose of the fund, savings may need to be a substantial part of the revenues during boom periods at least until a significant back-up is established (The Natural Resource Charter, 2009).

Choosing between the various ways of using resource revenues depends on a number of economic and political factors, and is country-specific. Therefore, existing stabilization funds have different characteristics in different countries. However, the stabilization funds have all or some of the following objectives: (1) to set aside revenue to smooth expenditure over time, thus countering the effects of price volatility and variations in production levels; (2) to save part of the revenue derived from current exploitation of natural resources for the benefit of future generations; and (3) to insure against extraordinary events (such as natural disasters).

Good stabilization funds are characterized by transparency of operations. Accessible reports are published in the public domain. Audit results are made regularly available to the public through the internet or printed media (The World Bank, 2009). There are numerous checks and balances, and fund managers, board members, and others involved in fund management and oversight are selected on merit. Norway's Special

Petroleum Fund has clearly specified rules and procedures and a well-known stabilization and savings objective. The Special Petroleum Fund is professionally managed, fully integrated with the budget, and benefits from high degrees of transparency and accountability. Venezuela also has a stabilization fund, but its integration with the budget is problematic, its management is weak and the rules of operation are non-transparent. Finally, stabilization funds have been more successful where there was a broad political consensus about its objectives (The World Bank, 2009). Effectiveness will be enhanced if there are transparent rules for asset accumulation and withdrawals. This will make it harder for governments to reduce contributions or speed withdrawals. Management of savings and stabilization funds should at a minimum meet the so-called “Santiago Principles” (see Annex 1).

Since stabilization funds call for saving a substantial proportion of natural resource revenues, it reduces the pressure of rising domestic demand that leads to real exchange rate appreciation and Dutch Disease effects. By smoothing expenditures, the policy also moderates the problems caused by volatility in natural resource prices and revenues.

3. Targeted public expenditures

In addition to physical infrastructure, spending on education, health, and social protection can all improve the investment climate. Low-income countries are capital scarce and lack infrastructure. They are also short of public services and public goods, including health and education services. To ensure enduring benefits for current and future generations the government must accumulate of other kinds of assets than extractive industries, like schools, roads, R&D, industrial capital, telecommunications, and other infrastructure. Natural resource revenues should be used to finance these assets and improve and modernize infrastructure.

Furthermore, it is recommended to establish *sustainable* expenditure patterns that benefit the majority of the population in a highly visible manner. For example, free education services or social protection schemes commit stable expenditure flows in a visible manner, so that they are relatively difficult to cut and divert to a narrow group of

beneficiaries. *Ad hoc* public expenditures that do not fit into the strategic framework or long term development goal are often inefficient and ineffective and should be avoided. A decrease in income taxes might not always be a good idea either, as income taxes create a sense of accountability between the government and its citizens.

BOX 11 – Good Practices Stabilization Funds

1. Policy makers have to articulate a clear proposal to obtain widespread political support
2. The public has to have a vested interest in the fund, and confidence that the fund is well managed, and transparent and used for purposes set out by law
3. All transfers have to be part of the budgetary process
4. Periodic financial reports audited by an independent firm have to be available to the general public

BOX 12 – Country experience with Petroleum Revenue Funds: Alberta, Canada

The Canadian province of Alberta has benefited from healthy petroleum revenues for decades. By 1975, royalties accounted for 41 percent of total government receipts. A savings fund was proposed in 1974 and, following vigorous debate during the 1975 election, the Alberta Heritage Savings Trust Fund Act was passed by parliament in 1976. The act set out three objectives: (1) save for the future, (2) strengthen or diversify the economy, and (3) improve the quality of life of Albertans. The finance minister is responsible for the operation of the fund.

In 1995, the government asked Albertans about the future of the Heritage Fund in a survey called "Can we interest you in an \$11 billion decision?" The respondents wanted to keep the fund for future generations and focus on generating higher returns on long-term investments. In response, the Heritage Act was amended and the fund was restructured. The fund could no longer be used for economic development or social investment purposes. A new business plan, which included a plan to increase long-term investments, was implemented in 1997. The fund's business plan is published as part of the provincial budget and the fund's income is consolidated into the provincial revenue. The amendment created a new Standing Committee (of the legislative assembly) tasked with the following responsibilities:

- ◆Review and approve the business plan annually
 - ◆Receive and review quarterly reports on the operation and results of the fund
 - ◆Approve the fund's annual report
 - ◆Review annually the performance of the fund and report to the legislation whether the mission of the fund is being fulfilled
 - ◆Hold public meetings with Albertans on the investment activities and results of the fund
- Performance measures include timeliness of reports and public accountability meetings, knowledge of Albertans about the fund, and whether half of Albertans can estimate the fund's value.

In 1998, the government surveyed Albertans about their fiscal priorities. Albertans ranked increasing savings in the Heritage Fund high, fourth in overall priority. This was echoed in another survey in 2000, again on fiscal priorities, where Albertans indicated support for a savings plan, including saving an unexpected petroleum windfall for the future. A survey conducted in 2002 specifically on the Heritage Fund showed that 61 percent of Albertans wanted the fund to continue to operate primarily as an endowment fund. After a transition period, the fund is now an endowment fund.

The fund's auditor is the Auditor General. The fund's portfolio consists of stocks, bonds, real estate, and absolute return strategies (designed to achieve positive returns in both up and down markets). About half of the fund is invested in stocks (Canadian, U.S., and non-north American). As with the Norwegian and Alaskan funds, the Heritage Fund has benchmarks against which its performance is measured. Through its 32-year history, the Heritage Fund has generated C\$30 billion in investment income.

The government of Alberta has conducted a number of surveys to ask its residents how they would like to see the petroleum revenues used. Albertans have given overwhelming support for channeling petroleum revenues to a savings fund for future generations.

Implementation

Implementation of the budget starts with the beginning of the fiscal year. The execution or implementation stage of the budget process is mainly in the hands of the executive. The finance ministry or treasury usually plays a leading role in assuring that funds are apportioned to spending departments in line with the approved budget.

Improvised budget cuts tend to adversely affect vulnerable groups that have a weak political voice, and who are most dependent on government initiatives. Frequent adjustments to budgets can reflect the uncertainties that are characteristic of the macroeconomic environment, but 'continuous' or 'repetitive budgeting' is also a symptom of a weak and ill-disciplined budget system. To ensure that its authority is not undermined by excessive adjustments, the legislature might find it useful to keep a close eye on implementation through scrutiny of actual spending during the fiscal year.

During budget execution, the legislature should have access to actual revenue and expenditure data on an ongoing basis. In this way, it will be able to keep track of the progress that is being made in implementing the approved budget. This provides an opportunity to pick up problems at an early stage, before they result in significant deviations between the approved budget and actual revenues and spending.

Legislative decision making needs to be based on comprehensive, accurate, appropriate and timely information supplied by the executive. The amount of supporting documentation that accompanies the budget figures is crucial. In a number of countries, the budget document itself contains little narrative that outlines the policies underlying tax and spending proposals. Often the only source of narrative information is the budget speech. This makes it difficult for parliamentarians and their staff to understand the policy basis of the budget, and to evaluate whether the budget adequately reflects stated government policy. Many budgets do not sufficiently relate expenditures to budget objectives. If this is the case governments should be encouraged to change the budget format so that it integrates relevant output and outcome information (www.parliamentarystrengthening.org / Budget Module).

There are many other information requirements that have to be met to optimize legislative oversight. Following approval of the budget, in-year actual spending information is essential. This can help the legislature to control unauthorized expenditures and variance between approved and actual figures in a timely fashion. Budgetary decisions should be made in the knowledge of actual spending information, rather than on the basis of budgeted figures that might be little more than fiction. Apart from good in-year reporting, this also requires effective interaction between the legislature and the audit body, for instance through regular liaison mechanisms. Another reform challenge is often to narrow the gap between the end of the fiscal year and the finalization of audit findings, to ensure that the usefulness of this information is maximized.

The OECD Best Practices for Budget Transparency give a good overview of the types of budget documentation that ideally should be available. Given the density and technical nature of budget documentation, though, the existence of sound and extensive budgetary information in itself is unlikely to be sufficient to ensure legislative oversight. Parliamentarians have to be empowered to independently analyze the budget if they are to play a meaningful role in the process. Even when the legislature has legal powers and the political space to shape budgets, analytical capacity is necessary to make sound budgetary choices. The ability to understand the budget and to make informed changes depends on sound analysis. It is important, therefore, for parliamentarians to have access to independent information and analysis on the budget preferably through parliament's own research service.

In addition to formal oversight tools, parliaments need access to information, sufficient staffing and funding, and sometimes, access to media communications, if they are to be effective. If the executive is unwilling to provide information, parliaments cannot investigate effectively. Without authority to compel the government to provide information, the legislature's hands are tied. But even when a parliament lacks some of the basic powers to ensure compliance, access to the communications media may help (www.parliamentarystrengthening.org / Budget Module).

Audit

During the audit and evaluation stage, an independent audit institution, such as an audit court or auditor general, analyses government accounts and financial statements. In most countries, the audit of accounts is followed by the consideration of audit findings by the legislature. If the process is effective, any recommendations based on audit findings are reflected in future budgets, which allows for continuous improvements in public spending and generally public financial management. Audit reports need to be produced and tabled in the legislature as speedily as possible to ensure their relevance and accuracy. Long delays undermine accountability, because officials who are responsible for a loss of public money may have moved on or retired by the time an incident receives attention. Delays may make it more difficult to pursue disciplinary measures. The timely submission of audit reports requires that departments produce their financial statements in time for the audit institution to meet the deadline. The relevant financial management legislation usually prescribes when and in what form the necessary information has to be submitted by departments to the auditors (IMF, 2007 and www.parliamentarystrengthening.org / Budget Module).

A national audit body should be set up under law. A national audit body, also known as a supreme audit institution (SAI), can only “accomplish their tasks objectively and effectively, if they are independent of the audited entity and are protected against outside influence.” The national audit body or equivalent organization should submit all reports, including its annual report, to the legislature and publish them. Mechanisms should be in place to monitor follow-up actions.

The chief auditor should report directly to the legislature. There should also be a presumption that all reports of the national audit body are automatically publicly available once submitted to the legislature—either immediately or within a specified period of time. To ensure that the executive cannot render the national audit body ineffective by denying it adequate funding, by controlling its staffing, or by delaying consideration of its reports there should be procedural mechanisms for providing a greater-than-usual degree of legislative oversight of the operation of the office.

One mechanism is to assign to a legislative committee the responsibility for proposing the office's annual budget and for setting broad areas of priority for the office, while leaving chief auditors some flexibility to initiate reports on any aspect of concern within their purview. It is important that the national audit body be given full access to all necessary records, documents, and personnel. Legislative requirements to this effect assist in obtaining the cooperation of audited agencies (IMF, 2007 and www.parliamentarystrengthening.org / Budget Module).

Typically, a nation's supreme audit agency (sometimes called the Auditor General – AG) reviews government accounts and prepares a yearly report for parliament. Auditors independent of the executive (i.e., those whom the executive cannot hire or fire, and whose budgets they do not control) are free to conduct independent investigations of executive spending and programs. Audit agencies need sufficient funds and adequate staff if they are to conduct their work effectively. The majority of Westminster parliaments use Public Accounts Committees (PACs) to follow-up on findings of public audits, to investigate irregularities reported, and to recommend changes to rectify any problems discovered. PACs invite ministers and other ministry officials to testify before the committee, and, in some systems, have the power to subpoena witnesses. Both government and opposition MPs serve on PACs, which more often than not are chaired by a key member of the opposition. AG staff members sometime assist members and staff of PACs in carrying out their investigations (IMF, 2007 and www.parliamentarystrengthening.org / Budget Module). The audit process will be discussed further in the 'Revenue Management' paragraph.

TIP 1 – Try to influence the budget

Identify ways to identify the budget (formally and informally) at each of the different stages of the budget cycle – preparation, drafting, legislative review, implementation and audit. Develop the capacity to evaluate the importance of legislative requests for resources relative to other proposed expenditures in the national budget.



**TIPS
for Legislators**

TIP 2 - Build cross-party support

Many legislatures have found Parliamentary Service Commissions (PSC) effective in building cross-party consensus on issues relating to the legislature’s budget. Typically composed of legislators (and sometimes members of the executive branch) these bodies are generally responsible for managing or making recommendations about the legislature’s budget, its staffing issues, and other administrative priorities. Independent commissions that include distinguished former legislators can also be used to review funding for the legislature.

TIP 3 – Use conservative budgetary oil prices

One way to help overcome extractive industries related challenges is to use conservative budgetary oil prices. This is a way of playing it safe. When oil prices turn out to be higher, the windfall revenues can be used to improve government finances. When oil prices turn out to be low and/or lower, the damage to the economy will be only minimal.

See also: Transparency and Accountability in Africa’s Extractive Industries: the role of the legislature (National Democratic Institute, 2007)

Public Hearings on the Budget

To actively stimulate participation and to access independent expertise, parliamentary committees can issue calls for written submissions on the budget and related legislation and invite outside experts to give evidence. Public hearings provide a structured way to bring the perspectives of outside experts into committee deliberations on the budget. Committees can benefit from independent analysis not only when parliamentary budget research capacity is limited or nonexistent, but also to supplement the overall level of information that is available on the budget.

Calls for submission can be placed in newspapers, in the broadcasting media, or on the internet. Committees draw on a broad mix of expertise, many of them supplementing evidence from politicians and government officials with inputs from private sector institutions such as banks or large consulting companies, think tanks, academics and civil society organizations and interest groups.

To maximize the benefits from public hearings outside participants have to be fully prepared. Parliament should publicize all relevant information to allow thorough preparation for hearings and the drafting of written submissions in accordance with its rules and procedures. All information before parliament should be publicly available, including committee evidence and reports on public hearings. Means of dissemination typically include parliamentary websites and public information offices (www.parliamentarystrengthening.org / Budget Module).

BOX 13 – Good practices regarding the budget

1. Fiscal information should be presented in a way that facilitates policy analysis and promotes accountability.
2. A clear and simple summary guide to the budget should be widely distributed at the time of the annual budget.
3. Fiscal data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional, and administrative category.
4. The overall balance and gross debt of the general government, or their accrual equivalents, should be standard summary indicators of the government fiscal position.
5. They should be supplemented, where appropriate, by other fiscal indicators, such as the primary balance, the public sector balance, and net debt.
6. Results achieved relative to the objectives of major budget programs should be presented to the legislature annually.
7. A commitment should be made to the timely publication of fiscal information.
8. The timely publication of fiscal information should be a legal obligation of government.
9. Advance release calendars for fiscal information should be announced and adhered to.
10. Fiscal information should be externally scrutinized.
11. Public finances and policies should be subject to scrutiny by a national audit body or an equivalent organization that is independent of the executive.
12. The national audit body or equivalent organization should submit all reports, including its annual report, to the legislature and publish them. Mechanisms should be in place to monitor follow-up actions.
13. Independent experts should be invited to assess fiscal forecasts, the macroeconomic forecasts on which they are based, and their underlying assumptions.
14. A national statistical body should be provided with the institutional independence to verify the quality of fiscal data.
15. Fiscal information should be externally scrutinized.
16. Basic requirements under this principle are to ensure that a national audit body, which is independent of the executive, provides timely reports (at a minimum on an annual basis) for the legislature and public on the financial integrity of government accounts.
17. Public finances and policies should be subject to scrutiny by a national audit body or equivalent organization that is independent of the executive.

Source: IMF, Code of Good Practices on Fiscal Transparency, 2007

Medium-term Expenditure Frameworks (MTEFs)

Resource-rich countries have to take into account the volatility in resource prices, and their effect on the budget and government policies. For instance, expenditures should not follow yearly fluctuations in prices. Rather, they should be compliant with a previously determined medium-term expenditure path that assures long-term fiscal sustainability (IMF, 2007). Many aspects of budgeting, especially large scale capital expenditure projects, stretch beyond the time horizon of annual budgets. Best practices have shown that medium-term expenditure frameworks (MTEF) are a useful tool to support sustainable fiscal planning beyond the time-frame of the annual budget. The MTEF can be used to indicate the financial resources needed during the medium term (which is usually between three to five years). The MTEF concept differs from multiyear budgeting, which uses fixed appropriations for a certain number of fiscal years (www.parliamentarystrengthening.org / Budget Module). A MTEF should provide a clear statement of the revenue and expenditure effects of maintaining current government policies. The MTEF also allows a clear fund allocation to long-term strategic priorities, instead of existing policies carrying out a short-term view on development. The MTEF should track the budget implementation of these new policies beyond the annual budget (IMF, 2007).

MTEFs are of significant important for resource-rich countries, because it should reflect the pace of exploitation of the resources and the management of resource revenues over the medium-term. These should be consistent with macroeconomic and fiscal stability, paying special attention to the volatility, unpredictability, and exhaustibility of resources (IMF, 2007). The MTEF should be linked to the country's strategic framework. There are some basic steps that need to be carried out in the process of compiling an MTEF. The first step involves the setting of aggregate and sectoral spending ceilings, based on realistic revenue projections and fiscal policy. The second step involves policy planning within the spending ceilings that have been established. This requires departments to cost programs and consider their linkage to strategic objectives. There will always be trade-offs that have to be negotiated. The third step is to make binding

political decisions and to have the MTEF approved by the cabinet (www.parliamentarystrengthening.org / Budget Module).

To enhance debate on public spending MTEFs should be tabled and discussed in parliament. It is only with narrative information on the content and direction of budget policy that the medium-term figures can be adequately interpreted and assessed by parliament. Usually, only the first year of a MTEF is approved by the legislature as the annual budget. The other years are nonbinding projections of the future cost of existing policy, which form the basis of the annual negotiations of allocations, resulting in a system of 'rolling budgets' (www.parliamentarystrengthening.org / Budget Module).

Fiscal rules

In order to ensure the sustainability of public finances and macroeconomic sustainability a system of fiscal rules has to be adopted. Examples of fiscal rules are requirements to balance the budget, limits placed on government borrowing, or limits placed on expenditure growth. Sometimes public borrowing is limited to the level of public investment or the fiscal deficit is constrained to a certain percentage by law. In general fiscal rules need to be simple and transparent. Transparency requires that fiscal rules are clearly defined, with well-specified reporting requirements (IMF, 2007).

Some countries rely on numerical fiscal rules. Numerical fiscal rules are intended as a permanent constraint on fiscal policy, generally in terms of an indicator of overall fiscal performance. The main types of numerical rules include:

- deficit rules (balanced budget),
- debt rules (ceilings),
- borrowing rules, and
- expenditure rules.

For instance, Chile has implemented a “structural surplus rule” that aims at a cyclically adjusted surplus for the government of 1 percent of GDP. The government has to explain any deviations in the fiscal outcome from the surplus rule (IMF, 2007).

The credibility of numerical rules and targets depends on the realism of the budget and on the quality of analyses. The effect of fiscal rules depends on political will and a careful development of the details of the framework.

Fiscal rules are intended to limit the scope for discretionary intervention of politicians, and should therefore be set in law to the greatest extent possible. However, at the same time fiscal terms need to be robust to changing circumstances. There has to be a clear strategy in the event that unforeseen circumstances (such as a sudden significant decrease in resource prices) cause actual spending or deficits to breach numerical targets. The fiscal regime should thus be structurally stable, yet responsive to changing economic conditions. When economic circumstances change, the fiscal regime should be changed to optimally capture resource rents (The Natural Resource Charter, 2009). A progressive fiscal regime, where the percentage of taxes and other payments to the government increases as the basis increases, can better adjust to changes in prices, volumes, and projects’ operating conditions. If the fiscal regime needs to be changed, changes should be predictable and based on equitable principles. Best practices show that fiscal rules are more successful where they came about through broad political consensus (IMF, 2007).

The fiscal regime should be competitive so that it attracts businesses in good economic times as well as in downturns. Both the company that will extract resources and the government should profit from extractive industries extraction. They should share an increase and a decrease in prices. In a downturn this can have a negative impact on the government’s budget, but by providing incentives to private investors to stick around for the long run, the fiscal regime will benefit the government in economic upturns or an increase in resource prices. The government’s goal should not be to find a way to make an oil or mining company pay as much taxes or royalties as possible. Contracts reflect a long-term investment of a company, and any initial investment of a company is high.

Therefore, companies have to be able to make a profit, and keep part of that profit as an incentive for investment.

In any case, a strong and coherent systematic legal framework for taxation and regulation needs to be in place before opening up the sector to competition. Recently, the Ghanaian Parliament urged the government to stop handing out licences until a decent regulatory framework is in place.

TIP 1 - Utilize the committee system to monitor and oversee the extractive industries sector

Extractive industries policies are most effective when they are well-managed and monitored, and when the results are publicized. Through organized and coordinated committee work, legislators can activate their oversight authority. Public committee hearings are also a useful way to raise public awareness and incorporate public input into the process.



**TIPS
for Legislators**

TIP 2 - Request regularly scheduled extractive industry briefings

Committees can request that senior government officials provide briefings on a regular schedule. Committee members will need to determine how often these briefings should take place to ensure effective information exchange.

TIP 3 - Be informed about how the industry works

Are there extractive industries and how much do they each contribute to the national economy? Which industries provide the most government revenue? How much do they contribute to GDP? Regulation and oversight of the extractive industries requires an understanding of complex technical and financial issues. Often concerns are raised about the capacity of individual legislators to understand and contribute to extractive sector management and oversight. Some pointed to a lack of formal education among certain legislators, and poorly trained legislative staff. Others explained that high turnover in the legislature made it difficult for legislators to build up specific areas of expertise over time.

Source: Transparency and Accountability in Africa's Extractive

Unit 3 Questions

Please answer each of the following questions. If you are taking this course in a group you may then meet to discuss your answers.

1. Is there a vision and plan for the contribution of extractive industries to the social and economic development in your country? How will extractive industries contribute to the long term plan for the country's development? How will the government assure that resources are converted into long-term, sustainable income and benefits for this generation and future ones?
2. Do the budget and/or Medium Term Framework explain how expected and realized revenues fit into the long term strategic vision? What are the government's priorities according to the budget?
3. Are spending levels in your country sustainable? How do national expenditure levels compare to income levels? How is the government's money spent?
4. If there is a Stabilization Fund, does it comply with the good practices set out in Box 10?

Relevant Internet Resources

The Natural Resource Charter: <http://www.naturalresourcecharter.org/>

Parliamentary Strengthening: <http://www.parliamentarystrengthening.org/>

OECD Best Practices for Budget Transparency:
<http://www.oecd.org/dataoecd/33/13/1905258.pdf>

The World Bank: www.worldbank.org

The African Development Bank: www.afdb.org

Revenue Watch Institute: www.revenuwatch.org

Publish What You Pay: www.publishwhatyoupay.org

Global Witness: www.globalwitness.org

Oxfam: <http://www.oxfamamerica.org/campaigns/extractive-industries>

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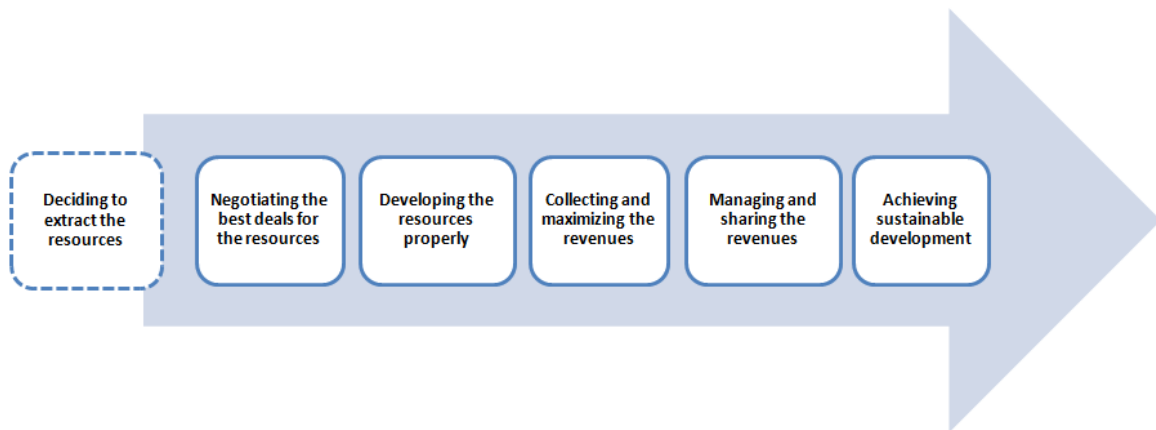
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The Stages of the 'Resource Chain'

Turning natural resources in the ground into improved well-being for citizens takes a series of steps that together can be termed the 'resource chain'. As described on page 31, the objective of maximizing benefits to current and future generations of citizens and achieving sustainable development can be broken down into several stages: the decision to extract; awarding contracts, actual extraction/operations, revenue collection and finally revenue expenditure (see the figure below). Each of these poses substantial challenges. Maximizing the benefits requires that different questions are raised at each stage.

Figure 9: Good governance along the value chain



Unit 4: Stage 1. Decision to Extract

Learning Objectives

Poverty and Social Impact Analysis

After studying this unit, you should be able to:

- Be able to tell what a Poverty and Social Impact Analysis (PSIA) is
- Know why a PSIA is useful in the extractive industries sector
- Know why it is important to take artisanal mining into account when making the decision to extract
- Know about the environmental implications of extractive industries operations
- Know how to make an informed choice in deciding between extraction or no extracting of oil, gas or minerals
- Be able to explain why it is important to recognize indigenous communities
- Be able to articulate in which cases extracting oil, gas, or minerals might not be the best decision
- Be able to explain what it takes for the local level to be able to benefit from extractive industries
- Recognize the importance of planning and active management of the use of land
- Realize that expectations regarding the wealth generated from extractive industries are often very high, and they differ per stakeholder

Introduction and Overview

When exploitation for oil has proved successful or when mineral resources are discovered the question policy makers ask themselves is usually not '*Should we exploit the resource?*' but rather '*How (fast) are we going to exploit the resource?*' This Unit will show that considering the first question (Should?) is a necessary prerequisite of the second question (How?). There are several factors that can together lead to the decision

to leave the resources in the ground. This Unit explains the importance of environmental impact, poverty and social impact, artisanal mining and indigenous communities, and lays out how effective land management and local content can make communities benefit from the extraction of extractive industries.

Poverty and Social Impact Analysis (PSIA)

Policymakers should be critical when determining whether or not it is in the interest of the country to extract its resources in the first place. Leaving them in the ground reduces the risk of populism and conflict, and they often generate a positive rate of return when left for future exploration. Also, the postponement and smoothing of the government's spending of resource revenues can be achieved by limiting the rate of resource depletion (The Natural Resource Charter, 2009).

Resource projects can have significant environmental effects. For example, it damages landscapes, produces waste, and pollutes air and sea, river and drinking water. The initial decision to extract should take into account the possible environmental consequences of development through an environmental assessment (see Box 14). If the decision is made to extract, the government must account for the environmental consequences in the development plan of the area. Throughout the life of the project environmental and social assessments should be executed, accompanied by a plan to minimize or mitigate possible adverse environmental and social consequences specific to the project (The Natural Resource Charter, 2009).

Other than environmental effects, extraction may also affect income and social groups differently. Special attention has to be paid to the effect on vulnerable and low-income groups. Understanding the impact of policy interventions on different groups is critical to designing effective policy strategies. Poverty and Social Impact Analysis (PSIA) refers to the analysis of the distributional impact of the decision to extract on the welfare of different groups, with a specific emphasis on the poor and vulnerable (The World Bank, 2007). Similar analysis can be applied to other effects (such as the environment). Good practice would require that budget documentation include at least a simple analysis of the impact of the decision to extract on the environment and low-income groups.

Poverty and Social Impact Analysis helps to:

- Analyze links between resource extraction and the impact on poverty or particular social groups;
- Explicitly consider trade-offs among extraction decisions on the basis of their distributional impacts;
- Enhance the positive impacts of resource extraction, while minimizing negative impacts;
- Identify mitigating measures and risk management systems; and
- Assess the risks of resource extraction (IMF, 2007 and World Bank, 2007).

BOX 14 – Extractive Industries, Communities and the Environment

Romania: "In 2000, the dam from a gold mine spilled 100,000 metric tons of toxic wastewater, killing fish and poisoning the drinking water of 2.5 million people"

India: "Bauxite mines and an aluminum smelter would displace three villages in an ecologically sensitive area inhabited by tribal people. Police fired upon a public protest"

Zambia: "Local communities in the Copperbelt suffer from asthma, lung diseases, and other health problems caused by pollution from copper mines and smelters"

Brazil: "Tens of thousands of small-scale miners work the Amazon region for gold, using mercury and little protective equipment"

Guyana: "A 1995 tailings spill sent 3 billion liters of contaminated effluent from this gold mine into Guyana's largest river"

Source: "Dirty Metals. Mining, Communities and the Environment", a report by Earthworks and Oxfam America (2004)

More specifically, in making the decision to extract, some key areas to consider are:

Macro-economic framework, social and economic planning

The consequences of resource exploitation for the national economy should be taken into consideration. Some factors to take into account are price and revenue volatility, resource dependency, the strength and size of other sectors of the economy. This has been explained in Unit 3 of this Module.

Employment, Artisanal and Small-Scale Mining

Millions of people make their living through artisanal and small-scale mining, which provides an important, and sometimes the only, source of income. This part of the sector is characterized by low-income workers, unsafe working conditions, serious environmental impacts (see Box 10), exposure to dangerous materials (see Box 15), and conflict with companies and governments (Costa and Scoble, 2005). While considering resource extraction policy makers should know whether or not artisanal mining is taking place, what the scale of the activities are, and who is positively and negatively affected by artisanal mining activities.

Parliamentarians can press for a transparent land allocation process, and a documentation of all mining sites in the country. It can also initiate public awareness campaigns for investors and small scale miners, informing them about their rights and responsibilities.

BOX 15 – Small-Scale Mining in Tanzania

In Tanzania small scale miners have lost many of their most productive areas to investors. Small scale miners' organizations as well as politicians have argued that the government needs to do more to secure the livelihoods of artisanal and small scale miners. A National Policy for Artisanal Small Scale Miners has been propagated. The licensing process has led to conflict between large scale miners and small scale miners in Tanzania. There is no planning and co-ordination on the distribution of land at the national level. Investors work with maps that have not been updated for years, and as a result large companies filed for licenses on what appeared to be an open area, but in fact had small scale miners operating on it.

Source: Land Tenure and Mining in Tanzania (Chr. Michelsen Institute, 2008)

Environmental Implications

Minerals and petroleum activities can have a significant environmental impact. Environmental risks and potential hidden costs from permanent environmental damage after extraction need to be considered (See Box 10). Good practice is the enforcement of adequate environmental and social regulations and the establishment of an independent authority charged with approving and monitoring environmental and social impact assessments (World Bank, 2009). The most successful examples of environmental and social impact mitigation involve early consultation and participatory practices at the local community level (World Bank, 2009). The consultation process with local communities has to start at the initial stages of a project, to minimize environmental and social impacts and ensure that the communities receive adequate compensation based on impact of the project on their livelihood. With early involvement in the process, communities' understanding of, and support for, the project is more likely and reduces the potential for conflict.

In Tanzania, small-scale artisanal miners have occupied the forests in a nature reserve, causing severe environmental destruction by felling old indigenous trees to dig up gold. Tanzanian mining laws require that all mineral prospecting and exploration be carried out under valid licenses, but none of these small-scale miners operating in the forest are

licensed. MPs have visited the mining sites and the nature reserve for a firsthand feel of the extent and proportions of environmental damage. The Parliamentary Committee has convened a meeting of all stakeholders in order to come up with immediate interventions and long-term solutions to the small-scale mining problem (WWF, 2004).

The Control, Use, and Management of Land

Alternative economic uses of land concession (such as tourism, farming, forestry, etc) should be considered and compared to the consequences of extraction. Analysis of the options for the use of the land will have to consider employment creation, revenue generation, environmental sustainability, and social implications. How the land is currently used and what extraction means for that is also important.

There is frequently a lack of planning, legal or other frameworks to balance and manage possible uses of land. As a result, there are often conflicts around issues such as compensation, resettlement, land claims of indigenous peoples, and protected areas. The government is responsible for environmental standards and determining the rights of local communities. These standards may refer to international standards such as the Equator Principles. For the list of the 9 Equator Principles, see Appendix 1.

The United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP) have held hearings as part of the International Expert Workshop on Indigenous People's Rights, Corporate Accountability and Extractive Industries. The goal of these hearings was to create a better mechanism to force extractive industries to comply with the provisions of the UNDRIP (See Annex 5 for the provision of the UNDRIP). One of the findings of the hearings was that according to Indigenous People the governments intend to craft or enact laws which serve the politicians' self-interest and are detrimental to the tribal communities. In Peru tensions between Indigenous People and the state escalated into deadly conflict in June 2009, as local communities demonstrated and demanded to repeal 10 legislative decrees they consider dangerous for the rainforest, as well as their communities. The decrees would endanger reserved forest spaces to benefit investment in large extractive industries. After the protests, Parliament has repealed the decrees and is currently consulting all stakeholders (including indigenous peoples) on how to

improve existing laws and avoid conflict. Peru suspects that the dissemination of information on existing laws, rights and government plans has been insufficient, which caused confusion and misunderstandings.

Another example can be found in Cambodia, where the mining sector grew between the 1990s and early 2000s. Some negative impacts were reported as displacing small-scale miners, restricting access of local communities to areas they depend on for their livelihoods, violating communities' traditional lands, and poisoning water sources (www.globalwitness.org). Since 2005 an increasing number of large scale exploration licences were granted, and the fear is that the reported negative effects for the local communities will increase drastically. In Cambodia, two laws cover the management and exploitation of mineral resources: the Law on Mineral Resource Management and Exploitation (2001) and the Law on Environmental Protection and Natural Resource Management (1996). However, the Mineral Resource Management Law is weak and has a number of gaps including a lack of compensation for those displaced by mining operations. The law states that before entering any privately owned land for exploration or mining, the concessionaire must compensate the "private land owner" for inconvenience and damage to the land. "Private land ownership" refers to those with title on the land registry. Those with possession rights are normally not interpreted to meet these conditions, until they have transformed their possession rights into a title. Indigenous communal land titles are not included in the "private land ownership". This leaves those without the legal title - most Cambodian households - with little protection. By contrast, the Land Law gives indigenous communities the right to continue to live on and manage their traditional lands according to traditional customs, until they are able to get a collective title. Therefore any exploration or mining license granted on traditional indigenous land is unlawful if it impedes the community's ability to continue to manage the land according to their custom. Licenses have all been granted without the free and informed consent of affected communities (www.globalwitness.org).

BOX 16 – Women and the Extractive Industries

The benefits and risks of extractive industries are often measured broadly at the community level, but fail to distinguish the different impacts on men and women. Evidence suggests that a gender bias exists in the distribution of risks and benefits in extractive industries projects: benefits accrue mostly to men, in the form of employment and compensation, while the costs, such as family or social disruption and environmental degradation, fall most heavily on women.

The development effectiveness and sustainability of extractive industries projects could increase significantly by taking into account how gender bias issues affect the sector and how extractive industries activities can benefit men and women more equally.

Source: “*Women and the Extractive Industries*” *Fact Sheet*, www.worldbank.org/eigender

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Promoting the Local Level

Extractive industries development can also bring benefits at the local level. However, uneven distribution of benefits and costs within communities, and outsourcing affect communities negatively. In some cases natural resources extraction can generate social or cross-border conflict. While considering the decision to extract the employment and welfare consequences for local communities have to be taken into consideration. Parliaments can hold hearings and conduct field visits to see if and how the local community is taken into account in the development of EI activities.

The promotion of local content involves conditions on the use of host-country goods or services by the extractives sector. Most countries have a National Law or Code for Oil, Gas, or Mining activities, which means that regardless of individual contracts provided to national or international EI companies, exploration and/or extraction operations have to take place within this framework. Often there is a section within the Law or Code that deals with the promotion of local content specifically. Best practices show there are certain measures one can take to avoid conflict or local exploitation (Hackman, 2009).

The EI sector is characterized by large-scale, capital intensive, high risk investments, requiring high amounts of skill and sophisticated technology. Many countries at the time of discovery of their resources are not well prepared to carry out production on their own. This prevents them from exploiting the resources by themselves and keeping the profits within their own country. Exploitation often calls for the involvement of international companies. As a result, large portions of the profits generated will flow out of the host-country to be paid out to shareholders of the international companies. A huge amount of income is lost to the local community (Hackman, 2009). There are also limited opportunities in the form of linkages to the domestic economy to benefit from the extractive activity. This is because of the capital intensive--EI activities do **NOT** generate much employment--, highly technical, and export oriented nature of the industry (Hackman, 2009).

In order to promote and encourage local content, it is useful for a country to specify a clear and unambiguous definition of what 'local content' means . There must also be an independent authority responsible for monitoring and ensuring that local content conditions are being met by companies as well as by the government.

The usual conditions or requirements for the promotion of local content are the use of domestically produced goods and services, the participation of a state oil company, the employment and training of locals and technology transfers to the domestic economy. However, there are challenges to the implementation of these four policy measures (Hackman, 2009).

State Participation - Government's participation through a state oil, gas, or mining company (National Oil Company or NOC) has benefits and disadvantages. The benefits include that the state can have greater influence in decisions regarding the commercialization of the natural resource, and the NOC would gain knowledge and experience on the running of operations in the oil industry. The NOC can use its influence to get more local companies involved in the oil industry, as well as encourage spillovers into the non oil economy (Hackman, 2009).

The challenges lie mainly in the fact that NOCs are commercially inefficient. They are run poorly from an economic and financial view point and have a long way to go in terms of catching up with the efficiency of IOCs. They are characterized by huge losses and political interference. There may also be conflicts of interest arising from the dual role of government as the facilitator of regulation over the industry and as a shareholder at the same time. The state oil company should not be used by the government as a tool to achieve political ends, but should be run considering the commercial interests (Hackman,2009). For more detailed information on NOCs, including a list of countries that have them, what makes them work well, etc. see Unit 5 of this Module.

Provision of Goods and Services by Locals - Developing countries often lack the technology, highly-skilled labor force and capacity to provide certain activities, which makes the use of local goods and services for EI development difficult. Experience shows that the commitment of international companies to increase local content can be misleading. In Nigeria for instance, it was found that multinational service providers had resorted to creating bogus companies to fill the local content requirement. Multinationals may also set extremely high quality standard for indigenous companies (Hackman, 2009).

As we have said earlier in this unit, there would be numerous opportunities for the domestic economy to benefit through non-core oil activities like hospitality services, office and residential accommodation, insurance, banking, etc. However, the long-term risk of these activities is that the EI resources are not forever, so the labor opportunities will be lost when the country runs out of its resources. The government can also take steps to discover which new activities might be profitable to service the EI sector (Hackman, 2009). A thorough assessment of the sector's needs and national capacity to provide services to the sector can improve the link between the EI sector and the local economy. For example, as a result of analyzing the gaps in its national capacity, Brazil has initiated qualification programs to strengthen the competitiveness and capacity of the business climate (Chatham House, 2007). Some countries (like Norway and the UK) have neutral organizations to facilitate the link between the local economy and the EI

sector. They also provide objective information to the oil companies on capabilities of supplier and contractors (Chatham House, 2007).

Training and Technology Transfers - Technology can be transferred in physical form through tools, equipment, and blueprints, but it can also be shared through skills and information transfers. Because most developing countries have little or no previous experience in extractive industries operations, there can be difficulty in practice in absorbing the new technology in the short run. In the long run, however, the transfers can pay off and the locals can take over industry activities (Hackman, 2009).

Employment and Training of Local Staff - The extractives sector is capital intensive, not labor-intensive. There are few opportunities for employment in core oil and gas related activities. Countries that begin oil and gas production must therefore be wary of expecting too much from the industry in terms of direct employment and income generation. Otherwise this can lead to conflict between the local and indigenous community, the companies, and the government (Hackman, 2009).

BOX 17– Unrealistic expectations

The discovery of oil and other resources often create unrealistic expectations about future income that lead to sustained increases in public spending. Inflation and debt rise, while loans are secured (often on favorable terms) with the backing of unreasonable projections of future earnings.

The mining and minerals industry faces some of the most difficult challenges of any industrial sector – and is currently distrusted by many of the people it deals with day to day. It has been failing to convince some of its constituents and stakeholders that it has the 'social license to operate' in many parts of the world, based on the many expectations of its potential contributions:

- o *Countries* expect that extractive industries development will be an engine of sustained economic growth.
- o *Local communities* expect that the industry will provide employment, infrastructure, and other benefits that counter the risks and impacts they experience and will leave them better off than when the project started.
- o *The industry's employees* expect safer and healthier working conditions, a better community life, and consideration when their employment ends at mining closure.
- o Local citizens and *human rights campaigners* expect companies to respect and support basic rights, even when they are operating where government does not.
- o *Environmental organizations* expect a much higher standard of performance and that the industry will avoid ecologically and culturally sensitive areas.
- o *Investors* expect higher returns and have shown concern about the industry's financial results at times of depressed commodity prices.
- o *Consumers* expect safe products produced in a manner that meets acceptable environmental and social standards.

Unit 4 Questions

Please answer each of the following questions. If you are taking this course in a group you may then meet to discuss your answers.

1. Explain how the local level can be promoted by the extractive industries sector in theory, and why in practice that sometimes turns out to be difficult. How is the local level promoted in your country?
2. In your country, are there environmental risks of current EI projects?
3. In your country, is land use documented? How?
4. What are the rights for indigenous people and local communities that are affected by extractive industries projects in your country? Are local communities involved and consulted from the start of the project, and during the lifetime of the project? Do they support the project? Are they compensated for any negative effects of extractive industries? How?
5. What do different stakeholders expect from extractive industries in your country? Is that realistic? (See also Box 13)

Relevant Internet Resources

The Natural Resource Charter: <http://www.naturalresourcecharter.org/>

Parliamentary Strengthening: <http://www.parliamentarystrengthening.org/>

Global Witness: www.globalwitness.org

Women and the Extractive Industries Fact Sheet: www.worldbank.org/eigender

Equator Principles: <http://www.equator-principles.com/>

United National Declaration on the Rights of Indigenous Peoples:
<http://www.un.org/esa/socdev/unpfii/en/declaration.html>

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Unit 5: Stage 2. Contracts

Learning Objectives

Legal Extraction

After studying this unit, you should be able to:

- Understand the legal basis for the ownership of resources and their exploration, development and production
- Understand the relationship between the constitution, a sector law or code and a license agreement
- Be able to explain the pro's and con's of having a National Oil or Mining Company
- Be able to tell how public oversight and control over oil companies can be enhanced by parliament
- Know what corporate social responsibility is in relation to extractive industries
- Be able to explain the elements of a good procurement process
- Know the difference between the primary types of contracts
- Understand the value of contract transparency and how contract transparency relates to a Freedom of Information law
- Appreciate the need for documentation of exploration and exploitation contracts and territories

Introduction and Overview

In this stage of the extractive industries value chain governments negotiate a contract with relevant firms. These contracts are crucial, as they establish how much the government will receive from the exploitation of their resources, and can also have important clauses for communities and the environment. This Unit will discuss the legal

context of extractive industries contracts, best practices regarding the process of licensing and negotiation, the issue of contract confidentiality and transparency. Finally it will address how parliament can participate best in this stage of value chain.

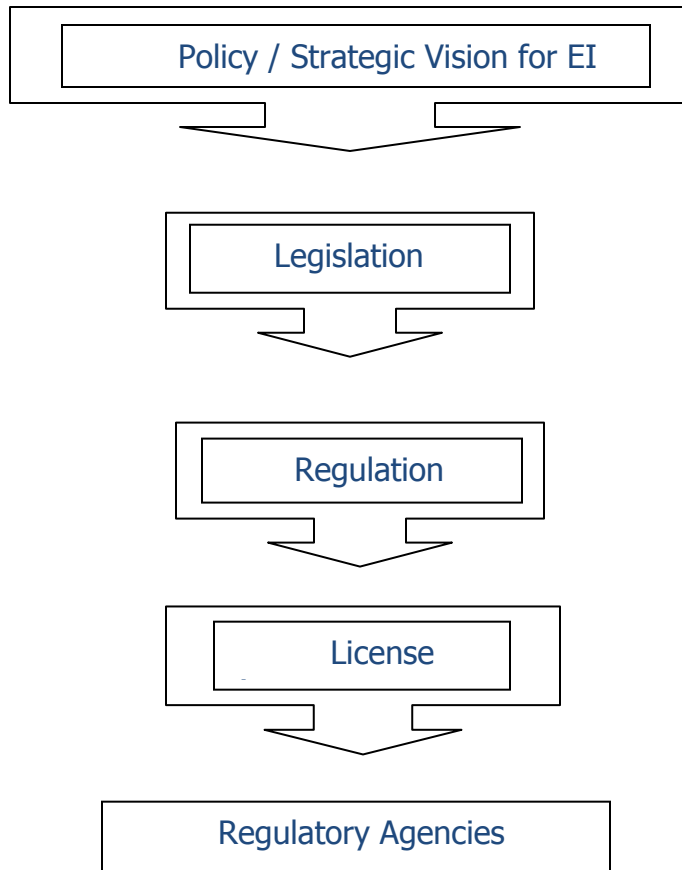
Legislation

Legislation regarding extractive industry operations usually encompasses several standard principles:

- Resources belong to the state, and should ultimately benefit the citizens of the state;
- The right to explore and exploit the resources can be temporarily transferred to a person or company through a license or lease;
- The holder of the license or lease must act in accordance with predetermined conditions; and
- At the end of the license or lease the rights return back to the state (The World Bank, 2009).

The legal basis for the ownership of resources and their exploration, development, and production is usually established in the constitution (for some examples, see Box 14). A sector law or code then sets out the principles of law. Provisions that do not affect principles of law, or that may need periodic adjustments such as technical requirements, administrative procedures, and administrative fees, are set as regulations. A well-defined sector law usually includes a definition of the role of the state; security of title; freedom to operate on a commercial basis; access to resources; comprehensive environmental protection requirements; and a framework for fiscal terms (World Bank, 2009).

Figure 10: Relationship between the strategic vision, legislation, regulations and long-term development



In most countries, rights are divided into exploration and exploitation licenses. Exploration licenses give holders the right to explore for resources that might exist in the granted area. If the resource has been discovered, access to the exploitation of the resource normally requires the granting of a license for exploitation. Governments usually grant exploration and exploitation rights in particular areas by means of concessions, leases, licenses, or agreements. Efficient and effective granting procedures are based on:

- 1) A clear legal and regulatory framework;
- 2) Well-defined institutional responsibilities; and
- 3) Transparent and non-discretionary procedures (The World Bank, 2009).

Sound principles for the design of efficient contracts are needed, to inflict a number of requirements. First of all, exploration companies should have incentives to extract and to invest in both production and exploration. Second, contracts should be time-consistent, which reduces the company's risk of uncertainty of contract renegotiations or early determination. ***Terms should be set in law*** to the greatest extent possible, to not only enhance stability for the investor but also ensure equal treatment (The Natural Resource Charter, 2009).

Country circumstances vary significantly, and the contract's content and design should reflect this. The timing of payments, commitments in the form of local goods and services, or payment in the form of infrastructure or social service projects vary per country and per contract. For instance, a government faced with spending pressure can commit to an extraction-for-infrastructure contract (see also Box 20), if this maximises benefits for citizens.

BOX 18 – Legislation on Ownership of Extractive Industries

Ghana:

“Every mineral in its natural state in, under or upon any land in Ghana, rivers, streams, water-courses throughout Ghana the exclusive economic zone and any area covered by territorial waters or continental shelf **is the property of the Republic of Ghana** and shall be vested in the Provisional National Defence Council **for and on behalf of the people of Ghana**. 2. Where any land is required to secure the development or utilization of a mineral resource the Council may acquire the land or authorize its occupation and use under any applicable enactment for the time being in force.”

Source: <http://www.ghana-mining.org/ghweb/en/ma/mincom/mclegislation/untitled.html>

Liberia:

“**The Republic shall**, consistent with the principles of individual freedom and social justice enshrined in this Constitution, **manage** the national economy and the natural resources of Liberia in such manner as **shall ensure the maximum feasible participation of Liberian citizens under conditions of equality as to advance the general welfare of the Liberian people and the economic development of Liberia.**”

Source: Constitution of Liberia: <http://www.liberianlegal.com/constitution1986.htm> (article 7)

Norway:

“It is **the responsibility of the authorities of the State** to create conditions enabling the Sami people to preserve and develop its language, culture and way of life. Every person has a right to an environment that is conducive to health and to natural surroundings whose productivity and diversity are preserved. Natural resources should be made use of on the **basis of comprehensive longterm considerations** whereby this **right will be safeguarded for future generations** as well. In order to safeguard their right in accordance with the foregoing paragraph, **citizens are entitled to be informed of the state of the natural environment and of the effects of any encroachments on nature that are planned or commenced.** The State authorities shall issue further provisions for the implementation of these principles.”

National Oil Companies (NOCs)

A NOC is an oil company fully or for the majority owned by the government. NOCs account for more than half of the global production of oil and they control about 90% of proven oil reserves (see the United States Energy Information Administration). Many countries choose to have National Oil Companies (NOCs) take responsibility for exploration, development and export of oil reserves, or have them partner with other companies to do so. In these cases the NOCs also pay tax and royalty or other forms of compensation to the government. The government has an interest in making sure the NOC is an efficient producer and accurately pays the amount of money owed the government for the public treasury (The Natural Resource Charter, 2009).

Countries with NOCs include:

- Abu Dhabi – Abu Dhabi National Oil Company
- Algeria – SONATRACH
- Angola – SONANGOL
- Brazil – PETROBRAS
- China – China National Offshore Oil Company (CNOOC)
- China - China National Petroleum (PETROCHINA)
- China – SINOPEC
- Colombia - Empresa Colombiana de Petroleos S.A. (ECOPETROL)
- Dubai – Emirates National Oil Company
- Ecuador – Empresa Estatal Petroleos del Ecuador (PETROECUADOR)
- Egypt - Egyptian General Petroleum Corporation (EGPC)
- Equatorial Guinea – GEPETROL
- India - Oil and Natural Gas Corporation
- Indonesia - PERTAMINA
- Iran - National Iranian Oil Company (NIOC)
- Iraq - Iraq National Oil Company
- Kazakhstan – KAZMUNAYGAS
- Kenya – National Oil Corporation of Kenya

- Kuwait - Kuwait Petroleum Corporation
- Libya - National Oil Corporation
- Malaysia – PETRONAS
- Mexico - Petroleos Mexicanos (PEMEX)
- Nigeria - Nigeria National Petroleum Company
- Norway – STATOIL
- Oman – Petroleum Development Oman
- Peru – Petroleos del Peru (PETROPERU)
- Qatar – Qatar Petroleum
- Russia – Rosneft
- Russia – GAZPROM
- Saudi Arabia - Saudi Arabian Oil Company (ARAMCO)
- Uzbekistan – UZBEKNEFTEGAZ
- Vietnam – Vietnam National Oil and Gas Group (Petro Vietnam)
- Venezuela - Petroleos de Venezuela (PDVSA)

Because of the ownership structure of NOCs there is sometimes confusion between the ministry of petroleum and the NOC over responsibility for policy making, and the difference between the two entities. For example, the Minister sometimes sits on the NOC board. It is usually most effective if the operator focuses on operating, and the regulator focuses on regulating. National resource companies should not be charged with regulatory functions. Defining the role of NOC's in the law can help avoid conflicts of interest (The Natural Resource Charter, 2009).

However, in practice there exist several models of the degree of independence between the regulator, the NOC and/or the Ministry of Petroleum. The Norwegian and Malaysian models can be seen as different ends of the spectrum. Norway separates policy (ministry), regulation (government-appointed and statutory bodies) and operations (NOC) into different entities. The Malaysian model has no ministry and policy, regulation and operations are housed in a single NOC whose head reports directly to the Prime Minister. Particular caution is needed to specify the boundaries of decision-making, approvals and regulation. The NOC needs to provide reliable information to government

to enable the government to choose the best policies for the petroleum sector (Chatham House, 2007).

Many producing countries choose to have a NOC to achieve national development goals. It distinguishes them from private companies and guides their decision-making in specific ways. Usually the goals of an NOC include one or more of the following objectives (see Chatham House, 2007 for a more elaborative discussion):

- ***Maximizing revenues for the state*** (maximization of net revenues matters most, so an efficient use of resources is important).
- ***National control of the country's resources*** (the NOC is a key instrument to achieve greater national independence from foreign companies. The NOC is a political vehicle for independence. The operations and decisions of the NOC run the risk of becoming politicized).
- ***Implementation of economic development policy*** (this is most important where the level of economic development is low, poverty levels are high and service delivery of the state is poor)
- ***Promoting social welfare*** (in countries where poverty levels are high and service delivery is poor, NOC can support the community in which it is working)
- ***Providing domestic energy*** (most NOC are responsible for the supply of fuel to domestic power stations and sometimes they provide subsidized energy to consumers)
- ***Petroleum diplomacy*** (NOCs are sometimes used as a tool for a country's foreign policy when dealing with foreign governments or foreign companies. For example, NOCs may favour particular countries through investments)

If a NOC has several objectives, some of these can be in conflict with each other. Its national social obligations and commercial objectives can be in conflict. For example, pressure to absorb unemployment and buy local goods and services can burden the NOC and affect efficiency. The extractives industry can create jobs that are not competitive or sustainable and drive out other economic activities. As the capacity of the

government grows, it should take over most social functions of the NOC so that the NOC can focus on optimizing resource development (Chatham House, 2007).

A balance must also be found between the fiscal contributions that the NOC makes to the national treasury (which can fund social welfare projects out of the national budget) and its own capital requirements to pursue its commercial role. Another point for caution is the lack of transparency and accountability regarding social spending of the NOC. NOCs may become politicized because of the way they allocate social spending, and it is often not clear which social programs are sponsored by the NOC (Chatham House, 2007).

The government is usually responsible for setting the objectives and targets of the sector. The key government objectives are to ensure that the development of petroleum resources is efficient and that the distribution of economic benefits reflects national priorities. Depending on the country, these are subject to parliamentary approval of some form (through legislation, approval of government policy, approval of agreements with foreign oil companies, or approval of the budget of the state oil company). The involvement of parliament in these matters can attract public attention to important issues affecting the sector and bring about dialogue between state institutions and the public regarding the most appropriate use of the sector. Active parliamentary involvement will increase the legitimacy of the decision taken. The national development objective and the role of the extractives sector in that national development strategy should be clear and well communicated to all stakeholders. The mission and purpose of the NOC should be well defined, with transparent objectives aligned with the national development goal. Decisions within the NOC are best when made by competent technical and commercial management within a clear regulatory framework, a minimum of political interference and bureaucratic procedures. Corporatization of the NOC, stock exchange listing and international competition can all lead to greater transparency (Chatham House, 2007).

In some countries the NOCs' expenditure must be presented for approval to the government. In some cases the NOC expenditure is then presented in the government

budget to parliament (Mexico, Norway). If money is allocated to the NOC through the government budget year by year, NOC investment and long-term planning becomes difficult. The preference for management of NOCs is a corporatized NOC with its own balance sheet and the right to retainer venue for reinvestment.

Operators usually invest in some kind of social or infrastructure building projects, which in the case of NOCs can be seen as being part of their national mission. The role of an IOC is different from that of an NOC. The NOC's role is linked to the national mission, while the contribution of an IOC to society will come primarily through regulation and taxation systems. The role of an international oil company (IOC) in a host country's governance is limited as it looks for economic results and operates in accordance with its contractual obligations and with national and international law. IOCs can choose to include activities to enhance its investments and public image through Corporate Social Responsibility (see the box below). CSR is the delivery of goods and services beyond tax requirements for the host country, and is an addition to the IOCs core business. Through the national legal framework, tax system and contractual obligations the state may give objectives to IOCs that are similar to NOCs. For example, some contracts state that a certain percentage of local contractors and firms have to be used. In its initial development Norway favoured private companies that were willing to transfer knowledge and help the NOC build technical capacity. However, in countries with low levels of development it is often difficult to facilitate knowledge transfer or use local contractors. In the case of IOCs transparency will be guaranteed through listed companies' accounts. Tax, environmental, safety and employment laws will require information from non-listed companies (Chatham House, 2007).

In some countries (Algeria, Mexico, Brazil, Norway) an independent state agency has been set up to regulate both state and foreign companies and in some cases to award licenses where state and foreign companies are in competition. There are various types of arrangements mixing private and public sector companies operating in a country. There are countries where a fully state-owned NOC works together with private companies. For example, they can partner through joint ventures or as contractors. There are also countries where a partially privatized NOC works alongside local and

foreign private sector companies (Chatham House, 2007). Commercial operations of the national oil company should be in open and genuine competition with other companies in order to avoid inefficiencies associated with monopoly positions (The Natural Resource Charter, 2009).

Transparency can be facilitated by having the national company organized as a separate legal entity with clearly established authorities and objectives and by having governing and management boards separate from the government. Public oversight and control can be enhanced by:

- (i) Public accounts maintained in accordance with international standards and subject to independent audit;
- (ii) Clearly identifying any private ownership interests and transactions with such interest holders;
- (iii) Having the national company make the same disclosures required of publicly held companies; and
- (iv) Conducting regular and systematic oversight through parliament or other oversight entities. NOC's should be subject to the same fiscal regime as private sector investors (see also the Resource Charter, 2009).

Mechanisms for accountability include regulation, performance contracts, industry audits and channels of communication with society. Some resource-rich countries have successfully built strong state agencies to monitor the performance of NOCs and IOCs (like Brazil, Algeria, Norway, and Canada).

BOX 19– Corporate Social Responsibility

Corporate social responsibility is a concept whereby organizations consider the interests of society by taking responsibility for the impact of their activities on customers, suppliers, employees, shareholders, communities and other stakeholders, as well as the environment. This extends beyond the obligation to comply with legislation and sees to improve the quality of life for the local community and society at large.

When extracting natural resources, companies face challenges that go beyond their core business, such as dealing with ecosystems, poor communities and weak local governance. Communities are increasingly intolerant of EI companies that sacrifice the environment for economic benefits (WRI, 2009). Communities from the Peruvian Amazon started a lawsuit in California against a petroleum company, claiming that the company dumped oil waste water into communities' water resources. Shell has faced a lawsuit for alleged human rights abuses in Nigeria in the 1990s, and so on.

The most successful companies are adapting to these circumstances by investing in improving their environmental and social management systems. According to best practices, communities must be engaged at all stages of operations, from exploration to restoration, and must have the opportunity to participate in key decisions (WRI, 2009). The International Council of Mining and Metals (ICMM) has been working on Indigenous Peoples issues for several years and has produced a Mining and Indigenous People's Review, outlining ICMM's member's policy on Indigenous Peoples, and drafting a Good Practice Guidance for mining companies (ICMM, 2005).

Procurement / Auction & Negotiations

Because individual negotiations between the government and companies are ideally suited to corruption, the government needs to adopt a process that is more transparent and competitive. Competition is a good mechanism for governments to ensure maximum value for their resources. Public procurement systems should be open and competitive. Competition between companies will ensure that the government gets maximum value because companies compete in offers. Competition will select the most technically capable firm, as this is the most efficient and cost-effective firm that will place the winning offer (The Natural Resource Charter, 2009). Transparent processes can increase competition and raise the standards of work programmes. It can also lead

to more investments. Countries like Brazil, Algeria, and Nigeria have improved transparency in the competition for awards and contracts.

A good solution is to auction the extraction rights by inviting bids on rates that companies would be willing to pay. An auction is a way of forcing companies to reveal the true value of a project because of competition for the project of other companies (van der Ploeg, 2007). The purpose of an auction is to obtain the highest economic value for the nation by awarding contracts to the most qualified company offering the largest expected return to the government.

The auction needs to be designed carefully, both in terms of selecting the bidding variables (e.g. royalty rate, production share, or profits tax) and the design of the auction process. Bidding procedures differ among countries. Some use rigid systems with only a few biddable parameters that affect the sharing of benefits between the country and the investors. In others, many terms are negotiable (The World Bank, 2009). The royalty rate could be conditioned on observable features such as basic geology and world prices. If bidding is on a single variable (such as total royalty) then other aspects of the mining contract such as risk sharing, knowledge transfer, and environmental safeguards have to be taken into account (The Natural Resource Charter, 2009).

However, sometimes an open bidding process is not the most suitable way to award licenses. In some cases there are not enough parameters already known because uncertainties are still high. In this case the project circumstances are not concrete enough to make an auction type of bidding process work. Flexible bidding can be tailored to the individual parameters of the project. This is especially important with projects with specific technical needs. Whichever system a country chooses, the selection criteria and reasons for the choice of winning company should be explained publicly.

Because a certain degree of technical and financial capacity is required to carry out exploration, development, and production activities, the minimum capability that

companies must demonstrate to be able to bid on the contract has to be previously defined. Therefore, a *pre-selection of bidders* should precede both an auction and face-to face negotiations to ensure that companies are qualified. The entailment of 'minimum capability' differs per project, and has to be defined in the development phase of the project (The Natural Resource Charter, 2009).

As much information as possible should be made public prior to the award of contracts, such as the fiscal regime under which firms will be operating, geological knowledge about the area, publicly available findings of survey work, and other information that is likely to increase transparency and will attract firms to the bidding/negotiation process. The rules and terms for bidding and negotiations should also be clear and publicly available (The Natural Resource Charter, 2009).

The relationship between the host-government and the company is likely to be long term, sometimes even up to several decades. The environment of volatile prices and uncertainties due to geology, technology and prices makes the contractual relationship complex. It is impossible to foresee and contract upon all possible future circumstances, and cover for the risks of uncertainty. Therefore, contracts need to explicitly recognize that during their term adjustments may be necessary to account for unforeseen circumstances. For instance, after a change in economic circumstances the fiscal regime or resource prices are sometimes considered unfair for one of the two parties. However, such renegotiations should be infrequent and reasonable, so that both parties get a fair rate of return out of the project.

Early Warning Indicators

Non-Transparent Procurement Process prone to corruption

- v High level of and/or increase in the number of contracts awarded without open bidding system*
- v High level of and/or increase in the number of contracts not awarded to the first ranked bidder*
- v The number of bids are not published*
- v The awards are not published*
- v High level of and/or increase in the number of days it takes to process an oil and/or mining license*
- v No and/or decreased public access to extractive industry license applications*

Terms of Contract

The contract between the government and EI operators should specify the rights and duties of all parties involved for the duration of the contract. It should specify taxation levels, fees, royalties, import and export duties, special exemptions from taxation, environmental and social obligations, the duration and changes to the agreement, rights of assignment, local content provisions, financial terms including lending policies, currency of operations and repatriation of profits, and disclosure provisions (Revenue Watch, 2008).

When determining the terms of a contract, it is important to understand that extractive industry companies take risks with regard to exploration and fluctuations in a commodity's price, and they provide financing for exploration and development as well as technical expertise and operational management. In return, companies deserve a fair reward, a fair rate of return on capital, and control over their operations (Revenue Watch, 2008). There are many unknowns when contracts are negotiated, such as the probability of extractives being found, the probability of it being technically exploitable, the current and future price of the resources, and how long it will take to get enough production to pay for the work that has been done. Contract terms therefore can vary

greatly. The lower is the risk for the company, the higher the return to the government (Revenue Watch, 2008).

In developing countries, international companies are often required to provide public goods such as hospitals, schools, and roads in the area they are operating. This requirement is usually a term of their contract. Policy makers have to keep in mind that providing public goods is a core task of the state, and is not the core competence of companies to build facilities for educational or healthcare purposes. There are often misunderstandings about the level of involvement of companies in the provision of these public goods and in the local level in general. This can be a major source of conflict. Best practices show that the state level should not be left out of the decision regarding public goods, and their provision. Coordination at a national or state level is necessary. Because of a lack of planning by the government, health care facilities, schools and infrastructure built by companies are often right next to the extractive activities, and do not necessarily benefit the population at large . For example, roads often do not connect villages or market places, but serve for a better transportation of the oil, gas, or minerals.

Primary Types of Contracts

The various types of contracts used in extractive industries determine the rights and obligations of the government and the commercial operators. These contracts allocate the risks of the venture between the parties, and the rewards to be realized if they are successful. The three main types of contracts are: (1) production sharing contracts, (2) concession agreements, and (3) technical service agreements.

1. Production Sharing Contracts

Under a production sharing contracts (PSCs) the company develops an oil field under the oversight of the government. The company provides all the capital and recovers its costs in the oil or minerals it extracts. Separately, the profit is shared between the government and the company in an agreed upon formula, and is distributed between the two parties. In a PSC, the government owns the resource even though it agrees by contract to compensate the company for developing the field through “in-kind”

payments. Stakeholders may want to look carefully at how the government, in the form of a national oil company or other entity, manages its PSC projects. It is often difficult to precisely determine what share of oil the government is entitled to from each PSC (Revenue Watch, 2008).

2. Concession Agreements

A concession agreement licenses a company to develop a geographic area. The rights to the resource are legally held by the commercial operator. The concession holder finances all the costs of exploration, development, and production. The government typically receives royalty, a fee for acreage size, and taxes paid by the joint venture, as well as bonuses and social taxes. The mining or oil law may set out the terms for compensation and implementing regulations. If the government is a partner in the joint venture, it also receives a share of the production corresponding to the share it owns (Revenue Watch, 2008).

3. Technical Service Agreements

Under technical service agreements, the government retains control of the resources and enters into an agreement for a company to provide technical services in the form of exploration work, construction, and managing the development. The government keeps the resource that is produced and the company gets paid in cash or commodity. Under this type of agreement, the compensation is not based on production but on activities. These are generally not attractive to companies but may be considered as a way to access prospective EIs (Revenue Watch, 2008).

BOX 20– “Extraction-for-Infrastructure” contracts

If the finance minister is concerned that spending ministers will gang up to press for excessive recurrent expenditure, then Chinese-style resource contracts provide a commitment technology. The Extraction-for-Infrastructure is a package deal in which extraction rights are exchanged directly for infrastructure rather than revenues passing through the budget.

However, there is a risk that these arrangements are not transparent and open to abuse. China is the only player that offers these type of contracts, so competition is low and this can fuel corruption. One way to overcome this is to increase competition and let other players bid on oil-for-infrastructure contracts. The contracts can also be broken down into component parts, or they should be subject to the same processes of competition for other resource

Another possible downside of these contracts is that not all infrastructure is good and necessary infrastructure. Good infrastructure connects economic centers and cities, creating internal markets that can fuel economic development. It can also be used to build schools or hospitals. Good infrastructure does NOT facilitate export of natural resources out of the country.

Contract Transparency

Public disclosure of contracts between governments and companies in the extractive industries is necessary to track revenue streams. At the same time it is important to protect social justice and the environment. Extractive industry contracts involve large amounts of public resources and include fiscal, social, and environmental matters. Citizens should therefore be entitled access to the contents of these contracts. Opening these contracts to the public could help to reduce corruption and result in fairer contract terms. For instance there is both growing government discontent with non-disclosed EI contracts signed over the past two decades which has lead to renegotiations of contracts in several countries (BIC, 2007).

International support for contract disclosure as a standard of international best practice is accumulating. The International Monetary Fund (IMF) as well as several governments claim that public disclosure of contracts should be considered a standard of international best practices that all EI companies are required to live up to. The IMF’s Guide on

Resource Revenue Transparency (2007) recommends contract transparency and says that good practice requires that all EI investment contracts are publicly disclosed. The Fund argues that the government is in a better negotiation position if it was understood that contract outcomes would be disclosed to the legislature and public. Incentives for the government to disclose data or contracts are to confer a sense of public ownerships and increase social stability, and to earn international credit and credibility.

Companies and governments have usually kept contracts in the extractive industries secret. The private sector argues that the contents of these contracts must remain secret to protect confidential business information. They claim that disclosure may reveal the cost structure or pricing strategy of a company and affect their competitive position. The IMF, leading economists, industry experts, and even EI companies themselves are challenging this standpoint. In its Guide on Resource Revenue Transparency the IMF claims that contract terms are usually known within the industry after signing, therefore little strategic advantage can be lost by contract disclosure (see also Revenue Watch's publication "Contracts Confidential").

Overall, the arguments in favor of EI contract confidentiality do not stand up against the potential public harm of secrecy. As a matter of public policy, disclosure of contracts should be the standard requirement for all EI projects worldwide. It is necessary to have access to the full contract, a summary of the most important clauses will not do. Where information about the sector and contract remains confidential and is not accessible to the public, the reasons for this should be explained and justified.

Liberia has recently passed the Liberia EITI Act, which incorporates contract transparency. Timor Leste is committed to contract transparency as well. Other examples of countries that have disclosed contracts in the EI sector (be it on an ad hoc base) are Peru and Ecuador.

Parliaments should request copies of negotiated agreements and use question sessions or committee sessions to ask questions regarding the selection process and companies' qualities (Revenue Watch, 2008). Recently, Ugandan MPs have demanded disclosure of

oil agreements from the government based on the Freedom of Information law that was enacted in the country in 2005. In most countries, however, the drafting and negotiation of contracts is the sole responsibility of the executive branch.

In some countries, contracts have to be approved by parliament for them to come into effect. Some examples of countries where parliamentary approval is required are Azerbaijan, Egypt, Georgia, Kyrgyzstan, Liberia, Sierra Leone, and Yemen.

Documenting Exploration and Exploitation contracts and territories

There are often problems with documentation of exploration and exploitation titles that have been awarded, and it is not clear which territories have been occupied for extractive purposes. Entities that give out licenses often exist at different levels (local, regional, and national) and do not communicate with each other to update their data. Also, governments sometimes use outdated maps of concession areas. In Cambodia, for example, the legal framework for how companies are given mining concessions is not clear. It is not clear how concessions should be granted, how they can be used, who awards and administers them, and how they relate to mining licenses. As a database for mining titles, cadastre is a useful solution to this problem, and is further explained in Box 16 below.

BOX 21 – Mineral Rights Cadastres

A mineral rights cadastre is the principal public institution that manages mining titles in a country. Such a cadastre, when well developed and backed by capable public mining sector institutions, integrates the regulatory, institutional, and technological aspects of mineral rights administration, and forms the cornerstone of good mineral resource management in a country.

The mineral rights cadastre addresses the following:

1. Formally captures applications for various types of mineral licenses (e.g. prospecting, exploration, mine development)
2. Captures changes and updates to mineral titles any time a title is granted or changes owner
3. Checks license applications for possible overlaps with earlier claims or other impediments
4. Advises the granting authority if a license application is technically admissible or not
5. Monitors compliance with payment of fees and/or other requirements to keep a mineral rights title valid
6. Advises the granting authority when mineral rights titles should be canceled

Mining Cadastres should be openly accessible to the public.

Source and for more information: "Mineral Rights Cadastres: Promoting Transparent Access to Mineral Resources" by the Oil, Gas, and Mining Policy Division of the World Bank. www.worldbank.org/ogmc

Unit 5 Questions

Please answer each of the following questions. If you are taking this course in a group you may then meet to discuss your answers.

1. What is the legal basis for the ownership and management of extractive industries in your country? What does the constitution say? Is there a sector law? What are the main pieces of legislation regarding the EI sector? Are they clear? Do they contradict?
2. Does your country have a National Oil or Mining Company? Compare the mandate, governance and rules and regulations regarding your country's NOC to the best practices you have read in this chapter. Focus especially on transparency, and oversight/monitoring.
3. What is the procurement process for exploration or exploitation licenses for natural resources in your country? How does that compare to the best practices described in this unit?
4. What is the role of parliament in the procurement process? Can it oversee and observe the selection process?
5. Does parliament have access to the full contracts and agreements? Are the contracts available to the public? How are they accessible? Explain how this relates to a Freedom of Information law.

Relevant Internet Resources

The Natural Resource Charter: <http://www.naturalresourcecharter.org/>

Parliamentary Strengthening: <http://www.parliamentarystrengthening.org/>

United States Energy Information Administration: www.eia.doe.gov

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Unit 6: Stage 3. Collection of Revenues

Learning Objectives

Governments, Revenues, Integrity and Extractive Industries

After studying this unit, you should be able to:

- Be able to talk about the government's main types of revenues from the extractive industries sector
- Know the difference between royalties, dividends, bonuses and taxes
- Be able to distinguish between different kinds of taxes extractive industries companies pay to the government
- Know what the Extractive Industries Transparency Initiative (EITI) is, and how parliament can be involved in the EITI process

Introduction and Overview

Revenues from the extractive industries sectors play an important role in resource-rich countries. Oil, gas and minerals often provide more than 40% of state fiscal receipts. This Unit will give an overview of which government institutions can collect these revenues and what the main types of revenues from the extractive industries sector are. The Unit will go into detail regarding the Extractive Industries Transparency Initiative (EITI), which sets a global standard for transparency in the revenues from the extractive industries sector by requiring disclosure of payments (by companies) and receipts (by the government). Finally, this Unit will provide entry points for the legislature in this stage of the extractive industries value chain.

Government Collection of Revenues

A country's legislation, regulations, and contractual agreements determine which payments the country receives in return for giving a company the right to extract the resource, and to which government entity the company must pay. Usually there are several government institutions responsible for collecting different kind of payments from one company. For effective oversight it is important to track and map the stream of oil or mineral revenues in detail. Government entities that typically are involved with financial flows are:

- **The central bank** for evidence that the payment was received by the government;
- **The taxation authority** responsible for assessing and collecting taxes;
- **The regulatory authority** that usually manages the collection of industry-specific revenues, such as royalties;
- **The national oil company**;
- **Regional and local governments**; and
- **Quasi-governmental organizations** such as training organizations and development corporations (Revenue Watch, 2008).

The government is responsible for revenue collection, revenue management and revenue disbursement. Efficient revenue collection requires adequate incentives and administrative simplicity, but is also dependent on the choice of fiscal regime and fiscal instruments, and in part on the administrative and audit capacity of institutions. All payments should flow into correctly audited government accounts. Parliaments or the relevant parliamentary should hold the government agencies accountable for receiving and managing the revenues on a regular basis. Most revenue payments are dependent upon the quantity and quality of resources produced, so for effective oversight it is crucial to independently collect and verify data on the volumes produced, consumed, and exported, and on the market prices or the resources (Revenue Watch, 2008).

EI activities are subject to taxes that apply to all other sectors of the economy and taxes that are specific to the industry. In addition, non-tax forms of rent collection (such as

royalties, bonuses, and production sharing) are often used. When there is a national oil or mining company, the government should receive dividends and other forms of payment as a shareholder of the company. Depending on its sort, revenue streams can be collected in cash or in kind (Revenue Watch, 2008). Indirect benefits such as of infrastructure should also be considered. Total government revenues are an aggregate of the financial share of taxes, royalties, shares of production, and other cash generated. Governments take in revenue from the oil, gas, and minerals sector in different ways, but primarily through:

- Taxes
- Royalties
- Payments in-kind
- Bonuses
- Dividends
- Rents

Taxation

Governments earn income through various kinds of taxes. The most common ones are listed below, and are retrieved from "Drilling Down, The Civil Society Guide to Extractive Industry Revenues and the EITI" (Revenue Watch, 2008), which provides a more in-depth overview of extractive industry revenue management for additional information.

Taxes on Profits. Many countries tax a producer's profits from extraction. These are taxes that are levied on the difference between revenues and costs. In some cases, there is both a basic rate of tax and an additional tax on excess profits, or profits incurred when prices exceed a certain level.

Corporate Tax. A corporate tax is levied on a company's profit, calculated from gross sales minus operating costs, capital charges, interest and depreciation, depletion allowances, and any other deductibles. The scope of permissible "operating costs" is

critical to the calculation. Be aware that there are many disputable items in operating costs. Many international extractive companies have set up centralized procurement organizations in other countries—the cost seen by the local entity will be an invoice from that procurement organization, not from an independent supplier, so there may be poor transparency in terms of what the external cost might have been. Usually such organizations will add a percentage markup to cover their administrative and overhead costs, and perhaps make a profit. In an oil and gas company, exploration costs are hard to tie back to physical activity. Good control systems are required to monitor and manage exploration costs. Such costs are usually tax deductible, so they will directly affect the amount of tax paid by the company.

Local Income Tax. Countries may require companies operating in local areas to pay taxes directly to local governments. These arrangements are intended to ensure that some benefits of mining are retained locally. Occasionally, the mine makes direct cash or in-kind contributions to the local communities. Such contributions, however, need to be handled with extreme sensitivity as they may fuel conflict between communities which provide labor, skills, and services to the operation yet do not benefit unequally from these arrangements.

Value Added Taxes. Most countries have a value added tax from 10 to 20 percent, which is assessed on activities that add value to a product or service provided. These taxes accrue directly to the government and are related to the economic activity created.

Import and Export Taxes. Import and export taxes are levied by most countries on imported goods in order to encourage domestic production. Sometimes, taxes are levied on exported goods in order to generate additional tax revenues for the government.

Excess Profit Taxes. An “excess profits tax” may be defined in relation to the profitability of the venture, so that this tax may only be applied when the project has a rate of return exceeding a specific and predetermined level or percentage. Alternatively, a “basic tax” may be applied to the profit of all projects; further tax may only be applied

to specific projects due to the unique character of their size or location. In these instances, such a tax is described as “ring-fencing.”

Windfall Revenues and Taxation. During the recent surge in metal and other commodity prices many companies made substantial profits that led countries to assess an additional profits tax, which was not specified in the original contract. In these cases the additional profit tax is sometimes known as a “windfall tax.” Increasingly, countries include these in their contracts, with the trigger point defined by a formula linked to pay-back on the original investment, agreed return on investment (ROI) rates, the commodity price against a base line, and gross profit. If the formula is well conceived, both parties should be satisfied with the distribution of “unexpected profits.”

Dividend Withholding Tax. When companies transfer dividends or net profits from one country to another, there may also be a dividend withholding tax, which can be an additional tax on profits. This is usually in the range of five to fifteen percent. Some countries have double taxation treaties with other countries so that dividends or profits are not taxed twice. This can have the effect of reducing the amount of tax paid in the exporting country or of canceling the tax altogether.

Royalties

Royalty refers to a sum of money paid by a holder of a concession to the government. It is a revenue-based tax, but the actual definition of what revenue is taxed can vary. The definition of ‘revenue’ should be explained in the contract or legislation, and the amount payable is calculated through a formula set out in legislation or in the contract itself. It is usually based on a percentage of the value of the oil or mineral extracted. Royalties usually constitute a major source of income for the government and can be paid in cash or in kind. If a government chooses to be paid in cash, then the company sells all of the production and pays royalty on all of it. When governments choose to be paid in kind, a portion of the physical oil derived from the total production is delivered to the government’s representative. Governments often decide to take in royalties in kind when

there is a need to supply local refineries or consumers. The contract should clearly state on which production the royalty is levied.

Dividends

A dividend payment is a distribution of profit to shareholders of the development company. When a government is a shareholder in the company, it can be entitled to dividends. The procedure for declaring and paying a dividend will be found either in the corporate law of the country or local jurisdiction, or in the corporate bylaws and other organizational documents of the company itself.

BOX 22 – The East African Legislative Assembly (EALA)

Members of the legislative body of the East African Community (EAC), EALA, have begun to promote resource revenue transparency at a regional level and in their member countries of Burundi, Kenya, Rwanda, Tanzania and Uganda. In early 2008, EALA held an initial workshop convening EALA members and member country legislators to learn about extractive industries in the region and discuss potential areas for cooperation. The body passed a 21-point resolution, in which it recommended that all EAC countries join EITI. EALA also established an ad-hoc committee to organize its efforts on extractive industries. Among the committee's first official activities was a site visit to a mining operation in Tanzania. The members consulted with local government officials, industry operators and local civil society organizations.

Source: NDI, Transparency and Accountability in Africa's Extractive Industries: the role of the legislature (2007)

Extractive Industries Transparency Initiative (EITI)

The 'EITI Guide for Legislators' (National Democratic Institute, 2009) explains why parliamentarians might want to consider advocating for the country to join the Extractive Industries Transparency Initiative (EITI), an international transparency initiative meant to facilitate the publication of company payments and government receipts. The rest of this paragraph is derived from the EITI Guide for Legislators (NDI, 2009).

EITI is a global standard for transparency in revenues from oil, gas and mining industries. It requires that companies disclose their payments made to governments and that governments disclose the revenue received from companies, and supervised by a multi-stakeholder committee consisting of the government, civil society, private sector representatives, and in some cases the legislature.

EITI focuses on the reconciliation of company payments with government receipts and

Box 23 – EITI Candidate Countries

For a country to become an EITI "candidate," the government must publicly commit to the Initiative and complete the Sign Up phase. As of January 2010 there are 27 EITI candidate countries:

Albania	Kazakhstan	Norway
Burkina Faso	Kyrgyz Republic	Peru
Cameroon	Madagascar	Republic of Congo
Central African Republic	Mali	Sao Tome en Principe
Cote d'Ivoire	Mauritania	Sierra Leone
Democratic Republic of Congo	Mongolia	Tanzania
Equatorial Guinea	Mozambique	Tanzania
Gabon	Niger	Yemen
Ghana	Nigeria	Zambia

Source: www.eitransparency.org

the disclosure of that information to the public. The goal is to identify potential discrepancies between payments and receipts and investigate and address the underlying causes. The EITI process is carried out using the services of an independent administrator and conducted under the supervision of a multi-stakeholder steering committee. The administrator produces a public report with revenue and payment data and an explanation of data discrepancies and process shortcomings. Each EITI program must adhere to the EITI Principles and Criteria and must complete several steps in four phases (endorsement, initiation, implementation and review). The process is designed to be flexible so that each country may adapt it as necessary. Once established, the EITI process should be conducted annually.

Once a country has fully implemented EITI, and has successfully undergone the validation process it becomes EITI "compliant." As the EITI program continues, Validation is conducted every two years. Currently (as of January 2010) there are two countries that are EITI compliant: Azerbaijan and Liberia.

Countries choose to join EITI for a variety of reasons. **EITI can help to:**

- **Ensure oil and mineral revenues are used to benefit the local population.** This is the primary benefit of EITI.
- **Strengthen budget monitoring and oversight.** EITI reports can be powerful tools for citizens and legislators to understand how much money the government collects and how the funds are spent. In some cases, EITI has led to the government's recovery of unaccounted-for funds or company underpayments.
- **Reinforce anti-corruption and good governance agendas.** Effective EITI programs can make corrupt practices more difficult to hide. By promoting transparency in an area where secrecy is often the norm, EITI participation can help establish precedents for improving transparency in other areas of government.

- **Build citizen trust in public institutions.** When elected officials use EITI to promote openness and public discussion about how the government receives and spends revenue, citizens may feel empowered and better connected to the policy process; more confident that their interests will be taken into consideration in government decision-making; and more likely to believe that they can play a role in holding their government accountable.
- **Reduce hostilities between governments, companies and communities or citizens.** Extractive industries tend to be disruptive to the communities in which they operate. Since they involve physical upheaval of land, and workers from outside the community (and sometimes outside the country), there tends to be hostility, which in extreme cases can lead to conflict. The government and companies often blame each other. Transparency can build trust among these actors, and EITI can create a safe forum for dialogue, understanding, and resolution.
- **Improve the investment climate.** A country's implementation of EITI sends a signal to international investors and companies that the government is committed to strengthening transparency and accountability. The country may be perceived as a more attractive destination for investment, which may spur economic growth in other sectors; in the longer-term, access to cheaper capital may increase as the country's risk ratings improve.

Legislators can help ensure that their government signs up, that the program follows EITI Criteria and Principles that it is relevant to the particular needs of the country, and that it is properly managed, monitored, and publicized.

How Can Legislators Best Monitor the Activities of the Multi-Stakeholder Group?

Whether legislators sit on the Multi-Stakeholder Group (MSG) or not, overall engagement on EITI is more likely to be effective when they stay apprised of MSG activities. The following paragraphs share several strategies for staying informed and questions to ask when doing so.

Be Informed about How the MSG Works - Legislators should inquire about who makes up the MSG. How were members chosen? Do members represent a sufficiently broad range of stakeholders and do they include at least senior company, civil society and government officials? Which government agency is responsible for coordinating EITI? Is there a separate national secretariat? What is their schedule for MSG meetings?

Establish Communication Early - The earlier legislators establish mechanisms of communication with the EITI national secretariat and the MSG, the better informed they will be. Committees can request a copy of the EITI work plan and regular briefings by the EITI senior government official or the MSG chairperson. In cases where a committee chairman or member sits on the MSG, he or she should inform colleagues of EITI developments and problems.

Promote Full Engagement by Civil Society and Companies on the MSG - EITI programs are most successful when all non-government stakeholders are able to fully participate. Yet there are sometimes obstacles that legislators may want to monitor, and encourage the government to address. Non-government actors should be independent of government, and free to express themselves. Civil society representatives residing outside the capital may have difficulty traveling to meetings held in the capital without advance notice or funding for travel costs. If the government has communicated poorly with companies about their role on the MSG they may misunderstand what is required.

How Can Legislators Ensure EITI Follows the Agreed Work Plan?

In these early EITI stages legislators, whether MSG members or not, can help to guarantee the effectiveness of the EITI process by monitoring whether it is following the agreed work plan.

Encourage Government and the MSG to Remove Obstacles to Implementation - Confidentiality clauses, sometimes included in contracts between companies and the government, can be an obstacle to implementation. Failure to remove them can delay the EITI process, derail it, or render the exercise ineffective. Legislators should encourage the government to excuse companies from this obligation.

Another common obstacle has been tax law that prohibits government from releasing company tax information to a third party. This is another instance where the government can change the law, if required, to make EITI work.

Encourage Government to Address Delays - Legislators may be able to reduce delays in implementation of EITI, and ensure that funding deficiencies do not unnecessarily disrupt the process. Legislators can help address causes for any delays and encourage the government to stick to its agreed work plan through parliamentary questions, and through informal meetings with government officials involved in EITI and company representatives. Legislators may also help ensure that funding is disbursed in the timeframe outlined in the work plan.

Request Regularly Scheduled EITI Briefings - Committees can request that the EITI senior government officials provide EITI briefings on a regular schedule. Committee members will need to determine how often these briefings should take place to ensure effective information exchange.

Some factors to consider include the length of the legislative session and pressing non-EITI events or issues.

Request that the Administrator's Progress Reports be Presented to the Legislature - The MSG may require that the administrator provide progress reports to the MSG on a periodic basis. Progress reports may help identify problems early in the process. They are likely to include what actions have been taken to date, to which companies or government entities reporting templates have been sent, what companies or entities have completed them, and tasks yet to be completed.

Request Automatic Forwarding of Public EITI Documents - Most documents produced as part of the EITI process should be made public. This includes the EITI work plan; MOUs signed between the government and the MSG; the EITI reporting template, and the MOU signed by the administrator. Committees could request that they receive, as a matter of course, copies of all relevant EITI documents.

What Should Legislators do to Promote Improvements in the EITI Report and Process?

Depending on the oversight tools and authority that legislatures and their committees possess, they may have several options for addressing report shortcomings. Legislators may:

Meet with the Administrator and with CSOs to Discuss Report Findings - As soon as the report is released, legislators should have the administrator explain the findings. They could also ask CSOs active on EITI to share their analysis.

Hold Public Hearings about the Report's Findings - Public hearings can be used to gather information about the EITI report findings, solicit input on ways to improve the EITI process, or raise public awareness about EITI. For example, Nigeria's EITI communications strategy included "Road Shows," public forums outside the capital to raise public awareness and discuss EITI. They are carried out by the EITI national secretariat around the country. National Assembly members participate by presiding over the forums, making presentations, and contributing to the discussion.

Establish Select (investigative) Committees to Examine Major Discrepancies or Problems

- If problems identified are serious and are not being addressed by the government, select committees can be an effective way to shed more light on the problem. Select committees are temporary committees established to examine a particular issue and can have a deterrent effect on corruption.

Produce Committee Reports Highlighting Areas for Government Action

- Committee reports provide the government and the public with the committee's analysis of a particular issue or program with recommendations for action. A committee report on EITI might highlight recommendations included in an EITI report but not yet acted upon by government or might draw attention to the government's action or lack of action to reconcile discrepancies highlighted in the EITI report.

Seek Government Action through Parliamentary Questions

- Oral or written parliamentary questions typically provide regularly scheduled opportunities for individual legislators to pose questions to executive leaders for verbal response.

Request that an Audit be Conducted

- Where discrepancies or other problems have been identified, commissioning an additional audit may be the only way to examine why they occurred. In some countries, legislative committees may have the authority to request that the government conduct such an audit to resolve outstanding problems.

How Can Passing an EITI Law Help Make the EITI Program More Successful?

Enshrining the EITI process into law can strengthen the program in several ways. The EITI process depends on a government's desire to carry it out. The company and government entity compliance in reporting is not legally binding. An EITI law can ensure that the EITI program is sustainable, survives changes in government, and provides for penalties where companies and government entities fail to report.

An EITI law strengthens the legislature’s role in EITI as well. In the process of drafting, debating and reviewing the law, legislators can shape the program to ensure that it reflects country circumstances, accurately articulates citizens’ needs, and complements other laws and programs related to extractive industries. Most importantly, a law will strengthen the formal legislative oversight role over EITI.

BOX 23 – The Nigeria EITI (NEITI) Act of 2007

The Nigeria EITI (NEITI) Act became law in May 2007, making Nigeria the first country to give statutory backing to its EITI program. The Act requires annual reporting, establishes the NEITI Secretariat as a permanent legal entity, outlines rules and procedures for appointing MSG members, and legally defines the MSG’s role.

The law also strengthens NEITI by:

- Making company and government reporting mandatory (those that do not comply may be penalized)
- Requiring audit reports be reviewed by the Auditor General
- Requiring audit reports be submitted to the National Assembly
- Requiring bi-annual NEITI activity reports to the National Assembly

To review, amend and pass the NEITI bill, the National Assembly drew on support and expertise of CSOs, EITI experts, and international organizations. To better analyze and understand the NEITI bill, the Senate Committee on Establishment and Public Service of the National Assembly held a retreat to discuss its provisions. Committee members, with the support of international organizations, invited NEITI Secretariat staff and World Bank representatives to brief them on the major pieces of the legislation.

International legislative experts worked with them to analyze each section of the bill. A copy of the NEITI Act can be found in Appendix 1.



**TIPS
for Legislators**

TIP 1 - Coordinate efforts with civil society organizations

Some CSOs are very active on extractive industry issues. And they may have links with international organizations such as Transparency International and Publish What You Pay Campaign, which provide them with financial support and information about the extractive industries, and the EITI process. These organizations can provide legislators with useful information on EITI and the extractive industries, be helpful advocates in encouraging the government to adopt or improve EITI, provide informed ideas for developing a policy to strengthen or complement EITI and help to hold the government accountable for unaccounted or mismanaged revenues.

TIP 2 - Incorporate EITI into constituent communication

Citizens often care very deeply about whether the proceeds of natural resource extraction in their country are benefitting them, but know little about what the government receives, or how it spends extractive industries revenues. Legislators can transmit this information through their regular contact with citizens.

TIP 3 - Strengthen and utilize the committee system

Legislatures with effective committee systems divide their work, accomplishing much more than those without effective committees. Committees with jurisdiction over EITI-related issues can develop specific EITI expertise and are often better able to work across party lines, making the small compromises necessary to reach agreement on legislation and policies. Through public hearings, committees are also a useful, and often the only, venue to include public input into the policymaking process. Since EITI involves issues that are typically covered by several committees – natural resources, budget and finance, public accounts, anti-corruption – effective oversight requires that the activities of these committees be coordinated and that information be shared between them. Legislatures also establish ad-hoc, select, or investigative committees to study or to deal with specific issues. With regard to EITI, creating such a committee is likely to be most useful once a report has been released, to investigate shortcomings or discrepancies identified by the administrator and which the government has failed to address or correct.

TIP 4 - Build relationships with other EITI actors

And finally, legislators can become better informed and more effective overseers of the EITI process by working with their peers in other EITI countries, in regional EITI networks, international legislative networks and with international donors.

TIP 5 - Pass a resolution of the legislature

The legislature can encourage the executive to sign on to EITI by passing a resolution asking the government to join EITI. Such a resolution may be stronger if it specifies a time frame for action. If the executive declines to sign up within that time period, the legislature might publicly question the relevant minister during plenary debate, or through parliamentary questions or a public hearing.

Unit 6 Questions

Please answer each of the following questions. If you are taking this course in a group you may then meet to discuss your answers.

1. Which data is there available on revenues from extractive industries in your country? Is this data publicly available?
2. Which government entities are responsible for the collection of revenues? Is there good revenue management coordination at the government level? Are all involved agencies accurately delivering on their responsibilities?
3. Do you think it is or has been a good idea for your country to sign up for EITI?
4. If your country signed up for EITI, is Parliament represented on the Multi-Stakeholder Group? Why (not)? Is Parliament regularly informed by the proceedings of the EITI process? What could Parliament in your country do to be more involved in the EITI process?

Relevant Internet Resources

Extractive Industries Transparency Initiative: www.eitransparency.org

East African Legislative Assembly: <http://www.eala.org/>

Parliamentary Strengthening: <http://www.parliamentarystrengthening.org/>

Select Bibliography

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Unit 7: Stage 4. Revenue Management

Learning Objectives

Responsible Spending

After studying this unit, you should be able to:

- Know how to link the spending of the extractive industries revenues to the budget and to the strategic framework
- Know how Parliament can impact the monitoring of spending
- Appreciate the importance of different types of audits

Introduction and Overview

If the revenues of extractive industries are used well, the resources can create long-term economic growth and development. This Unit will address the issue of revenue management and link it to the budget, medium term frameworks and the strategic framework for the extractive industries sector. The Unit will focus on financial auditing of the public sector, and ways in which the legislature can use its oversight function and hold the government to account regarding its spending behaviour.

Revenue Spending

The way revenues out of EI activities are spent should not be ad hoc, but should rather be outlined in the strategic framework, as well as in the annual and medium-term budget. Revenues can be put into a Stabilization Fund, used for long-term sustainable investments, or they can be used to improve government finances.

The government should have publicly stated its objectives with respect to revenue management and how it will disburse revenues. Determining appropriate spending choices requires broad political consensus. Choices need to take into consideration the nonrenewable and volatile nature of oil and mining revenues, the sustainability and efficiency of expenditure, and the importance of economic diversification.

The actual use of government revenues in sustainable projects, including capital or recurrent operating and maintenance expenditures, must take place within the framework of the national budget. Spending should be transparent and accounted for. Legislators can increase fiscal accountability by monitoring public expenditures and verifying the effectiveness of budget execution. Parliaments should establish an impact monitoring system that quantifies the effectiveness of spending. This is a complex endeavor and will likely require assistance from experts, such as auditors. Corporate audits, value for money audits, tax audits and national exploitation company audits can all help to test the soundness of government's revenue collection and revenue spending.

The management of public finances requires the implementation of systems for budget execution and improvements in public accounting and overall financial reporting. Benchmark indicators exist in the area of public finance management, such as those proposed by the Public Expenditure and Financial Accountability (PEFA) initiative (See Appendix 2). In any case, a sound public investment management system is needed to help screen proposed investment projects based on factors including their cost-benefit or cost effectiveness and implementation readiness. Optimal evaluation of EI projects will include an estimate of their environmental impacts, as well as expected socioeconomic benefits and their long-term sustainability.

Once information on budget execution is available, it is of key importance to track spending and its actual impact all the way down to the end users. In this respect, parliamentarians might want to hold consultations and meetings with their constituents and organize field trips in order to verify the completion of infrastructure and proper delivery of commissioned investments. These meetings and field visits should provide an opportunity to understand many of the causes underlying poor budget execution, and

should therefore serve as a basis for parliaments to propose reforms to address any ascertained weaknesses. In addition, parliamentarians might want to verify how annual spending has contributed to long-term development goals. In the case of redistribution of revenue shares to local and regional governments it is crucial that effective oversight and budget control mechanisms are in place at the sub-national level (www.parliamentarystrengthening.org / Budget Module).

Lastly, it is essential for Parliament to make sure that both the government and the contracted company have complied with contract provisions, including when the provision of infrastructure or other development projects was part of the contract. If necessary, Parliament can use hearings and field visits to collect evidence and to get its questions answered.

BOX 24 – Revenue sharing with the local level

Another important issue is revenue sharing between the central government and local government, which is generally established in a country's constitution, by law, or both. Fiscal decentralization is challenging given that EI revenue is uncertain, volatile, does not last forever, and typically is concentrated in few producing regions. The use of rule-based, transparent, simple and equitable allocation criteria is thus recommended. To support the sound implementation of fiscal decentralization, especially where regional and sub-national authorities do not have sufficient capacity, the role of the parliament is to provide assistance, supervision, and scrutiny at the regional/sub-national level to ensure that this revenue is properly utilized.

On another note, projects and infrastructure developed in the EI-producing regions merit special attention and should take into consideration the need to develop non-EI activities to avoid over dependency on the EI and to support the local and regional economy once the EI resources are depleted.

TIP 1 – Use the EITI report

Legislative engagement is equally important when the report is released. Legislators can use the report as a tool for holding the government accountable. Depending on the oversight tools and authority that legislatures and their committees possess, they may have several options for addressing report shortcomings.

TIP 2 - Seek government action through parliamentary questions

Oral or written parliamentary questions typically provide regularly scheduled opportunities for individual legislators to pose questions to executive leaders for verbal response.

TIP 3 - Request that an audit be conducted

Where discrepancies or other problems have been identified, commissioning an additional audit may be the only way to examine why they occurred. In some countries, legislative committees may have



Parliamentary Audits

Financial auditing is traditionally the focus of public sector auditing. Audits are critical to sound industry management, and can provide legislators and the general public with useful information on problem areas, as well as recommendations for reform. During the audit and evaluation stage, an independent audit institution, such as an audit court or auditor general, analyses government accounts and financial statements. In most countries, the audit of accounts is followed by the consideration of audit findings by the legislature. If the process is effective, any recommendations based on audit findings are reflected in future budgets, which allows for continuous improvements in public spending and generally public financial management. Accounting rules and procedures for EI operations and regular audits that meet international standards are critical, particularly to assess production and export volumes, prices, and capital and operating costs, as well as to monitor compliance with procurement procedures, local content obligations, and social compensation requirements.

Typically, a nation's supreme audit agency (sometimes called the Auditor General – AG) reviews government accounts and prepares a yearly report for parliament. Auditors independent of the executive are freer to conduct independent investigations of executive spending and programs. Audit agencies need sufficient funds and adequate staff if they are to conduct their work effectively. In the Auditor General model, financial audit focuses on the accounts of government departments in order to present a judgment about the accuracy and fairness of an organization's financial statements. Because it is impossible to check every single transaction, auditors use strategies such as sampling techniques or the examination of the auditee's financial system to arrive at their judgment. The main skill needed for financial audit in the auditor general tradition is knowledge of accountancy.

In the audit court model, the emphasis of financial audit is on certifying the legality of spending, to see whether government revenue and spending have been authorized and used for approved purposes, and whether departments and agencies have conformed to all pertinent laws and regulations. This means that financial audit in the court model requires mainly legal skills (www.parliamentarystrengthening.org / Budget Module).

A few legislatures do not consider audit findings in detail, but to ensure effective scrutiny most parliaments use committees to examine the reports of the public auditor on the accounts of government departments. There are different options for establishing committee capacity to consider audit findings. In some legislatures the same committee that is responsible for approving the budget is also tasked with considering audit reports.

BOX 25 – Participatory budgeting

Many villages affected by extractive industries have seen little of the government's social spending of revenues from the extractive industries sector. The extractive industries revenues can serve as a basis for poverty reduction by including the participation of affected communities in the management of revenues. Countries and villages could adopt a system of open and participatory budgeting so that citizens can influence spending priorities for extractive industries revenues.

BOX 26– The use of public funds in Nigeria

Nigeria's National Assembly has initiated investigations into the use of public funds. During its 1999 – 2003 term in office, the House Public Accounts Committee examined the records of dozens of government agencies that had not been audited for several years. During a two-day workshop in August 2000, the committee met with the Auditor General, the Accountant General and the Public Accounts Commission to discuss oversight roles and possibilities for cooperation. Also in 2003, the House Committee on Petroleum Resources held a public hearing to investigate allegations that the Nigerian National Petroleum Company had failed to forward millions of dollars in oil revenues to the appropriate federal account. The hearing sparked extensive media coverage regarding oil revenues and federal collection mechanisms, increasing the information available to the public.

Another ad-hoc committee was initiated by the House of Representatives to investigate the activities and operations of the Nigeria National Petroleum Cooperation (NNPC). The committee reported in 2009 that the NNPC failed to remit about \$1.87 billion in revenues to the Federation Account in the years 2004-2007. According to the committee, the company had given unregistered foreign companies licenses for tax-evasion purposes. The NNPC had also manipulated prices for exported crude oil. The committee ordered the NNPC to account for the losses within one week.

See also: *Transparency and Accountability in Africa's Extractive Industries: the role of the legislature (National Democratic Institute, 2007)*

The majority of Westminster parliaments use Public Accounts Committees (PACs) to follow-up on findings of public audits, to investigate irregularities reported, and to recommend changes to rectify any problems discovered. PACs invite ministers and other ministry officials to testify before the committee, and, in some systems, have the power to subpoena witnesses. Both government and opposition MPs serve on PACs, which more often than not are chaired by a key member of the opposition. AG staff members sometime assist members and staff of PACs in carrying out their investigations. The public accounts committee process has its starting point with a report from the auditor general. After receiving an audit report, hearings are the principal mechanism by which officials from departments, agencies or other relevant bodies answer to the committee. The summoned officials appear in front of the committee during the hearing. In most public accounts committees, interrogation focuses not on the relevant minister but on the accounting officer. The accounting officer is the civil servant in a department who is accountable to the legislature for financial management, usually the administrative head of a department. A draft report on the hearing is prepared and debated in the committee. While it is not normally required that reports have to be adopted unanimously by the committee, some committees have found it useful to hold back reports until consensus has been established (www.parliamentarystrengthening.org / Budget Module).

TIP - Sharing and publicizing information

Public accounts committees might pressure government by publicizing the findings and conclusions of their investigations. Parliaments worldwide use public hearings, including budget hearings, to pressure government through the press coverage that hearings receive. Legislators are uniquely positioned to help communicate results through public outreach activities. They often already have experience working with the media and engaging citizens, and often already use a variety of mechanisms for doing so. They may also have a good understanding about how citizens feel about extractive industry transparency, and what they are most interested to know. Legislators generally have two objectives in sharing information with the public: educating the public about the importance of extractive industries; and drawing attention to problems in the report that the government needs to address. If the objective is to highlight shortcomings in the report, legislators will want to emphasize only the most important issues and communicate them clearly. Possible activities for legislators or parties include town hall meetings, participation in a radio or television show, and political party's newsletters.

Source: National Democratic Institute (2007)



**TIP
for Legislators**

The finalization of a report on audit findings by a legislative committee should not be the end of the ex post scrutiny process. Mechanisms should be in place to help ensure that remedial action is taken in response to adverse findings in external audit reports. One mechanism would be a regulatory requirement that the audited agency respond to the findings publicly, in writing, and indicate the actions it will take in response. Another mechanism would be for a public accounts committee to review the public accounts, to consider the chief auditor's report, and to hold the executive accountable for remedying deficiencies exposed through audit. Transparent follow-up to external audits is an important feature that promotes concrete action for improvement.

In some countries, committee reports have to be followed by a formal response from the government. However, such reports only have practical value if the government

addresses the issues they raise, and implements the recommendations of the committee. In practice, while experiences vary, a formal response from the government is not always sufficient for ensuring that the committee's recommendations are acted upon.

With regard to particularly important issues, the legislature might consider interim reporting requirements to ensure that the government takes remedial action as speedily as possible. This can take the form of periodic committee briefings by relevant officials (www.parliamentarystrengthening.org / Budget Module).

BOX 27 – How does the system for using public money break down?

Sometimes public money is misused because the system does not work as it should. Some of the most frequent problems in the system of public finances include:

- Money that should go to the government is never received
- The accounting records are not audited in a timely manner
- The government spends money in unauthorized ways
- Accounting records are not well kept
- The government does not respond to questions raised by the legislator and does not change its pending practices
- The legislature does not review the audit reports

Unit 7 Questions

Please answer each of the following questions. If you are taking this course in a group you may then meet to discuss your answers.

1. In your country, is the money spent according to the plans? Does expenditure fit into the development strategy and strategic framework?
2. In your country, are expenditures benefiting the people?
3. In your country, how does Parliament monitor the management of revenues of the extractive industries sector? What is the role of the Public Accounts Committee? Is there another committee that focuses on this topic?
4. Are there value-for-money audits? What is the benefit of value-for-money audits in the case of the extractive industries sector?
5. Has the National Oil Company been audited?
6. Is government book keeping up to date? Are there quality control and review mechanisms? Are internal audits of government departments conducted? Does the Auditor General have access to necessary data?

Relevant Internet Resources

Parliamentary Strengthening: <http://www.parliamentarystrengthening.org/>

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www.parliamentarystrengthening.org

Glossary

Resource curse	The resource curse (also known as the paradox of plenty) refers to the paradox that countries with an abundance of natural resources, specifically non-renewable resources like minerals and fuels, tend to have less economic growth and worse development outcomes than countries with fewer natural resources
Dutch Disease	The Dutch Disease is a concept that explains the apparent relationship between the increase in exploitation of natural resources and a decline in the manufacturing sector. The theory is that an increase in revenues from natural resources will de-industrialize a nation's economy by raising the exchange rate, which makes the manufacturing sector less competitive
Economic Diversification	Economic diversification is when the country has incomes from many different sources that are not directly related to each other.
Fiscal Discipline	Fiscal Discipline is the management of the government budget so as to avoid excessive fiscal deficits, thus restraining government spending.
Centralized political economy models	Centralized political economy models assume that the presence of natural resources increases the value of staying in power and increases the likelihood that

	others will challenge the government for its power.
Rent-seeking models	Rent seeking refers to efforts, both legal and illegal, to acquire access to or control over opportunities for earning rents. In oil dependent countries, rent-seeking refers to widespread behavior, in both the public and private sector, aimed at capturing oil money through unproductive means.
Power of the purse	Parliament's role in the budget process.
Stabilization Fund	A Stabilization Fund is a fund created by a government as a savings account for future financial support and investments.
Exchange rate volatility	Exchange rate volatility refers to the swings in the charge for exchanging currency of one country for currency of another.
Foreign borrowing	Foreign borrowing or external debt is that part of the total debt in a country that is owed to creditors outside the country. The debtors can be the government, corporations or private households.
Numerical fiscal rules	Numerical fiscal rules set numerical targets for budgetary aggregates. They pose a permanent constraint on fiscal policy expressed in terms of a summary indicator of fiscal outcomes, such as the government budget balance, debt, expenditure, or revenue developments. Fiscal rules enhance budgetary discipline, and may further contribute to the reduction of uncertainty about future fiscal

	<p>policy developments. However, fiscal rules can only yield these benefits if appropriate institutions for monitoring and enforcement mechanisms are in place, or if they are supported by strong political commitment.</p>
Populism	<p>Populism refers to the political doctrine that supports the rights and powers of the common people in their struggle with the privileged elite.</p>
Exploration license	<p>An exploration license is a license to explore for oil or gas in a particular area issued to a company by the state.</p>
Exploitation license	<p>An exploitation license is a license to exploit discovered oil or gas sources and is issues to a company by the state.</p>
Revenue Stream	<p>A revenue stream is a form of revenue, referring specifically to the individual methods by which money comes into the treasury. A revenue stream has volatility, predictability, risk, and return.</p>
Production Sharing Agreements/ Production Sharing Contract (PSA/PSC)	<p>Production sharing agreements (PSAs) or Production Sharing Contracts (PSCs) are a common type of contract signed between a government and a resource extraction company (or group of companies) concerning how much of the resource (usually oil) extracted from the country each will receive.</p>
Investment and expenditure smoothing	<p>Smoothing is an economic concept which refers to balancing out and/or</p>

spread out spending and saving to attain and maintain the highest possible living standard over the course of one's life or several generations. With smoothing, the primary goal of financial planning is to avoid abrupt changes in one's standard of living.

Appendix 1

The "Equator Principles"

A financial industry benchmark for determining, assessing and managing social & environmental risk in project financing

www.equator-principles.com

PREAMBLE

Project financing, a method of funding in which the lender looks primarily to the revenues generated by a single project both as the source of repayment and as security for the exposure, plays an important role in financing development throughout the world. Project financiers may encounter social and environmental issues that are both complex and challenging, particularly with respect to projects in the emerging markets.

The Equator Principles Financial Institutions (EPFIs) have consequently adopted these Principles in order to ensure that the projects we finance are developed in a manner that is socially responsible and reflect sound environmental management practices. By doing so, negative impacts on project-affected ecosystems and communities should be avoided where possible, and if these impacts are unavoidable, they should be reduced, mitigated and/or compensated for appropriately. We believe that adoption of and adherence to these Principles offers significant benefits to ourselves, our borrowers and local stakeholders through our borrowers' engagement with locally affected communities. We therefore recognise that our role as financiers affords us opportunities to promote responsible environmental stewardship and socially responsible development. As such, EPFIs will consider reviewing these Principles from time-to-time based on implementation experience, and in order to reflect ongoing learning and emerging good practice. These Principles are intended to serve as a common baseline and framework for the implementation by each EPFI of its own internal social and environmental policies, procedures and standards related to its project financing activities. We will not provide loans to projects

where the borrower will not or is unable to comply with our respective social and environmental policies and procedures that implement the Equator Principles.

STATEMENT OF PRINCIPLES

EPFIs will only provide loans to projects that conform to Principles 1-9 below.

Principle 1: Review and Categorisation

When a project is proposed for financing, the EPFI will, as part of its internal social and environmental review and due diligence, categorise such project based on the magnitude of its potential impacts and risks in accordance with the environmental and social screening criteria of the International Finance Corporation (IFC).

Principle 2: Social and Environmental Assessment

For each project assessed as being either Category A or Category B, the borrower has conducted a Social and Environmental Assessment ("Assessment") process to address, as appropriate and to the EPFI's satisfaction, the relevant social and environmental impacts and risks of the proposed project. The Assessment should also propose mitigation and management measures relevant and appropriate to the nature and scale of the proposed project.

Principle 3: Applicable Social and Environmental Standards

For projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the Assessment will refer to the then applicable IFC Performance Standards and the then applicable Industry Specific EHS Guidelines. The Assessment will establish to a participating EPFI's satisfaction the project's overall compliance with, or justified deviation from, the respective Performance Standards and EHS Guidelines.

Principle 4: Action Plan and Management System

For all Category A and Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the borrower has prepared an Action Plan (AP) which addresses the relevant findings, and draws on the conclusions of the Assessment. The AP will describe and prioritise the actions needed to implement mitigation measures, corrective actions and monitoring measures necessary to manage the impacts and risks identified in the Assessment. Borrowers will build on, maintain or establish a Social and Environmental Management System that addresses the

management of these impacts, risks, and corrective actions required to comply with applicable host country social and environmental laws and regulations, and requirements of the applicable Performance Standards and EHS

Guidelines, as defined in the AP. For projects located in High-Income OECD countries, EPFIs may require development of an Action Plan based on relevant permitting and regulatory requirements, and as defined by host-country law.

Principle 5: Consultation and Disclosure

For all Category A and, as appropriate, Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, the government, borrower or third party expert has consulted with project affected communities in a structured and culturally appropriate manner.⁴ For projects with significant adverse impacts on affected communities, the process will ensure their free, prior and informed consultation and facilitate their informed participation as a means to establish, to the satisfaction of the EPFI, whether a project has adequately incorporated affected communities' concerns.

In order to accomplish this, the Assessment documentation and AP, or non-technical summaries thereof, will be made available to the public by the borrower for a reasonable minimum period in the relevant local language and in a culturally appropriate manner. The borrower will take account of and document the process and results of the consultation, including any actions agreed resulting from the consultation. For projects with adverse social or environmental impacts, disclosure should occur early in the Assessment process and in any event before the project construction commences, and on an ongoing basis.

Principle 6: Grievance Mechanism

For all Category A and, as appropriate, Category B projects located in non-OECD countries, and those located in OECD countries not designated as High-Income, as defined by the World Bank Development Indicators Database, to ensure that consultation, disclosure and community engagement continues throughout construction and operation of the project, the borrower will, scaled to the risks and adverse impacts of the project, establish a grievance mechanism as part of the management system. This will allow the borrower to receive and facilitate resolution of concerns and grievances about the project's social and environmental performance raised by individuals or groups from among project-affected communities. The borrower will inform the affected communities about the mechanism in the course of its community engagement process and ensure that the mechanism addresses concerns promptly and transparently, in a culturally appropriate manner, and is readily accessible to all segments of the affected communities.

Principle 7: Independent Review

For all Category A projects and, as appropriate, for Category B projects, an independent social or environmental expert not directly associated with the borrower will review the Assessment, AP and consultation process documentation in order to assist EPFI's due diligence, and assess Equator Principles compliance.

Principle 8: Covenants

An important strength of the Principles is the incorporation of covenants linked to compliance. For Category A and B projects, the borrower will covenant in financing documentation:

- a) to comply with all relevant host country social and environmental laws, regulations and permits in all material respects;
- b) to comply with the AP (where applicable) during the construction and operation of the project in all material respects;
- c) to provide periodic reports in a format agreed with EPFIs (with the frequency of these reports proportionate to the severity of impacts, or as required by law, but not less than annually), prepared by in-house staff or third party experts, that i) document compliance with the AP (where applicable), and ii) provide representation of compliance with relevant local, state and host country social and environmental laws, regulations and permits; and
- d) to decommission the facilities, where applicable and appropriate, in accordance with an agreed decommissioning plan.

Where a borrower is not in compliance with its social and environmental covenants, EPFIs will work with the borrower to bring it back into compliance to the extent feasible, and if the borrower fails to re-establish compliance within an agreed grace period, EPFIs reserve the right to exercise remedies, as they consider appropriate.

Principle 9: Independent Monitoring and Reporting

To ensure ongoing monitoring and reporting over the life of the loan, EPFIs will, for all Category A projects, and as appropriate, for Category B projects, require appointment of an independent environmental and/or social expert, or require that the borrower retain qualified and experienced external experts to verify its monitoring information which would be shared with EPFIs.

Principle 10: EPFI Reporting

Each EPFI adopting the Equator Principles commits to report publicly at least annually about its Equator Principles implementation processes and experience, taking into account appropriate confidentiality considerations.

Annex 2 - Santiago Principles

Generally Accepted Principles and Practices (GAPP)

GAPP **1.** **Principle**

The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).

- *GAPP 1.1 Subprinciple* The legal framework for the SWF should ensure the legal soundness of the SWF and its transactions.
- *GAPP 1.2 Subprinciple* The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and the other state bodies, should be publicly disclosed.

GAPP **2.** **Principle**

The policy purpose of the SWF should be clearly defined and publicly disclosed.

GAPP **3.** **Principle**

Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

GAPP 4. Principle

There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations.

- *GAPP 4.1 Subprinciple* The source of SWF funding should be publicly disclosed.
- *GAPP 4.2 Subprinciple* The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

GAPP **5.** **Principle**

The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

GAPP **6.** **Principle**

The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

GAPP **7.** **Principle**

The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.

GAPP **8.** **Principle**

The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

GAPP **9.** **Principle**

The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.

GAPP **10.** **Principle**

The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

GAPP **11.** **Principle**

An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

GAPP **12.** **Principle**

The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

GAPP **13.** **Principle**

Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.

GAPP **14.** **Principle**

Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

GAPP **15.** **Principle**

SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

GAPP **16.** **Principle**

The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

GAPP **17.** **Principle**

Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

GAPP **18.** **Principle**

The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.

- *GAPP 18.1 Subprinciple* The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.
- *GAPP 18.2 Subprinciple* The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.
- *GAPP 18.3 Subprinciple* A description of the investment policy of the SWF should be publicly disclosed.

GAPP **19.** **Principle**

The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

- *GAPP 19.1 Subprinciple* If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.
- *GAPP 19.2 Subprinciple* The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles.

GAPP **20.** **Principle**

The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

GAPP **21.** **Principle**

SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

GAPP **22.** **Principle**

The SWF should have a framework that identifies, assesses, and manages the risks of its operations.

- *GAPP 22.1 Subprinciple* The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning, and an independent audit function.
- *GAPP 22.2 Subprinciple* The general approach to the SWF's risk management framework should be publicly disclosed.

GAPP **23.** **Principle**

The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

GAPP **24.** **Principle**

A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

Annex 3: The Performance Measurement Framework - PFM

The focus of the PFM performance indicator set is the public financial management at central government level, including the related institutions of oversight. For more information, dissemination and training, please refer to www.pefa.org. The Performance Measurement Framework identifies the critical dimensions of performance of an open and orderly PFM system as follows:

1. **Credibility of the budget** - The budget is realistic and is implemented as intended.
2. **Comprehensiveness and transparency** - The budget and the fiscal risk oversight are comprehensive and fiscal and budget information is accessible to the public.
3. **Policy-based budgeting** - The budget is prepared with due regard to government policy.
4. **Predictability and control in budget execution** - The budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.
5. **Accounting, recording and reporting** – Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes.
6. **External scrutiny and audit** - Arrangements for scrutiny of public finances and follow up by executive are operating.

Appendix 4 - NEITI Act

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE, (NEITI) ACT, 2007

EXPLANATORY MEMORANDUM

This Act provides for the establishment of the Nigeria Extractive Industries Transparency Initiative (NEITI) charged with the responsibility, among other things, for the development of a framework for transparency and accountability in the reporting and disclosure by all extractive industry companies of revenue due to or paid to the Federal Government.

NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

(NEITI) ACT, 2007

A BILL

FOR

AN ACT TO PROVIDE FOR THE ESTABLISHMENT OF THE NIGERIA EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (NEITI) AND FOR RELATED MATTERS.

Enacted by the National Assembly of the Federal Republic of Nigeria:

1.(1) There is established a body to be known as the Nigeria Extractive Industries Transparency Initiative, (in this Act referred to as "the NEITI".)

(2) The NEITI:

(a) shall be an autonomous self-accounting body, which shall report to the President and the National Assembly,

(b) shall be a body corporate with perpetual succession with a common seal,

and

(c) may:

- (i) sue and be sued in its corporate name, and
- (ii) acquire, hold and dispose of movable and immovable properties in the discharge of its functions under this Act.

2. The primary objectives of the NEITI are:

- (a) to ensure due process and transparency in the payments made by all extractive industry companies to the Federal Government and statutory recipients.
- (b) to monitor and ensure accountability in the revenue receipts of the Federal Government from extractive industry companies.
- (c) to eliminate all forms of corrupt practices in the determination, payments, receipts and posting of revenue accruing to the Federal Government from extractive industry companies;
- (d) to ensure transparency and accountability by government in the application of resources from payment received from extractive industry companies, and
- (e) to ensure conformity with the principles of Extractive Industries Transparency Initiative

3. For the purpose of realizing its objectives under this Act. The NEITI shall perform the following functions:

- (a) develop a framework for transparency and accountability in the reporting and disclosure by all extractive industry companies of revenue due to or paid to the Federal Government;
- (b) evaluate without prejudice to any relevant contractual obligations and sovereign obligations the practices of all extractive industry companies and government respectively regarding acquisition of acreages, budgeting, contracting, materials procurement and production cost profile in order to ensure due process, transparency and accountability.
- (c) ensure transparency and accountability in the management of the

investment of the Federal Government in all extractive industry companies,
(d) obtain, as may be deemed necessary, from any extractive industry company an accurate record of the cost of production and volume of sale of oil, gas or other minerals extracted by the company at any period, provided that such information shall not be used in any manner prejudicial to the contractual obligation or proprietary interests of the extractive industry company,

(e) request from any company in the extractive industry, or from any relevant organ of the Federal State or Local Government, an accurate account of money paid by and received from the company at any period, as revenue accruing to the Federal Government from such company for that period; provided that such information shall not be used in a manner prejudicial to contractual obligations or proprietary interest of the extractive industry company or sovereign obligations of Government,

(f) monitor and ensure that all payments due to the Federal Government from all extractive industry companies, including taxes, royalties, dividends, bonuses, penalties, levies and such like are duly made;

(g) identify lapses and undertake measures that shall enhance the capacity of any relevant organ of the Federal State or Local Government having statutory responsibility to monitor revenue payments by all extractive industry companies to the Federal Government,

(h) disseminate by way of publication of records, report or otherwise any information concerning the revenues received by the Federal Government from all extractive industry companies as it may consider necessary;

(i) promote or undertake any other activity related to its functions and which in its opinion, is calculated to help achieve its overall objectives as enumerated in section 2 of this Act;

(j) ensure that all fiscal allocations and statutory disbursements due from the Federal Government to statutory recipients are duly made.

4. (1) The NEITI shall in each financial year appoint independent auditors for the purpose of Appointment auditing the total revenue which accrued to the

Federal Government for that year from extractive industry companies, in order to determine the accuracy of payments and receipts.

(2) The independent auditors appointed under subsection (1) of this section shall undertake a physical, process and financial audit on such terms and conditions as may be approved by the National Stakeholders Working Group (NSWG).

(3) Upon the completion of an audit, the independent auditors shall submit the reports together with comments of the Extractive Industries Company to the NEITI, which shall cause same to be disseminated to the National Assembly and the Auditor-General of the Federation and also ensure their publication.

(4) The NEITI shall submit a bi-annual report of its activities to the President and National Assembly.

(5) An auditor or auditing firm that has audited any extractive industry company in any given year shall not be appointed in the same year for the purposes of subsection (2) of this section.

(6) An auditor or auditing firm shall not be engaged for more than two years consecutively for the purposes of subsection (2) of this section.

(7) The Auditor-General of the Federation shall not later than 3 months after the submission of the audit report to the National Assembly publish any comment made or action taken by the Government on the audit reports.

5. (1) The governing body of the NEITI shall be the National Stakeholders Working Group (in this Act referred to as "the NSWG")

(2) The NSWG shall be responsible for the formulation of policies, programmes and strategies for the effective implementation of the objectives and the discharges of the functions of the NEITI.

(3) Without prejudice to subsection (2) of this section, the NSWG shall have powers to recommend the annual budget and work-plan of the NEITI and ensure the periodic review of programmes performance by the NEITI.

6. (1) The NSWG shall be constituted by the President and shall consist of a

chairman and no more than 14 other members one of whom shall be an Executive Secretary.

(2) (a) In making appointment into the NSWG, the President shall include:

- (i) representative of extractive industry companies,
- (ii) representative of Civil Society,
- (iii) representative of Labour Unions in the extractive Industries,
- (iv) experts in the extractive industry, and
- (v) one member from each of the six geopolitical zones.

(b) the Chairman and other members of NSWG other than the Executive Secretary shall serve on part-time basis.

(3) The appointment of Executive Secretary shall be for 5 years and no more.

7. A person appointed as a member of the NSWG shall hold office for 4 years and no more.

8. The members of the NSWG as well as any person appointed to any of its special committees under section 2 may be paid such allowances out of the funds of the NEITI as the National Revenue Mobilization and Fiscal Commission may approve.

9. (1) The NSWG shall ordinarily meet quarterly for the dispatch of business at such times and places as it may determine, but not less than four times in a year.

(2) At every meeting of the NSWG, the Chairman shall preside and in his absence, a member of the NSWG appointed by the members from among themselves shall preside.

(3) Questions proposed at a meeting of NSWG shall be determined by a simple majority of members present and voting and in the event of an equality of votes, the person presiding shall have a casting vote.

(4) The NSWG may at any time co-opt any person to act as an adviser at any of its meetings but no person so co-opted shall be entitled to vote at any meeting.

(5) The validity of the proceedings of the NSWG shall not be affected by the

absence of any member, vacancy among its membership or by any defect in the appointment of any of the members.

10. The quorum of the NSWG at any meeting shall be 8 members.

11. The NSWG may constitute such special committees as it considers fit to deal different aspects of its responsibilities.

12. (1) The NSWG may create departments and engage the services of such staff and consultants as it may consider necessary for the NEITI.

(2) The NEITI shall have an Executive Secretary who shall

(a) be appointed by the President upon the recommendation of the NSWG provided he is a graduate with relevant qualifications and at least 10 years cognate experience;

(b) be responsible for the day-to-day administration of the NEITI; and

(c) serve as Secretary to NSWG.

(3) The staff and consultants of the NEITI may be engaged on such terms and conditions as the NSWG may determine.

(4) The NSWG shall fix the remunerations, allowances and benefits of the staff and consultants of the NEITI.

(5) (a) The NSWG shall recommend to the President for appointment, qualified validator line with NEITI guidelines as contained in second schedule to this Act; and

(b) NSWG shall fix the remunerations, allowances and benefits for the validators.

13. (1) The funds of the NEITI shall consist of:

(a) such sums as may be provided by the Federal Government and appropriated by the National Assembly based on the budget submitted by the NSWG and which shall be released as and when due; and

(b) such sums as may be paid to the NEITI by way of grants, donations and gifts provided the sources of such grants, donations and gifts are

properly disclosed and not in conflict with the provisions of this Act.

(2) The NEITI shall apply the proceeds of the funds established under section 13 (1) of this Act to the

(a) cost of administration;

(b) payment of salaries, allowances and benefits to members of the NSWG or any of its committees;

(c) payment of salaries, remunerations, allowances, pensions benefits to officers and employees for NEITI;

(d) payment of all purchases;

(e) payment for all contracts, including mobilization, fluctuation, variations, legal fees and cost of contract-administration; and

(f) carrying out of other activities that would promote its objectives which are connected to all or any of the functions of NEITI under this Act, and

(g) payment for validators.

(3) The Government body of NEITI, the NSWG, shall not later than 30th September in each year, submit to the President and the National Assembly an estimate of the expenditure and income of NEITI during the succeeding year and the NEITI shall cause to be kept proper accounts in respect of each year and proper records in relation thereto.

14. (1) the NEITI shall cause the account of total revenue which accrued to the Federal Government from all extractive industry companies, its receipts, payments, assets and liabilities to be audited not later than 6 months after the end of each year by independent auditors appointed on such terms and conditions as the NSWG may approve and on the confirmation of the audit, the independent auditor shall submit the report with comments of the audited entity to the NEITI which shall cause same to be published for the information of the public, provided that the contents of such report shall not be published in a manner prejudicial to the contractual obligations or proprietary interests of the audited entity.

(2) The NEITI shall have power to borrow money from banks with the approval of NSWG.

(3) The NEITI shall prepare and submit to the President and the National

Assembly not later than 30th September in each year, a report of its activities during the immediate preceding year, and shall include in such report the audited accounts of the NEITI for that year and the auditor's report thereon.

15. (1) the NEITI shall maintain bank accounts, the signatories of which shall be determined by the NSWG in accordance with the regulation made pursuant hereto.

(2) The accounts may be opened in such banks as the NSWG may determine.

16. (1) An extractive industry company which

(a) gives false information or report to the Federal Government or its agency regarding its volume or production, sales and income; or

(b) renders false statement of account or fails to render a statement of account required under this Act to the Federal Government or its agencies, resulting in the underpayment or non-payment of revenue accruable to the Federal Government or statutory recipients commits an offence and is liable on conviction to a fine not less than N30,000,000.

(2) Where the Extractive industry has been convicted of an offence under subsection (1) of this section, the court shall, in addition to the penalty prescribed there under, order the company to pay the actual amount of revenue due to the Federal Government.

(3) An extractive industry company which delays or refuses to give information or report under this Act, or willfully or negligently fails to perform its obligations under this Act, commits an offence and is liable on conviction to a fine not less than N30,000,000.

(4) Without prejudice to subsections (1), (2) and (3) of this section, the President may on the recommendation of the NSWG suspend or revoke the operational license of any extractive industry company which fails to perform its obligations under this Act.

(5) If any extractive industry company commits an offence against the Act, every Director or other persons concerned in the management of the company commits the offence and is liable on conviction to not less than 2 years imprisonment or a

fine not less than N5,000,000 unless that person proves that

- (a) the offense was committed without his consent or connivance, and
- (b) the person exercised all such diligence to prevent the commission of the offense as ought to have been exercised by that person, having regard to the nature of his functions in that company and to all the circumstance.

(6) A government official who renders false statement of account or fails to render a statement of account required under this Act to the Federal Government or its agencies, resulting in the underpayment or non-payment of revenue accruable to the Federal Government or statutory recipients, commits an offense and is liable on conviction to not less than 2 years imprisonment or a fine not less than N5,000,000, unless that person proves that

- (a) the offense was committed without his consent or connivance, and
- (b) the person exercised all such diligence to prevent the commission of the offense as ought to have been exercised by that person, having regard to the nature of his functions in that company and to all the circumstance.

17. The NSWG may make regulations as it may consider expedient for the purpose of giving effect to the provisions of this Act and for regulating any matter that falls within the scope of the functions of the NEITI.

18. Subject to the provisions of this Act, no suit shall be commenced against NEITI before the expiration of 30 days after written notice of an intention to commence the suit shall have been served upon NEITI as a defendant or its agent, and the notice shall clearly and explicitly state:

- (a) the cause of action,
- (b) the particulars of the claim,
- (c) the names of the legal practitioners representing the plaintiff and their addresses, and
- (d) the relief sought.

19. (1) The Executive Secretary of the NEITI, his officers, employees or agents shall personally be subject to any action, claim or demand by, or liable to any person in

respect anything done or omitted to be done in the exercise of any function or power conferred by this Act upon the NEITI or member of the NSWG.

(2) A member of the NSWG, the Executive Secretary or any officer of the NEITI shall be indemnified out of the funds of the NEITI against any liability incurred by him in defending any proceeding, whether civil or criminal, if the proceeding is brought against him in his capacity as a member of NSWG, Executive Secretary, officer or any employee of the NEITI.

(3) Subject to the provisions of this Act, the provisions of the Public Officers Protection Act shall apply in relation to any suit instituted against any officer, or employee of NEITI or member of the NSWG.

20. A notice, summons, other court process, other documents required or authorized to be served upon the NEITI under the provisions of this Act, any other law or enactment shall and be served by delivering it to the Executive Secretary or by sending it by registered post and addressed to the Executive Secretary at the principal office of the NEITI.

21. In this Act:

“Extractive Industry Company” means any company in Nigeria that is engaged in the business of prospecting, mining, extracting, processing and distributing minerals and gas including oil, gold, coal, tin, bitumen, diamonds, precious stones and such like, includes

any agency or body responsible for the payment of extractive industry proceeds to the Federal Government or its Statutory Recipient.

“Federal Government” means the Federal government of Nigeria.

“Government” means the three tiers of the government of Nigeria, including Federal, State and Local Government, and their respective Ministries, agencies and departments.

“President” means the President and Commander-in-Chief of the Armed Forces of Federal Republic of Nigeria;

“Statutory Recipient” means any entity to whom by law, extractive industry companies or Government are obliged to make payments,

“Extractive Industry Expert” means a person who has spent a minimum of ten (10) years in a management position in the extractive industry.

“NSWG” means National Stakeholders Working Group.

22. This Act may be cited as the Nigeria Extractive Industries Transparency Initiative Act 2007.

SCHEDULE Section 2(7)

SUPPLEMENTARY PROVISIONS RELATING TO THE NIGERIA EXTRACTIVE INDUSTRY TRANSPARENCY INITIATIVE, ETC.

Proceedings of the Governing Body

1-(1) Subject and section 27 of the Interpretation Act, Cap. 192 LFN, 1990 the NSWG may make standing order to regulate its proceedings for those of any of its Committee.

(2) The quorum of the NSWG shall be the Chairman or any other person presiding at a meeting in his absence and 4 other members of the governing body and the quorum of any Committee shall be as determined by the governing body.

2-(1) The NSWG shall meet whenever it is summoned by the Chairman and if the Chairman is required to do so by notice given to him by not less than 4 other members, he shall summon a meeting of the NSWG to be held within 14 days from the date on which the notice was given.

(2) At any meeting of the NSWG, the Chairman shall preside but if he is absent, the members present at the meeting shall appoint one of them to preside at the meeting.

(3) When the NSWG desire to obtain the advice of any person on a particular matter, it may co-opt him for such period as it deems fit, but a person who is a member by virtue of this sub-paragraph shall not be entitled to vote at any meeting of the NSWG and shall not count towards a quorum.

(4) The NSWG shall ordinarily meet at such times and places as it may determine, and for not less than four times in a year.

(5) Questions proposed at a meeting of the NSWG shall be determined by a simple majority of members present and voting, and in the event of an equality of votes, the Chairman or another person shall have a second or casting vote.

Committees

3-(1) The NSWG may appoint one or more Committees to carry out on its behalf such of the functions of NEITI as it may determine.

(2) A Committee appointed under this paragraph shall consist of such number of persons as may be determined by the NSWG and a person shall hold office on the Committee in accordance with the terms of his appointment.

(3) A decision of a Committee shall not have effect until it is confirmed by the NSWG.

Miscellaneous

4-(1) The fixing of the seal of NEITI shall be authenticated by the signatures of the Chairman and Secretary of the NSWG generally.

(2) Any contract or instrument which, if made or executed by a person not being a body corporate could not be required to be under seal, may be made or executed on behalf of NEITI by the Secretary of the NSWG generally or any other person specifically authorized by the NSWG to act for that purpose.

(3) A document purporting to be duly executed under the seal of NEITI shall be received in evidence and shall, unless the contrary is proved, be presumed to be so executed.

(4) The validity of any proceeding of the NSWG or of a Committee shall not be adversely affected by

(a) A vacancy in the membership of the NSWG or a Committee, or

(b) A defect in the appointment of a member of the NSWG or Committee, or

(c) Reason that a person not entitled to do so took part in the proceedings of the NSWG or Committee.

Appendix 5 - United Nations Declaration on the Rights of Indigenous Peoples

Adopted by General Assembly Resolution 61/295 on 13 September 2007

The General Assembly,
Guided by the purposes and principles of the Charter of the United Nations, and good faith in the fulfilment of the obligations assumed by States in accordance with the Charter,

Affirming that indigenous peoples are equal to all other peoples, while recognizing the right of all peoples to be different, to consider themselves different, and to be respected as such,

Affirming also that all peoples contribute to the diversity and richness of civilizations and cultures, which constitute the common heritage of humankind,

Affirming further that all doctrines, policies and practices based on or advocating superiority of peoples or individuals on the basis of national origin or racial, religious, ethnic or cultural differences are racist, scientifically false, legally invalid, morally condemnable and socially unjust,

Reaffirming that indigenous peoples, in the exercise of their rights, should be free from discrimination of any kind,

Concerned that indigenous peoples have suffered from historic injustices as a result of, inter alia, their colonization and dispossession of their lands, territories and resources, thus preventing them from exercising, in particular, their right to development in accordance with their own needs and interests,

Recognizing the urgent need to respect and promote the inherent rights of indigenous peoples which derive from their political, economic and social structures and from their cultures, spiritual traditions, histories and philosophies, especially their rights to their lands, territories and resources,

Recognizing also the urgent need to respect and promote the rights of indigenous peoples affirmed in treaties, agreements and other constructive arrangements with States,

Welcoming the fact that indigenous peoples are organizing themselves for political, economic, social and cultural enhancement and in order to bring to an end all forms of discrimination and oppression wherever they occur,

Convinced that control by indigenous peoples over developments affecting them and their lands, territories and resources will enable them to maintain and strengthen their institutions, cultures and traditions, and to promote their development in accordance with their aspirations and needs,

Recognizing that respect for indigenous knowledge, cultures and traditional practices contributes to sustainable and equitable development and proper management of the environment,

Emphasizing the contribution of the demilitarization of the lands and territories of indigenous peoples to peace, economic and social progress and development, understanding and friendly relations among nations and peoples of the world,

Recognizing in particular the right of indigenous families and communities to retain shared responsibility for the upbringing, training, education and well-being of their children, consistent with the rights of the child,

Considering that the rights affirmed in treaties, agreements and other constructive arrangements between States and indigenous peoples are, in some situations, matters of international concern, interest, responsibility and character,

Considering also that treaties, agreements and other constructive arrangements, and the relationship they represent, are the basis for a strengthened partnership between indigenous peoples and States,

Acknowledging that the Charter of the United Nations, the International Covenant on Economic, Social and Cultural Rights (2) and the International Covenant on Civil and Political Rights,² as well as the Vienna Declaration and Programme of Action,⁽³⁾ affirm the fundamental importance of the right to self-determination of all peoples, by virtue of which they freely determine their political status and freely pursue their economic, social and cultural development,

Bearing in mind that nothing in this Declaration may be used to deny any peoples their right to self-determination, exercised in conformity with international law,

Convinced that the recognition of the rights of indigenous peoples in this Declaration will enhance harmonious and cooperative relations between the State and indigenous peoples, based on principles of justice, democracy, respect for human rights, non-discrimination and good faith,

Encouraging States to comply with and effectively implement all their obligations as they apply to indigenous peoples under international instruments, in particular those related to human rights, in consultation and cooperation with the peoples concerned,

Emphasizing that the United Nations has an important and continuing role to play in promoting and protecting the rights of indigenous peoples,

Believing that this Declaration is a further important step forward for the recognition, promotion and protection of the rights and freedoms of indigenous peoples and in the development of relevant activities of the United Nations system in this field,

Recognizing and reaffirming that indigenous individuals are entitled without discrimination to all human rights recognized in international law, and that indigenous peoples possess collective rights which are indispensable for their existence, well-being and integral development as peoples,

Recognizing that the situation of indigenous peoples varies from region to region and from country to country and that the significance of national and regional particularities and various historical and cultural backgrounds should be taken into consideration,

Solemnly proclaims the following United Nations Declaration on the Rights of Indigenous Peoples as a standard of achievement to be pursued in a spirit of partnership and mutual respect:

Article

1

Indigenous peoples have the right to the full enjoyment, as a collective or as individuals, of all human rights and fundamental freedoms as recognized in the Charter of the United Nations, the Universal Declaration of Human Rights⁽⁴⁾ and international human rights law.

Article 2

Indigenous peoples and individuals are free and equal to all other peoples and individuals and have the right to be free from any kind of discrimination, in the exercise of their rights, in particular that based on their indigenous origin or identity.

Article 3

Indigenous peoples have the right to self-determination. By virtue of that right they freely determine their political status and freely pursue their economic, social and cultural development.

Article 4

Indigenous peoples, in exercising their right to self-determination, have the right to autonomy or self-government in matters relating to their internal and local affairs, as well as ways and means for financing their autonomous functions.

Article 5

Indigenous peoples have the right to maintain and strengthen their distinct political, legal, economic, social and cultural institutions, while retaining their right to participate fully, if they so choose, in the political, economic, social and cultural life of the State.

Article 6

Every indigenous individual has the right to a nationality.

Article 7

1. Indigenous individuals have the rights to life, physical and mental integrity, liberty and security of person.
2. Indigenous peoples have the collective right to live in freedom, peace and security as distinct peoples and shall not be subjected to any act of genocide or any other act of violence, including forcibly removing children of the group to another group.

Article 8

1. Indigenous peoples and individuals have the right not to be subjected to forced assimilation or destruction of their culture.
2. States shall provide effective mechanisms for prevention of, and redress for:
 - (a) Any action which has the aim or effect of depriving them of their integrity as distinct peoples, or of their cultural values or ethnic identities;
 - (b) Any action which has the aim or effect of dispossessing them of their lands, territories or resources;

- (c) Any form of forced population transfer which has the aim or effect of violating or undermining any of their rights;
- (d) Any form of forced assimilation or integration;
- (e) Any form of propaganda designed to promote or incite racial or ethnic discrimination directed against them.

Article 9

Indigenous peoples and individuals have the right to belong to an indigenous community or nation, in accordance with the traditions and customs of the community or nation concerned. No discrimination of any kind may arise from the exercise of such a right.

Article 10

Indigenous peoples shall not be forcibly removed from their lands or territories. No relocation shall take place without the free, prior and informed consent of the indigenous peoples concerned and after agreement on just and fair compensation and, where possible, with the option of return.

Article 11

1. Indigenous peoples have the right to practise and revitalize their cultural traditions and customs. This includes the right to maintain, protect and develop the past, present and future manifestations of their cultures, such as archaeological and historical sites, artefacts, designs, ceremonies, technologies and visual and performing arts and literature.
2. States shall provide redress through effective mechanisms, which may include restitution, developed in conjunction with indigenous peoples, with respect to their cultural, intellectual, religious and spiritual property taken without their free, prior and informed consent or in violation of their laws, traditions and customs.

Article 12

1. Indigenous peoples have the right to manifest, practise, develop and teach their spiritual and religious traditions, customs and ceremonies; the right to maintain, protect, and have access in privacy to their religious and cultural sites; the right to the use and control of their ceremonial objects; and the right to the repatriation of their human remains.
2. States shall seek to enable the access and/or repatriation of ceremonial objects and human remains in their possession through fair, transparent and effective mechanisms developed in conjunction with indigenous peoples concerned.

Article 13

1. Indigenous peoples have the right to revitalize, use, develop and transmit to future generations their histories, languages, oral traditions, philosophies, writing systems and literatures, and to designate and retain their own names for communities, places and persons.
2. States shall take effective measures to ensure that this right is protected and also to ensure that indigenous peoples can understand and be understood in political, legal and administrative proceedings, where necessary through the provision of interpretation or by other appropriate means.

Article 14

1. Indigenous peoples have the right to establish and control their educational systems and institutions providing education in their own languages, in a manner appropriate to their cultural methods of teaching and learning.
2. Indigenous individuals, particularly children, have the right to all levels and forms of education of the State without discrimination.
3. States shall, in conjunction with indigenous peoples, take effective measures, in order for indigenous individuals, particularly children, including those living outside their communities, to have access, when possible, to an education in their own culture and provided in their own language.

Article 15

1. Indigenous peoples have the right to the dignity and diversity of their cultures, traditions, histories and aspirations which shall be appropriately reflected in education and public information.
2. States shall take effective measures, in consultation and cooperation with the indigenous peoples concerned, to combat prejudice and eliminate discrimination and to promote tolerance, understanding and good relations among indigenous peoples and all other segments of society.

Article 16

1. Indigenous peoples have the right to establish their own media in their own languages and to have access to all forms of non-indigenous media without discrimination.
2. States shall take effective measures to ensure that State-owned media duly reflect indigenous cultural diversity. States, without prejudice to ensuring full freedom of expression, should encourage privately owned media to adequately reflect indigenous cultural diversity.

Article 17

1. Indigenous individuals and peoples have the right to enjoy fully all rights established under

applicable international and domestic labour law.

2. States shall in consultation and cooperation with indigenous peoples take specific measures to protect indigenous children from economic exploitation and from performing any work that is likely to be hazardous or to interfere with the child's education, or to be harmful to the child's health or physical, mental, spiritual, moral or social development, taking into account their special vulnerability and the importance of education for their empowerment.

3. Indigenous individuals have the right not to be subjected to any discriminatory conditions of labour and, inter alia, employment or salary.

Article 18

Indigenous peoples have the right to participate in decision-making in matters which would affect their rights, through representatives chosen by themselves in accordance with their own procedures, as well as to maintain and develop their own indigenous decision-making institutions.

Article 19

States shall consult and cooperate in good faith with the indigenous peoples concerned through their own representative institutions in order to obtain their free, prior and informed consent before adopting and implementing legislative or administrative measures that may affect them.

Article 20

1. Indigenous peoples have the right to maintain and develop their political, economic and social systems or institutions, to be secure in the enjoyment of their own means of subsistence and development, and to engage freely in all their traditional and other economic activities.

2. Indigenous peoples deprived of their means of subsistence and development are entitled to just and fair redress.

Article 21

1. Indigenous peoples have the right, without discrimination, to the improvement of their economic and social conditions, including, inter alia, in the areas of education, employment, vocational training and retraining, housing, sanitation, health and social security.

2. States shall take effective measures and, where appropriate, special measures to ensure continuing improvement of their economic and social conditions. Particular attention shall be paid to the rights and special needs of indigenous elders, women, youth, children and persons with disabilities.

Article 22

1. Particular attention shall be paid to the rights and special needs of indigenous elders, women,

youth, children and persons with disabilities in the implementation of this Declaration.

2. States shall take measures, in conjunction with indigenous peoples, to ensure that indigenous women and children enjoy the full protection and guarantees against all forms of violence and discrimination.

Article 23

Indigenous peoples have the right to determine and develop priorities and strategies for exercising their right to development. In particular, indigenous peoples have the right to be actively involved in developing and determining health, housing and other economic and social programmes affecting them and, as far as possible, to administer such programmes through their own institutions.

Article 24

1. Indigenous peoples have the right to their traditional medicines and to maintain their health practices, including the conservation of their vital medicinal plants, animals and minerals. Indigenous individuals also have the right to access, without any discrimination, to all social and health services.

2. Indigenous individuals have an equal right to the enjoyment of the highest attainable standard of physical and mental health. States shall take the necessary steps with a view to achieving progressively the full realization of this right.

Article 25

Indigenous peoples have the right to maintain and strengthen their distinctive spiritual relationship with their traditionally owned or otherwise occupied and used lands, territories, waters and coastal seas and other resources and to uphold their responsibilities to future generations in this regard.

Article 26

1. Indigenous peoples have the right to the lands, territories and resources which they have traditionally owned, occupied or otherwise used or acquired.

2. Indigenous peoples have the right to own, use, develop and control the lands, territories and resources that they possess by reason of traditional ownership or other traditional occupation or use, as well as those which they have otherwise acquired.

3. States shall give legal recognition and protection to these lands, territories and resources. Such recognition shall be conducted with due respect to the customs, traditions and land tenure systems of the indigenous peoples concerned.

Article **27**

States shall establish and implement, in conjunction with indigenous peoples concerned, a fair, independent, impartial, open and transparent process, giving due recognition to indigenous peoples' laws, traditions, customs and land tenure systems, to recognize and adjudicate the rights of indigenous peoples pertaining to their lands, territories and resources, including those which were traditionally owned or otherwise occupied or used. Indigenous peoples shall have the right to participate in this process.

Article **28**

1. Indigenous peoples have the right to redress, by means that can include restitution or, when this is not possible, just, fair and equitable compensation, for the lands, territories and resources which they have traditionally owned or otherwise occupied or used, and which have been confiscated, taken, occupied, used or damaged without their free, prior and informed consent.
2. Unless otherwise freely agreed upon by the peoples concerned, compensation shall take the form of lands, territories and resources equal in quality, size and legal status or of monetary compensation or other appropriate redress.

Article **29**

1. Indigenous peoples have the right to the conservation and protection of the environment and the productive capacity of their lands or territories and resources. States shall establish and implement assistance programmes for indigenous peoples for such conservation and protection, without discrimination.
2. States shall take effective measures to ensure that no storage or disposal of hazardous materials shall take place in the lands or territories of indigenous peoples without their free, prior and informed consent.
3. States shall also take effective measures to ensure, as needed, that programmes for monitoring, maintaining and restoring the health of indigenous peoples, as developed and implemented by the peoples affected by such materials, are duly implemented.

Article **30**

1. Military activities shall not take place in the lands or territories of indigenous peoples, unless justified by a relevant public interest or otherwise freely agreed with or requested by the indigenous peoples concerned.
2. States shall undertake effective consultations with the indigenous peoples concerned, through appropriate procedures and in particular through their representative institutions, prior to using their lands or territories for military activities.

Article**31**

1. Indigenous peoples have the right to maintain, control, protect and develop their cultural heritage, traditional knowledge and traditional cultural expressions, as well as the manifestations of their sciences, technologies and cultures, including human and genetic resources, seeds, medicines, knowledge of the properties of fauna and flora, oral traditions, literatures, designs, sports and traditional games and visual and performing arts. They also have the right to maintain, control, protect and develop their intellectual property over such cultural heritage, traditional knowledge, and traditional cultural expressions.
2. In conjunction with indigenous peoples, States shall take effective measures to recognize and protect the exercise of these rights.

Article**32**

1. Indigenous peoples have the right to determine and develop priorities and strategies for the development or use of their lands or territories and other resources.
2. States shall consult and cooperate in good faith with the indigenous peoples concerned through their own representative institutions in order to obtain their free and informed consent prior to the approval of any project affecting their lands or territories and other resources, particularly in connection with the development, utilization or exploitation of mineral, water or other resources.
3. States shall provide effective mechanisms for just and fair redress for any such activities, and appropriate measures shall be taken to mitigate adverse environmental, economic, social, cultural or spiritual impact.

Article**33**

1. Indigenous peoples have the right to determine their own identity or membership in accordance with their customs and traditions. This does not impair the right of indigenous individuals to obtain citizenship of the States in which they live.
2. Indigenous peoples have the right to determine the structures and to select the membership of their institutions in accordance with their own procedures.

Article**34**

Indigenous peoples have the right to promote, develop and maintain their institutional structures and their distinctive customs, spirituality, traditions, procedures, practices and, in the cases where they exist, juridical systems or customs, in accordance with international human rights standards.

Article 35

Indigenous peoples have the right to determine the responsibilities of individuals to their communities.

Article 36

1. Indigenous peoples, in particular those divided by international borders, have the right to maintain and develop contacts, relations and cooperation, including activities for spiritual, cultural, political, economic and social purposes, with their own members as well as other peoples across borders.

2. States, in consultation and cooperation with indigenous peoples, shall take effective measures to facilitate the exercise and ensure the implementation of this right.

Article 37

1. Indigenous peoples have the right to the recognition, observance and enforcement of treaties, agreements and other constructive arrangements concluded with States or their successors and to have States honour and respect such treaties, agreements and other constructive arrangements.

2. Nothing in this Declaration may be interpreted as diminishing or eliminating the rights of indigenous peoples contained in treaties, agreements and other constructive arrangements.

Article 38

States in consultation and cooperation with indigenous peoples, shall take the appropriate measures, including legislative measures, to achieve the ends of this Declaration.

Article 39

Indigenous peoples have the right to have access to financial and technical assistance from States and through international cooperation, for the enjoyment of the rights contained in this Declaration.

Article 40

Indigenous peoples have the right to access to and prompt decision through just and fair procedures for the resolution of conflicts and disputes with States or other parties, as well as to effective remedies for all infringements of their individual and collective rights. Such a decision shall give due consideration to the customs, traditions, rules and legal systems of the indigenous peoples concerned and international human rights.

Article 41

The organs and specialized agencies of the United Nations system and other intergovernmental organizations shall contribute to the full realization of the provisions of this Declaration through the mobilization, inter alia, of financial cooperation and technical assistance. Ways and means of ensuring participation of indigenous peoples on issues affecting them shall be established.

Article 42

The United Nations, its bodies, including the Permanent Forum on Indigenous Issues, and specialized agencies, including at the country level, and States shall promote respect for and full application of the provisions of this Declaration and follow up the effectiveness of this Declaration.

Article 43

The rights recognized herein constitute the minimum standards for the survival, dignity and well-being of the indigenous peoples of the world.

Article 44

All the rights and freedoms recognized herein are equally guaranteed to male and female indigenous individuals.

Article 45

Nothing in this Declaration may be construed as diminishing or extinguishing the rights indigenous peoples have now or may acquire in the future.

Article 46

1. Nothing in this Declaration may be interpreted as implying for any State, people, group or person any right to engage in any activity or to perform any act contrary to the Charter of the United Nations or construed as authorizing or encouraging any action which would dismember or impair, totally or in part, the territorial integrity or political unity of sovereign and independent States.

2. In the exercise of the rights enunciated in the present Declaration, human rights and fundamental freedoms of all shall be respected. The exercise of the rights set forth in this Declaration shall be subject only to such limitations as are determined by law and in accordance with international human rights obligations. Any such limitations shall be non-discriminatory and strictly necessary solely for the purpose of securing due recognition and respect for the rights and freedoms of others and for meeting the just and most compelling requirements of a democratic society.

3. The provisions set forth in this Declaration shall be interpreted in accordance with the principles of justice, democracy, respect for human rights, equality, non-discrimination, good governance and good faith.

(2) See resolution 2200 A (XXI), annex.

(3) A/CONF.157/24 (Part I), chap. III.

(4) Resolution 217 A (III).