

*Parliamentary Oversight
of the
Extractive Industries Sector*



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Introduction

In practice, oil, gas and mineral resources have had an adverse effect on the economies of several resource-rich nations. Instead of contributing to poverty alleviation and economic growth, resource revenues often lead to large-scale corruption, underdevelopment, and in some cases has fueled conflict and war. This can be attributed to the absence of strong, transparent, accountable governing institutions and sound legal and regulatory frameworks that would lend to managing resource revenues effectively. In these countries large and unregulated inflows of funds to government have created incentives for corruption. This undermines the relationship between citizens and governments. In these environments, policy makers are easily tempted to provide short-term solutions to long-term social and economic problems in return for economic benefit. As a result, these economies depend 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, the media, political parties, civil society organizations (CSOs) and, most importantly, legislatures.

The mineral value chain represents the stages involved in exploiting mineral resources. These stages include: the decision to extract; bidding and management; contracting with companies; revenue management; budgeting and expenditure management; and public service monitoring. The three core functions of parliament—representing constituent interests, legislating, and overseeing the executive branch—are crucial to improving governance and management of resource revenues along all six each stage of the value chain. This is because legislators are responsible for ensuring government allocates revenue appropriately, scrutinizing government’s expenditure of revenue and implementation of policy. The legislature is also responsible for ensuring extractive legal and regulatory frameworks address citizen’s needs and interests and making sure government holds industry accountable in complying with these frameworks.

Establishing a framework where natural resource wealth can be used to contribute to sustainable development is an enormous challenge. Policy makers face a myriad of difficult choices including deciding the pace at which extraction should occur, how best to minimize environmental damage, and implementing measures to take to avoid social conflict. Inter-generational in nature, these decisions have to be made in a highly volatile and uncertain environment largely due to the unpredictable nature of the industry. However there are several practical guiding principles that can help boost transparency, accountability and social and economic development in a resource-rich setting.

This document outlines the role parliament’s can play in the extractive industries sector, describing the stages of the extractive industries value chain, including the link to the national budget, with possible action steps for Members of Parliament for each of the stages Through these learning modules, members of parliaments (MPs) and their staff will be able to identify strengths and weaknesses in government’s extractive industries policy and how to make the extractive industries (EI) sector more developmentally oriented. The modules contain best practices in the area of EI governance and management. MPs can use these modules to better understand and analyze the costs and benefits of extractive industries policy outcomes, their effect on stability, growth and on the budget. These modules would also assist MPs to learn how to enhance benefits and mitigate the risks related to the extractive industries sector, so that they can more effectively oversee the executive branch of government. They will also equip MPs with information they can utilize to better inform debate around EI issues. Parliamentarians can also use these modules to enhance their ability to promote transparency and accountability throughout

the extractive industries value chain, and they will learn how to effectively participate in the Extractive Industries Transparency Initiative (EITI).

Parliament and the Resource Curse

Research indicates that a democratic government with strong checks and balances can minimize the resource curse (A. Wiig, 2008). A legislature effectively carrying out its three core functions – oversight, representation and lawmaking – is critical to the success of natural resource management. This is because parliament is the only public oversight institution with the constitutional mandate to oversee the implementation of policy by the government, scrutinize public expenditures, influence and shape policy through the lawmaking process, and represent citizen concerns and needs in decision making.

Parliament holds the ‘power of the purse’ (control over **public expenditures**), giving them the authority to review, amend and authorize national budgets. Given the sizeable impact of extractive **profits** on the national **budget** in resource rich countries, as components of both national **revenue** and **expenditure**, an understanding of the budget process is necessary for development of **national natural resource strategies**. By exerting its oversight authority during the budget process and in the development of medium and long term economic strategies, parliament can guide **economic policy** towards countering **Dutch Disease**, **economic diversification**, and **trade** openness.

Parliament’s Legislative Function & Extractive Industries

Through its *legislative* function, parliament is responsible for drafting and reviewing bills, and passing legislation needed for effective natural resources’ management and reform. The parliament can introduce laws to open up trade, and encourage or create incentives for private sector development, and regulatory frameworks that provide controls for how private cooperation’s operate in country. Additionally, legislatures can also introduce legislation that requires extractive companies to disclose the revenue they earn as a condition for being listed on stock exchanges. This was recently done by the United States Congress in 2010 with the Dodd-Frank Bill. In some countries, legislators have strengthened the implementation of Extractive Industry Transparency Initiative (EITI) by enshrining the implementation in law. The annual appropriation process is also another avenue where legislators can influence the management of extractive revenues.

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. Regulatory frameworks regarding the management of natural resources are often spread across different pieces of legislation and government policies (NDI, 2007). Through their lawmaking functions, legislators can support reform processes to improve regulations in order to create an enabling environment for sustainable and accountable management of the extractives. Moreover, given the multidisciplinary nature of the sector, a close coordination among different government entities is necessary to avoid regulatory gaps. Parliament can utilize its lawmaking function to develop comprehensive legislation to that would establish a more coherent legal and regulatory framework for the industry and addresses the complexity of issues comprehensive natural resource management requires.

Parliaments Representative Function & Extractive Industries

Parliaments are uniquely positioned to understand and monitor the effects of extractive industries on the citizens and act as a bridge between the government, private sector and civil society. Through its *representative* function parliament can ensure the voices, preferences and interests of the public are heard, respected and articulated. When a legislator represents constituents where extractive industries resources are located, there is a direct interest. By conducting public hearings, interviews with the media, constituent outreach, and other methods, legislators can incorporate citizen feedback into decision making around this sector and build public awareness about the challenges and opportunities associated with natural resource management.

Parliaments can potentially to serve as a forum for multiparty consensus on extractive industries' policies, and thus for countrywide support and ownership. This is because as an institution parliament is the most representative democratic institution in a governance system. The legislature represents people and groups, bringing their needs, aspirations and concerns to the national level where they can be factored into the policy making process. Legislatures not only represent the diversity and differences in a nation, but they mediate among the various interests they represent, reaching agreement on budgets and policies which meet national needs, even as they respond to specific geographical and group concerns.

Parliaments Oversight Function & Extractive Industries

One of the main functions of parliament is its work in scrutinizing the operations of the executive that is, exercising oversight of the implementation of laws, government policies, and government departments in order to enhance performance and accountability. Through its oversight function, parliament can conduct investigations to look into particular policy issues surrounding the sector. Parliament can also engage in the monitoring and evaluation of government policies, to ensure government's implementation of programs is being undertaken effectively and legally, and that funds are accounted for properly. These tasks can be accomplished through the use of various oversight tools including: the question period, committee hearings, and making recommendations for reform.

Tools for Oversight

Legislatures have developed several tools to assist them in practicing oversight. The types of tools available to parliament to undertake its oversight responsibilities are determined by parliament's **standing orders**. Some of the most common oversight tools are:

- **Question period:** the legislature sets aside time each week for MPs to question ministers. MPs typically direct these questions in advance to the Speaker, who determines whether and when they will be presented to the appropriate minister for response. Supplemental questions may also be raised during the question period. MPs use the question time to inquire a wide range of issues including government projects in their constituencies and the performance of ministries. Despite the importance of oversight, many MPs do not fully exercise this function. Some parliamentarians are concerned that oversight sounds too much like opposition. Although opposition members may use question time to gain political advantage, oversight is however not a function exclusively reserved for members of the opposition parties, rather a core function of every parliamentarian. Ruling party MPs have a responsibility to conduct oversight to ensure the government is delivering on its election platform. A vigilant press can reinforce parliament's oversight function by publicizing what takes place during the question period. Some parliaments have reformed their rules so that they have the authority to sanction or censure ministers who are not

responsive during the question period. Parliaments should keep an accurate record of promises made by ministers, and if ministers fail to follow through on their promises the legislature should express its displeasure through a resolution.

- Committee Hearings: the purpose of parliamentary committees is mainly to conduct inquiries into specified matters which includes taking submissions, hearing witnesses, going through evidence, discussing matters in detail and formulating conclusions and recommendations. Committees are a convenient vehicle for this activity and by concentrating on specific tasks or subjects, committees also offer the benefits of specialization.
- Request for documentation: Members or committees can continuously ask ministers to provide them with necessary and up-to-date documentation and information to conduct their oversight tasks. It is not uncommon for parliamentary committees to have the power to subpoena documents and summon witnesses.
- Interpellations: interpellation refers to the formal right of a parliament to submit formal questions to the government. In many parliaments, each individual member of parliament (MP) has the right to formally submit questions (possibly during question hour) to a member of government. The respective minister or secretary is then required to respond and to justify government policy. Interpellation thus allows the parliament to compel the government to answer requests for information, thereby promoting transparency and accountability.
- Ombudsman: an Ombudsman is a person who acts as a trusted intermediary between an organization and some internal or external constituent interests. In many instances the Ombudsman as an officer of parliament can act as an independent accountability institution. The ombudsman may, for example, investigate constituent complaints relating and attempt to resolve the issue, usually through recommendations (binding or not) or mediation. In some jurisdictions an ombudsman charged with the handling of concerns about national government is more formally referred to as the "Parliamentary Commissioner".
- Parliamentary debates: One characteristic of parliaments is that all MPs are equal in the plenary, no matter the size or location of their constituency. Debates in the plenary provide an opportunity for all MPs to express their views on specific issues, raising points of concern based on the feedback received from their constituency and advocating for one course of action over another.
- Audit and oversight agencies: a nation's supreme audit institution (SAI) (sometimes called the auditor general or cour des comptes) typically conducts a yearly review of government spending and issues its report. In Westminster systems the SAI submits its report to the legislature. External auditors are freer to conduct independent investigations than are those controlled by the executive. Audit agencies have evolved beyond conducting simple financial audits and have added what is known as value for money audits in order to determine not just whether funds were spent appropriately, but whether government programs obtained their desired results.

The Committee System

Another important oversight tool for parliament is the committee system. Legislatures accomplish more when they divide their tasks and responsibilities among smaller workgroups. Committees may be temporary (ad hoc) or permanent. Ad hoc committees are formed to review particular bills or deal with specific issues and are disbanded when their work is completed. Permanent (standing/portfolio/departmental) committees' jurisdictions tend to mirror the structure of cabinet ministries. Other oversight committees may focus on oversight specifically or may be responsible for rules, management or housekeeping matters. The types of committees in parliament include:

- Audit Committees (for example Public accounts committees): Audit Committees follow up on the findings of public audits. They study the audits, invite ministers, permanent secretaries or other ministry officials to the committee for questioning, and issue a report of their findings, often making specific recommendations. Typically, the government is required to report back to parliament on Audit Committee recommendations within a specified period, usually 2 to 6 months. Often an opposition member chairs the Audit Committee – this is particularly the case in Commonwealth countries. Audit Committees face several challenges: SAIs are often poorly funded, and their reports may be lengthy, complex, poorly organized, and difficult to understand. Funding and staff shortages mean that audit reports are often years behind. In many cases auditors are appointed by the executive and so may have little incentive to uncover problems. Investigating report findings is time and labor intensive so parliaments will need professional staff. Finally, sometimes governments are not responsive to parliament, and there may be few tools at a parliament's disposal to compel government compliance.
- Departmental, portfolio, permanent, or standing committees: as the name suggests, these committees are responsible for legislation pertaining to – and for oversight of – specific government ministries. Acting in their oversight capacity, these committees often have authority to question ministers and staff of ministries about the implementation of budgets and laws, and to determine whether specific public policy objectives have been achieved and, if not, make recommendations for reform.
- Temporary investigative committees: sometimes called select or ad hoc committees, these are temporary committees whose jurisdictions are limited to investigating the matter for which they were established.

Actions for Parliament: use the committee system to 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 use their oversight authority to affirm their role in representative and accountable policy implementation. A committee on extractive industries is an effective way for legislators to organize and coordinate their involvement in the extractive industries sector. In some cases, committee mandates might overlap. In these cases, coordination between existing committees can also be useful: often several committees—budget, oil or mining, anti-corruption, lands, public accounts—have purview of various aspects of the extractives sector. . At other times, depending on collective committee mandates, parts of the extractive industries sector do not fall under any of the committee's mandates. In this case, adjustments of the committee mandates might be necessary, or the legislature can establish ad-hoc, select or investigative committees to investigate specific issues. In any case, effective oversight throughout the whole extractive industries sector requires that the activities of these committees be coordinated and that information be shared

between them. Committees need to have clear mandates, roles and responsibilities as well as skilled members and support staff with access to relevant and accurate analysis and information.

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, and 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)

Factors that influence the role the legislature plays in the extractive industries sector governance

How effectively a parliament is able to discharge its oversight authority is contingent on a number of factors including the specific oversight powers provided to parliament under the constitution and standing orders. Other factors include the ability of parliament to access adequate information to perform their oversight tasks sufficiently, the technical parliamentary and extractive capacity of individual MPs, committees, committee leadership, and the political environment in parliament.

Regime type: No two parliaments are the same. However, most parliaments can be classified as falling within a parliamentary, presidential or hybrid system, with the key variable being the degree of separation between the executive and legislative powers. Legislatures in political systems with significant separation of powers between the executive and legislative branches have greater incentives to develop an independent parliament than legislatures in systems where the powers are unified.

- **Parliamentary system:** In parliamentary systems where the chief executive and cabinet are members of parliament selected from the majority party or coalition within the legislature, the legislature will have less incentive to develop independent capacities, especially if the political party system is strong (Barkin, 2009). Committees are controlled by the dominant party or parties. Continued cooperation between the executive and legislature is required for government to survive and to be effective in carrying out its program.
- **Presidential system:** In presidential systems, the chief executive (president) and members of the legislatures are elected separately, often for different terms. The center for conflict over policy making is usually between the executive and the legislature. There are incentives for the legislature to develop a strong committee system and professional staff.
- **Hybrid systems:** The term hybrid generally refers to a system with a separate elected president who shares executive power with a prime minister, who often, but not always, sits in parliament.

Most democracies in the world blend characteristics of these different systems and rarely conform precisely to these models.

Formal powers: constitutions and the legislature's standing orders generally define a legislature's formal powers. Some systems allow members to introduce legislation and some permit committees to introduce legislation, and some parliaments have formal authority to override a presidential veto. Other aspects of a legislature's formal powers are the time allotted to consider legislation and the right of executives to rule by decree during periods of national emergency and, in some cases, when the legislature is not in session.

Political environment: Political environment is a more subjective factor that determines parliament's power. The willingness of the executive and other political actors such as political parties to share information and the lawmaking role with parliament determines parliament's ability to meaningfully discharge its lawmaking function. "In countries where ruling party control is pervasive, legislatures are often used to rubber stamp executive policy after little or no debate (NDI, 2007 p. 11)." Additionally, "constitutions, legislation and other rules of procedure vest

significant legal authority in the executive, thereby diminishing the ability of legislatures to oversee the oil and mining sectors (ibid).”

Capacity: The legislature’s capacity and resources influence its ability to play a constructive role in governing more broadly and in particular governing the executive. Aside from political constraints, many parliaments are unable to execute the full extent of their formal powers due to the following: limited resources in the form of facilities, money, professional staff, a lack of services available to parliament through independent budget, research, policy, and legal analysis offices, and in some cases a lack of clarity about the role and responsibility of a legislator or committee member. As a result, parliamentarians are often not able to perform provide well informed input into legislation, regulations, and policies.

Actions for Parliament: Tools for Parliamentary Reform

Legislatures wishing to strengthen themselves as institutions need to do more than conduct legislative strengthening activities. Fundamental institutional changes need political leadership and support. Some suggestions are:

1. Establish a leadership group responsible for institutional strengthening, preferably established in law. This can be a parliamentary reform committee, which is often called a modernization committee, or the standing orders committee.
2. Draft a modernization plan that includes the goals of the institution, the steps to attain those goals, a timetable and resources needed, and potential sources of funding and expertise. Parliaments often draw upon regionally or internationally endorsed benchmarks to help guide their modernization plans.
3. If donors are involved, the legislature should establish a system of donor coordination.
4. Many legislatures have found Parliamentary Service Commissions (PSC) effective in building cross-party consensus on issues relating to the legislature’s budget, professional staffing, and capacity needs. These bodies are typically independent commissions that include distinguished former legislators can also be used to review funding for the legislature, and even controversial issues such as remuneration levels for MPs.

Staying informed on developments in the extractive industries sector

For parliament to be effective in playing a role in the governing of the extractives, it is essential that MPs are informed about the government's strategic framework to include, where and how resource revenues are reflected in the budget and medium term development strategy for revenue collection and targeted appropriations. It is also critical that MPs are well versed in extractive legislation and regulations and informed about developments in the extractives. Equipped with all this information, MPs are better placed to provide well informed inputs into policy debates related to the governing and management of the sector. Staying informed on industry developments is not an easy task and it is time consuming. As representatives of the people, MPs have busy schedules and multiple concerns and needs to address on behalf of citizens in other policy areas.

Actions for Parliament: Tools to help MPs stay informed

1. Parliament can use its available oversight tools to gather information on the extractive industries sector.
2. In addition to internally available government information, look outside parliament (internet,, civil society organizations (CSOs) publications, citizen report cards, etc.) to gather information. CSOs often have significant expertise in the extractives that MPs can utilize to undertake their responsibilities.
3. 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 and government departments should provide both periodic briefings to parliament and respond to ad hoc requests for information. Parliament could also second a liaison to the ministry with purview of the extractives. The liaison could facilitate regular information exchange outside the briefings between the parliament and the executive. Aside from requesting briefings with government officials, parliament could also request briefings with CSOs.
4. Coordinate legislative efforts with local CSOs and think tanks: Local and international civil society, academic institutions, international organizations, companies, former MPs, 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 Institute (RWI), Publish What You Pay, etc. may also be able to provide industry related information upon request.
5. 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 or parliaments themselves can organize such forums.
6. Establish contact with peers from other resource-rich countries: Establish contact with former or sitting MPs 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 and learning from their peers in other resource-rich countries by participating in regional networks.

Transparency in the extractive industries sector

A necessary prerequisite for effective oversight and good **governance** is **transparency**. Transparency requires openness in governance practices and systems. Transparency in governance entails that information is made available, is timely, is accurate and released regularly. The **information** provided by the government to the public should also be useful and easy to understand. Access to information empowers citizens to participate in public policy debates, provide input into issues related to service delivery, and monitor the management of public goods. In so doing, transparent governance strengthens the relationship between government and its citizens. It also assists the government to manage citizen's expectation.

Transparency along the extractive value chain is essential to improving the governance and management of the industry. This is because government's and industry's activities related to licensing, the implementation of contracts, collection, management, distribution of revenue, environment, and service delivery can be monitored and evaluated in a transparent environment. Ultimately this leads to greater accountability on the part of industry and government. Opportunities for corruption in the extractive sector begin at the contracting or procurement phase. This is because contracting and other procurement in the sector is often done under a shroud of secrecy. If the rules and terms for bids or concessions are made clear and available to the public and the legislature, detecting and correcting non-compliance with contractual terms would be an easier task for the public, legislature, and administrative government agencies to accomplish.

Unfortunately many resource countries do not have Freedom of Information Laws (FOI) that facilitates access to information and transparency in government. FOIs allow citizens and the legislature to request and access information from the government that would not otherwise be made routinely available such as extractive contracts. Passage of an access to information law is only one step in promoting open governance. It is important to address the culture of secrecy that exists in most governments and public bodies. Unfortunately, many countries endowed with natural resources utilize the revenue generated by these resources for political patronage. This is facilitated by the opaque nature of the sector. Where this occurs, politicians make political gains through patronage that allows them to remain in power and as a result there is no political incentive to promote transparency and accountability in the sector. A number of measures can be taken to address the culture of secrecy:

- Legislative advocacy for legal protection for **whistleblowers**, individuals who release information about wrongdoing or serious mismanagement. Legal protection helps to nurture a culture of whistle blowing.
- Routine disclosure can also play an important role in addressing the culture of secrecy. As more and more information is routinely disclosed, officials will become increasingly accommodating to the idea of openness, and gain a better sense of the appropriate limits of secrecy in government.

Actions for Parliament: promoting a transparent, resource-rich society

1. Opening up parliamentary processes to the public: Parliament can play an important leading role in promoting openness by starting with making own operations as transparent as possible. This should involve a number of institutional measures, such as televising and broadcasting the question period, publishing material online and holding public committee hearings. In democracies, general sessions of parliaments are open to the public and press, and in a growing number of countries committee meetings are open as well.
2. Setting up Constituency Offices: Legislatures are more accessible to constituents than are chief executives. In some countries these offices have been established, MPs have faced difficulties in traveling to their constituencies because of inflexibilities related to parliament's program of work and insufficient resources to efficiently utilize constituency offices (see case study below).
3. The role of and communication with media is of huge importance as well. Legislatures' debate and vote before the news media, and some even broadcast their sessions on television and radio.
4. Parliamentarians should play an active role in awareness-raising about the benefits of a Freedom of Information (FOI) law.

Participation and Representation in the extractive industries sector

Participation is the process by 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**.

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. For example, some revenue may be channeled through state-owned enterprises, which are difficult for citizens to monitor.

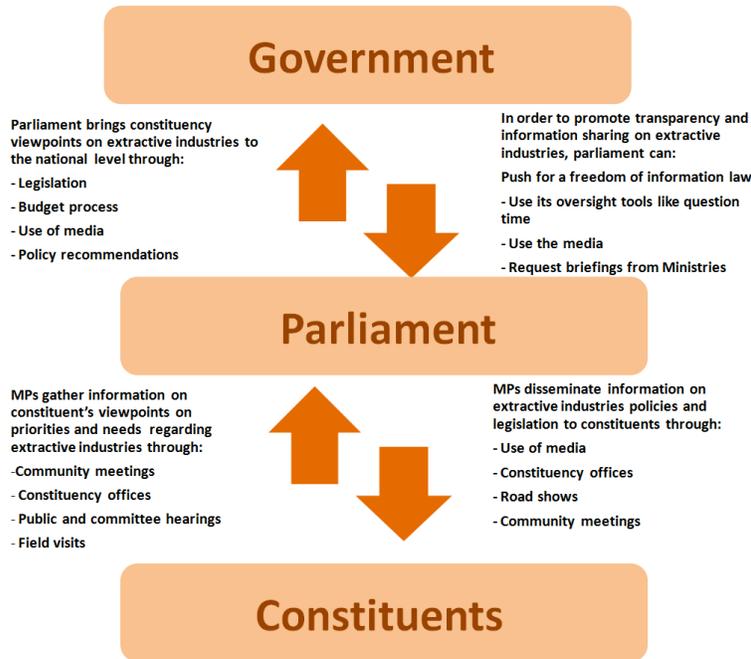
Constituents learn the opinions, decisions and actions from policymakers through the **media**. The media can be a platform that provides space for political negotiations. In countries where the media is vibrant and functions independently or relatively independently from government, parliament can spark greater citizen participation in the extractives by using the media as an outlet to inform citizens about developments in the sector.

Actions for Parliament: Building a participatory resource-rich society

1. Through public hearings, interviews with the media, constituent outreach including town hall meetings and other methods legislators can build public awareness about extractive industries and policy concerns surrounding the sector.
2. Incorporate extractive industries into constituent communication: Citizens often care 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.
3. Work through the media to build public awareness on extractive industries issues: Legislators can raise awareness on EI issues by conducting press conferences and other media activities.
4. Parliamentary debates could be televised and records of these debates could be made publicly available, including through the internet. Constituency offices can also help foster greater participation by disseminating EI related information, tracking citizens concerns and ensuring members are made aware of the concerns so that they can be followed up. 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.
5. Parliament can play a role in assuring that information is disseminated and accessible to the community. There are several ways to do this:
 - a. Publishing the legislative record after each session in Hansard, congressional record, or official daily.
 - b. Newsletters and other publications reporting on legislative and member activities.
 - c. Public participation offices that responds to citizen inquiries and conducts participatory outreach to citizens.
 - d. Open committee meetings, publishing meeting times and agendas in newspapers and on the internet.
 - e. Public hearings as an opportunity to listen to citizens and for citizens to see their MPs in action.

- f. TV or radio, broadcasting parliamentary sessions.
- g. Post information on parliamentary web sites.
- h. Meeting with constituents: physical space to meet with constituents.

Figure 1: Information exchange and participation

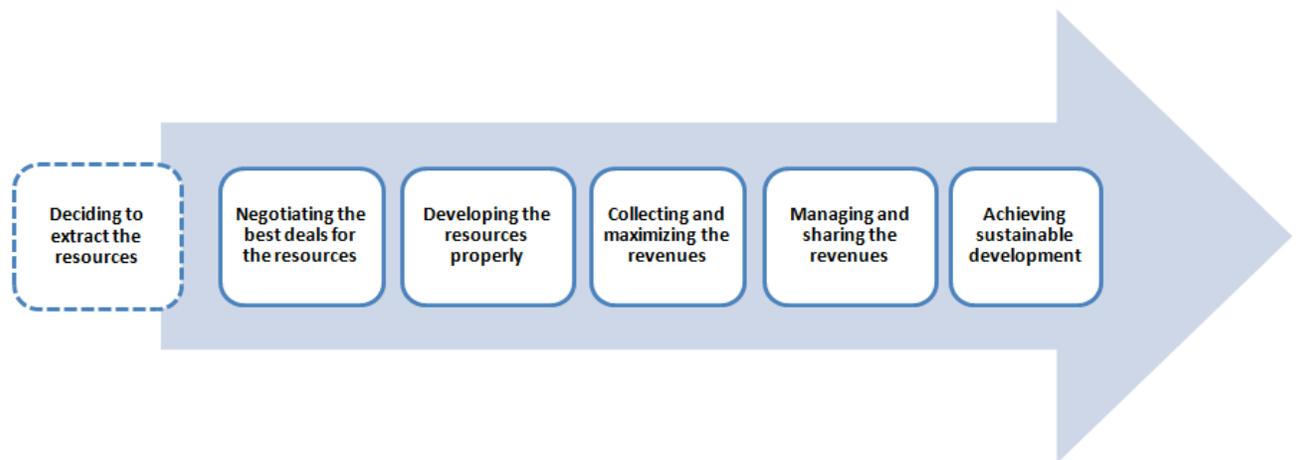


The Extractive Industries Value Chain

Topics: Strategic Framework, Development, Poverty, Poverty Reduction Strategy, Social Development, Economic Development, National Plan, National Vision, Planning Scenario, Predicted Revenues, Forecast, Prediction, Estimates, Fiscal Risk, Predicted Expenditures, Public Expenditures, Allocation of Revenues, Public Financial Management, Social Welfare, Job Creation, Infrastructure, Health, Education, Government Finances, Debt, Deficit, Fiscal Discipline, Price Volatility, Commodity Prices, Dutch Disease, Stabilization Fund, Economic Diversification, Export, Trade, Business Climate, Private Investments, Investment Climate, Private Sector, Budget, Budget Bill, Medium Term Economic Framework

Turning natural resources in the ground into improved well-being for citizens takes a series of steps that together can be termed the ‘resource/extractive value chain’. 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: Good governance along the value chain



The ultimate goal is to make resource revenues contribute to long-term sustainable **development**. Effective use of resources requires a **plan** or **vision** for 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 should be executed in a way that provides maximum benefit for the citizens. Citizens benefit from extractive industries if the sector’s revenues are used or invested by the government in ways that result 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.)

Legislative oversight along the value chain

Because of the multidisciplinary nature of the regulatory process and legal framework, close coordination among different government entities (and parliamentary committees) is necessary to avoid regulatory gaps. 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. Sometimes committee mandates might overlap. At other times, depending on collective committee mandates, parts of the extractive industries sector may not fall under any of the committee’s mandates. In this case, adjustments of the committee mandates might be necessary, or the legislature can establish ad-hoc, select or investigative committees to investigate specific issues. In any case, effective oversight throughout the whole extractive industries sector requires that the activities of these committees be coordinated and that information be shared between them.

A strategic framework for the extractive industries sector

The management of natural resources along the value chain should feed into the country’s long term **economic and social development** goals and **poverty reduction strategies** (the Natural Resource Charter, 2009). This ensures the development of natural resources facilitates the maximum benefit to the citizens of the country within the framework of its long-term development goals.

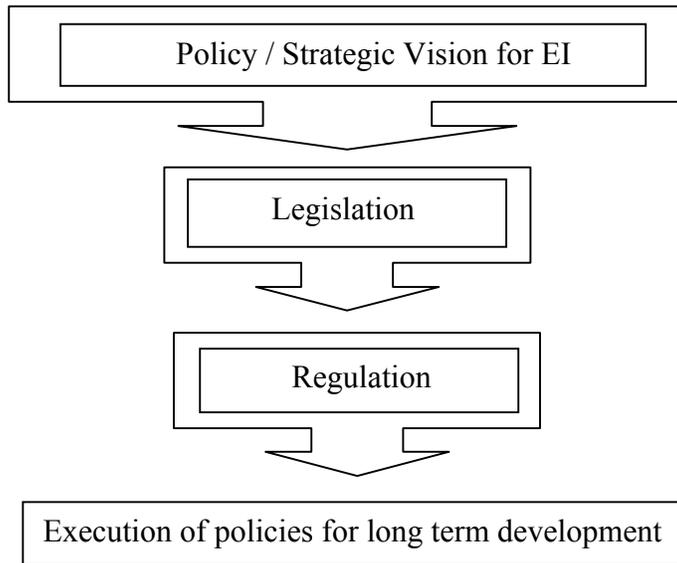
A country’s long term economic and social development goals should be clearly outlined in a strategic framework that uses social and economic **planning scenario**’s to reach the country’s long term goal. A **strategic framework** involves the development vision for a country, clarifying the role of 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, at present and for future generations. A strategic framework should reach beyond the annual budget and include a medium-term budget, strategies for consumption, investment and expenditure smoothing. It should also enable resource-revenues to contribute to the country’s economic and social development and poverty reduction.

Before depletion of the resource begins, policy makers have to think through why depletion is the right decision to make. In so doing, they should assess the costs and benefits of depleting, and not depleting. Once the decision to extract is made, contracts have to be awarded to companies that will execute the extraction. Operations of these companies have to be constantly monitored. The state also has to collect revenues in the form of taxes and royalties from these companies. Finally, when revenues are collected, they should be spent in ways to conform the country’s development 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 awarded contracts public; establish sufficient health and safety requirements, etc. Governments must create a **business** climate that attracts **private investment**, a necessary precondition to the development of the extractive industries. They must also ensure an equitable distribution of revenues to all citizens.

Because of the multidisciplinary nature of the regulatory process and legal framework, close coordination among different government entities is necessary to avoid regulatory gaps. National **investment** opportunities should not simply bubble up from within each sector ministry, but should be coordinated within an agreed 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.

Figure: Relationship between the strategic vision, legislation, and regulations



Botswana: Use of mineral revenues stated in National Development Plan, approved by Parliament

“It was agreed between Cabinet and Parliament, that the mineral revenues would be used only for capital projects. In turn these were to be approved by Parliament in a National Development Plan. We had five, sometimes six-year rolling National Development Plans which were reviewed and updated every three years. Over the years, the definition of capital or development projects was expanded to include recurrent expenditure on education and training and health services. It was argued that these were part and parcel of human resources development and that human beings were the country's most precious resource. Hence, 95% of Botswana students at tertiary institutions in and out of the country are paid for by government. For a new project to be implemented, it had to be included in the National Development Plan whose amendment had to be approved by parliament. This way, there was discipline in government expenditure and it minimized waste, certainly prevented extravagance on prestige projects. It also minimized or helped to minimize corruption. While the government initiated projects, determined priorities and responded to national emergencies such as frequent droughts, Parliament helped monitor the implementation of agreed policies and development priorities. The Government also allocated or gives subventions to District and Town Councils based on a formula, which takes into account population, geographical extent, climatic conditions, levels of development, etc. The strength of these arrangements is their transparency and accountability. These arrangements and practices are overseen by the constitutionally entrenched Auditor-General, the Public Accounts Committee of Parliament, Parliament itself, a free press and independent judiciary.”

Source: Presentation by his Excellency the former President of Botswana, Mr. Festus G. Mogae on “Extractive Industries and Africa’s Development: Lessons from Botswana” at the African Development Bank’s 2008 Eminent Speakers program. (<http://www.slideshare.net/simandef/extractive-industries-and-africas-presentation>)

Action for Parliament: Linking development frameworks to the extractive sector...

How can Parliament make sure that development frameworks and the extractive industries sector are linked?

1. 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.
2. Organize a public debate on the nation's priorities on how to use extractive industries for development
3. Make sure that government policy and expenditure is based on a shared vision of how to harness extractive industries for development
4. Make sure that this shared vision/strategic framework is linked to the Poverty Reduction Strategy
5. Make sure that the legislation and regulation regarding the extractive industries sector are in line with the strategic framework

... and translate it into the national budget

The country's strategic framework should be reflected, explained and safeguarded in the country's annual **budget**, **medium term economic framework** and mechanisms for **fiscal discipline**.

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 its 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 prioritizes 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 adhere 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.

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).

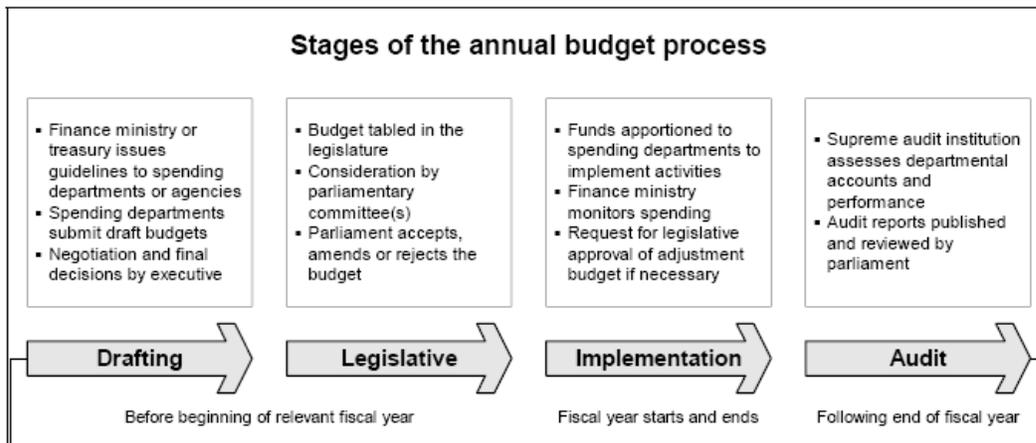
Because resources are limited, budgeting forces a government to consider the merit of competing claims on the public purse and to negotiate tradeoffs between them. The achievement of allocative efficiency or strategic prioritization requires government capacity to allocate resources and select programs 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.

Budgeting is a process rather than an event, and budget cycles are ongoing and interconnected. 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: The stages of the budget process

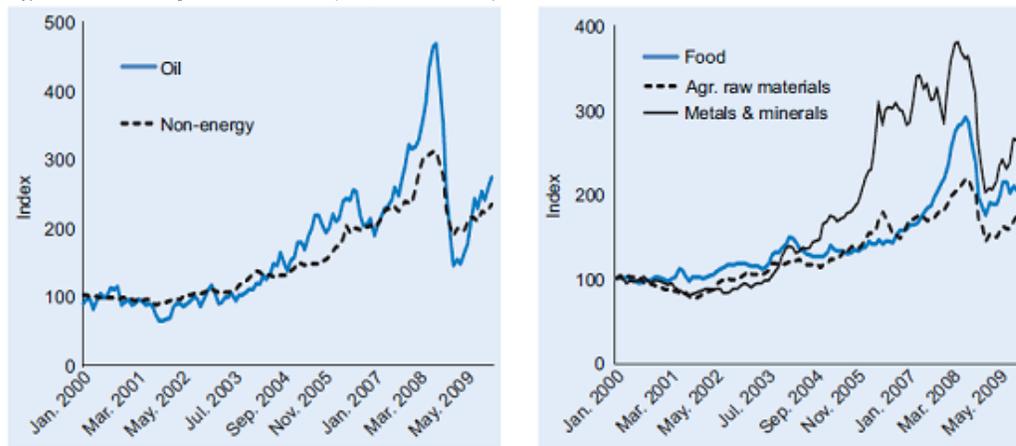


Drafting

The drafting stage compiles a draft budget that may or may not be submitted to the legislature. Although this stage is mostly internal to the executive, it is not necessary for this stage to be secretive or opaque. 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 is followed by 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 prior to the submittal of the draft.

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.

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



Source: World Bank data and staff estimates

Source: World Bank data and staff estimates

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.

Overly optimistic revenue **forecasts** are politically tempting because they create an imaginary space for promises of more money on services. The extractive sector presents difficulty in budgeting because commodity prices are extremely unpredictable—which creates volatility in revenue streams. To avoid overly optimistic forecasts, best practices include taking 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.

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. Assumptions regarding natural resource prices and production should be made transparent.

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. For instance, the world economy just saw the end of one of the biggest commodities booms ever. During the boom, countries that did not take advantage of the boom by boosting economic development, saving money, and improving **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). Contingency reserves, which set aside an amount for adapting the budget to changing circumstances or emergencies are often used as well. 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).

Actions for Parliament:

1. 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.
2. Related to this is the need to encourage or develop a non-extractive industries budget: Because oil, gas and minerals prices are so unpredictable, a budget that does not include any revenues from the extractive industries sector can serve as a worst-case baseline budget.
3. Use the committee system to evaluate estimated revenues from the extractive industries sector for the upcoming budget year: In some countries, this is the task of the Estimates Committee, which usually examines whether the money is well aid out within the limits of the policy implied in the estimates; carries out regular examination and scrutiny on

budgets, estimates and management thereof; conducts budget hearings; and makes recommendations and report to the House for formulation and implementation of future budget estimates.

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).

The way predicted revenues are planned for expenditure is critical. Revenues generated by the extractives should not be spent in an ad hoc manner rather their expenditure should be outlined in a strategic framework, and in an annual and medium-term budget. They should be spent according to set priorities, and be aimed at harnessing extractive industries for development purposes. Because natural resources are finite, the revenues generated from them are also finite if expended in an ad hoc way. To ensure extractive revenues are utilized for economic and social development for future generations, revenue can be deposited into a **stabilization fund**. Several resource rich countries use these types of funds for long-term sustainable investments or to improve **government finances**. Should this option be utilized governments should publicly state its objectives with respect to revenue management and how it will disburse revenues. Determining appropriate spending choices requires broad political consensus. In making these choices the government should consider 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.

Policy measures that will reduce the resource curse

Policy measures that will diminish the negative effects of the resource curse. The following measures are best practices and should be considered before approving the annual and medium term budget:

- **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. 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.

- ***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 prior to the depletion of resources which would lead to decreases in revenues. 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 put in a stabilization fund when commodity prices are high, which can be drawn upon 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).

How a government chooses to use resource revenues depends on a number of economic and political factors, and is country-specific. This is why where stabilization funds exist they have different characteristics. However, the stabilization funds have all or some of the following objectives: (1) to set aside revenue to smooth expenditure over time—thereby 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.

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.

- ***Countering 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.

- ***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. Again, expenditures have to be in line with the articulated development vision, and linked to the budget.

Furthermore, it is recommended a country 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.

- ***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 labour and should develop a labour-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 to trade with foreign countries, and creating better access to foreign markets to create export opportunities can also stimulate the **manufacturing** sector.

- ***Stimulate the private sector***

The **private sector** can stimulate efficient investment, especially for the growth of the non-resource economy. The private sector also supplies the capital goods that investors need. Since 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. Political patronage also has a distorting effect that private sector strengthening can help to ameliorate. Fiscal incentives and other stimuli can be used to help the private sector develop (The Natural Resource Charter, 2009).

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

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.

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.

Source: World Bank, Country Experience with Petroleum Revenue Funds – Part 1, 2009

Action for Parliament: Try to influence the budget

1. Identify ways to influence the budget (formally and informally) at each of the different stages of the budget cycle – preparation, drafting, legislative review, implementation and audit.
2. Develop the capacity to evaluate the national budget for approval. Evaluation often goes through a Budget Committee
3. It is important for Parliament to make informed recommendations based 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
4. Hold a public hearing 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.
5. Time to consider the draft budget: Another critical issue has to do with the amount of time legislatures are allowed to scrutinize, reflect on, and make or propose amendments to the budget. Very short budget considerations (up to two months) make it difficult for legislatures to receive much public input on the budget, or to make meaningful suggestions for changes. Members could introduce a proposal for reform to parliament's standing orders and the constitution to allow parliament more time to review the budget. This could be done by lobbying the parliamentary reform or modernization committee, members could use the media to advocate for this and inform the public about the constraints it is under to review the budget.
6. A common shortcoming for parliaments wishing to be more effective in the budget process is lack of budget expertise. Executive budgets are large, complex and difficult to understand. Some legislatures address this need through hiring short-term experts to assist them in analyzing the executive budget, or rely on partnerships with academia or civil society groups who help them. A more expensive approach is to build budget expertise inside the legislature. Some parliaments have established professional, non-partisan budget offices to assist legislatures in the budget process.

Implementation

The implementation of the budget will be discussed in the 'Revenue Collection' paragraph.

Audit

The audit process will be discussed in the 'Revenue Management' paragraph.

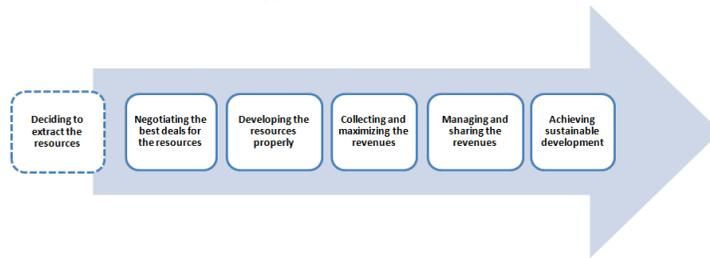
Medium Term Expenditure Framework

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 oil, gas, or minerals 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). 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 importance for resource-rich countries, because they 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](#).

Value Chain Stage 1: Decision to Extract



Topics: Environment, Poverty, Indigenous Peoples, Local Communities, Land Management, Artisanal Mining, Gender, Unsafe Working Conditions, Impact Analysis

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 section will illustrate 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 section explains the importance of **environmental** impact, **poverty** and social impact, artisanal mining and **indigenous** communities, and lays out how effective **land management** can minimize the risk of extractive industries extraction to local communities.

Potential Consequences of Extraction

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. 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, extraction 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. If the decision is made to extract, the government should 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 such as women and artisanal miners. Understanding the impact of policy interventions on different groups is critical to designing effective policy strategies. When making the decision to extract, the effect of extraction on the welfare of different groups, with a specific emphasis on the poor and vulnerable. 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.

Action for Parliament: Potential Consequences of Extraction

- 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 the potential consequences of extraction on the poor and the environment.

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

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, and conflict with companies and governments.

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.

Action for Parliament: Artisanal and Small-Scale Mining

1. Initiate a field visit to the prospective mining area to investigate the situation. In so doing, set clear objectives and expected outcomes for the visit so that it can yield the most useful information about artisanal and small-scale mining.
2. Initiate a public awareness campaigns for small scale and artisanal miners, informing them about their rights and responsibilities
3. Review legislation on the rights of artisanal miners

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).

Actions for Parliament: Environmental Implications

1. Initiate a field visit to the area to investigate possible environmental impact of mining or oil operations.
2. Start a consultation process with the local communities around the prospected areas to ascertain the communities' needs and concerns. Based on the findings propose recommendations to the government that address the communities' needs and concerns.

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)

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.

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. 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 is 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).

Action for Parliament: Use of Land

1. Initiate a committee study on the land allocation process
2. Organize a committee hearing on land allocation in resource-rich areas and utilize the findings from the hearing to inform debate within parliament on this issue.

Unrealistic expectations

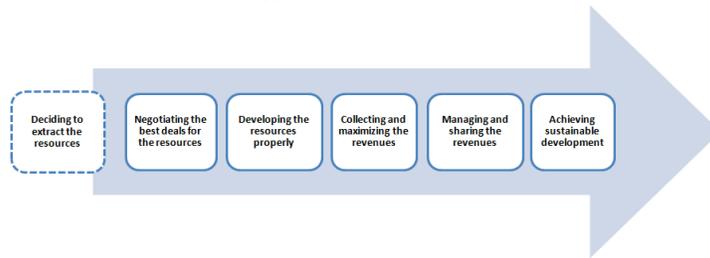
The discovery of oil and other resources often create unrealistic expectations about future income that lead to sustained increases in public spending. Inflation and debt rise, while loans are secured (often on favorable terms) with the backing of unreasonable projections of future earnings.

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.

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

Value Chain Stage 2: Contracts



Topics: Contracting and Licensing, Procurement, Competitive Bidding, Pre-Selection of Bidders, Terms of Contract, (re)Negotiations, Fiscal Regime, Local Communities, Local Content, Local Level, Environment, Public Goods, Planning, Infrastructure, Linkages to the Domestic Economy, Technology, (un)Employment, Public Disclosure, Contract Transparency, Private Sector, National Oil/Mining Company, Development, National Budget, Foreign Policy, Conflict of Interest

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 section will discuss the legal context of extractive industries contracts, best practices regarding the process of **procurement**, **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.

Exploration and exploitation licenses

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. 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).

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:

- A clear legal and regulatory framework;
- Well-defined institutional responsibilities; and
- 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, if this maximises benefits for citizens.

Actions for Parliament: Exploration and exploitation licenses

1. Review and understand the existing legal framework for licensing and contracting: legislation should to the extent possible comprehensively include contractual terms and bidding and procurement processes and procedures. Within the legal framework, Member of Parliament or Parliamentary Committees can encourage transparency and non-discretion in bidding processes.
2. Parliamentary committees can request information from the government on which companies have been awarded with contracts
3. In some countries the Auditor General can conduct an audit on the awarding procedures of certain contracts, after which the Public Accounts Committee can review the Auditor General's report.

Fiscal rules

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 able to be responsive 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 extractive company 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 oil or mining companies 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 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.

Actions for Parliament: Fiscal rules

- Review and try to understand the current legal framework and fiscal rules related to taxation and regulation of extractives companies and the private sector generally. Make sure that the fiscal regime is competitive and attracts business.

Promoting the Local Level/Local Content

Extractive industries development can also result in economic 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.

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, highly technical and export oriented nature of extractives activities. Therefore, EI activities do *NOT* generate much **employment** (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).

- *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 (Hackman, 2009). 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 do not last 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).
- *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 are difficulties in absorbing new technologies 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).

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Actions for Parliament: promoting the local level

- Parliaments can hold hearings to ascertain the extent to which the local community is taken into account in the development of EI activities, and whether or not the promised measures for local content are feasible in reality.

Procurement & Negotiations

Because individual **negotiations** between the government and companies are ideally suited for 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 bidding for exploration and exploitation rights. 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.

A good solution is to auction the extraction rights by inviting bids on rates that companies would be willing to pay. An auction can force 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, several 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 a 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 notion 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, lasting in some cases 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.

Actions for Parliament:

1. It is imperative for Parliament to oversee the procurement process for each new contract and/or license. For example, parliament can use question sessions to get clarity on the selection process and the qualities of the winning company.
2. In some countries, contracts have to be approved by parliament for them to come into effect (see the box below). If this is the case, parliament must have a good understanding of whether or not the awarding process has been fair and transparent, and the content of the contracts must be favorable to long term development of the country. Some donors or civil society organizations can help parliament analyze contracts.

Parliamentary approval of contracts

In most countries, the drafting and negotiation of contracts is the responsibility of executive branch ministries or state-owned enterprises. After this process, some countries require the final, negotiated contract or selected bid in an auction to be ratified by parliament for it to come into effect. Governments in a number of countries require oil, gas or mining contracts to be voted on publicly by the parliament.

The following countries require parliamentary vetting of contracts:

- *Azerbaijan*. The Azeri Constitution gives the Azeri Parliament the power to ratify or veto international agreements. Such international agreements include extractive industry contracts such as PSAs. All international agreements must be approved by the parliament, at which point they become Azeri law.
- *Egypt*. PSCs must have legislative approval to become operational.
- *Georgia*. Foreign investment contracts are international treaties and must therefore be approved by parliament.
- *Kyrgyzstan*. If a foreign legal entity or individual is a party to a PSA, it should be ratified by the parliament.
- *Liberia*. Parliament must ratify investment contracts after negotiation and signature by executive ministries.
- *Sierra Leone*. Parliament should have access to mining contracts before they are signed, though its powers are limited to an advisory capacity, i.e., it can suggest changes.
- *Yemen*. Contracts are made Acts of Parliament and become part of Yemeni law; this is required by its Constitution and the policy was recently upheld in an international arbitration proceeding against the country, after executive ministries signed and negotiated an extension to a PSA but the parliament vetoed it.

Quoted from: "Contracts Confidential", Revenue Watch Institute, 2009

Public Hearings on Contracts

In Liberia the contract renegotiation process for the country's major mining deals included debate, approval or deliberations of Parliament, media, CSO, and government. Parliament must ratify investment contracts after negotiations and played a large role in the renegotiations. The renegotiations were generally seen as successful for both government and the mining companies.

In Timor-Leste activities around licensing and contract awarding are widely heralded as robust and transparent. Contracts are published and parliament has organized public hearings before granting ratification.

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 led to renegotiations of contracts in several countries (BIC, 2007).

International support for contract disclosure as a standard of international best practice is gaining momentum. 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 view. In its Guide on Resource Revenue Transparency the IMF claims that contract terms become accessible after signing, therefore little strategic advantage can be lost by contract disclosure (see also Revenue Watch's publication "Contracts Confidential").

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.

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.

Actions for Parliament: Promote Contract Transparency

1. Parliaments should request copies of negotiated agreements. This can be done 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. In some countries, government is not responsive to parliamentary requests. In this case, one of the options is for parliament to reform its standing orders and the constitution to give parliament the authority to censure or sanction ministers who withhold information.
2. Parliament can push for the drafting or passing of a contract transparency or access to information law.
3. Once contracts are made available, there are several things committees can do to improve their capacity to analyze the contracts and put forward recommendations for improving them. For example, reaching out to local, regional, and international experts who can help the committees go through the contracts. This type of assistance is sometimes offered by donors.
4. Parliament needs to liaise on a regular basis with the administrative agencies that monitor the implementation of the contracts. This will allow a constant feedback loop of information to flow from these agencies. This way parliament will be able to determine when companies and government have deviated from contractual terms. If it turns out that companies or the government have deviated from the contractual terms, parliament can start a plenary debate to address the issues.

The struggle of MPs for contract transparency in Uganda

In Uganda, two journalists have sought to compel their government's disclosure of multinationals oil deals, highlighting the challenges to public transparency. The case was originally filed by lawyer and Member of Parliament Abdu Katuntu under Uganda's Access to Information Act, a legislation he introduced in 2005. Senior reporter Angelo Izama and Charles Mwanguhya Mpagi of Uganda's leading independent newspaper *Monitor* filed the case to appeal the refusal of Uganda's attorney general to provide them with certified copies of oil exploitation agreements—because of alleged confidentiality clauses in the documents—according to news reports. The journalists argued that the information was of public interest: Ugandans must be able to hold the government and its partners accountable for the exploitation of the oil. However, the Chief Magistrate said in his ruling that the petitioners had not proved either of the public benefit of disclosing the information to the public. The journalists, along with their partners the Open Society Institute's East Africa Initiative and Human Rights Network Uganda (HURINET), said they were considering appealing the ruling.

In June 2010, after almost two years of persistent demands by the legislators, energy and mineral development minister Hillary Onek finally tabled the agreements, but kept the details confidential. After his address, MPs were not allowed to debate the issue. MPs rejected calls to keep the agreements confidential. They wondered how they as representatives from the people, would keep quiet about the matter. The agreements have been committed to the committee on natural resources, which will continue the discussions.

Source: "Uganda: Govt to Take 80 Percent of Oil Profits" <http://allafrica.com/stories/201006300153.html> and "MPs Refuse to Keep Oil Agreements Confidential" <http://allafrica.com/stories/201006291150.html>

National Oil and Mining Companies (NOCs and NMCs)

A **national company** or a **parastatal** is a company fully or 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. 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).

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 international oil company (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.

In some countries 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).

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 law can help avoid **conflicts of interest** (The Natural Resource Charter, 2009). In practice there exist several models of the degree of independence between the regulator, the NOC and/or the Ministry of Petroleum or Mining. 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 favor particular countries through investments).

The national development objective and the role of the extractives sector in the 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). If an 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).

In some countries the NOCs' expenditure must be presented for approval to the government. 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 retain revenue for reinvestment.

Nigerian Senate investigates claimed insolvency of national oil company

In July 2010 THE claims and counter claims over alleged insolvency of the Nigerian National Petroleum Corporation, NNPC, came to a head at a hearing of the Senate Committee on Petroleum Upstream, yesterday. The Senate Committee had summoned the NNPC boss and the Minister of State for Finance to ascertain the truth in a controversy over whether or not the NNPC was insolvent. The Senators, led by the committee chairman, expressed shock at the propensity of the Federal Government to direct NNPC to release funds without recourse to due process and then ordered the corporation to present its annual accounts since 1999. While expressing surprise that the NNPC budget was approved only by the board of directors, the Senate committee members also requested the Group Managing Director to return to the National Assembly with copies of the law authorizing such approval. The committee had been told earlier that when the NNPC first deducted funds from the Federal Account, N85 billion was involved.

Source: "Nigeria: Senate Wades Into NNPC Insolvency Imbroglia"

Actions for Parliament: Overseeing National Oil/Mining Companies

1. Given the link between the fiscal contributions from the NOC and the national budget, Parliament needs to make sure that the NOC maintains accounts in accordance with international standards and that the NOC is subject to independent audit. The link between the NOC and the national budget could also mean that parliament has to approve the budget of the NOC every year;
2. Parliament needs to stimulate transparency in the extractive industries sector. In the case of NOCs, parliament needs to make sure that the NOC is subject to the same disclosures required of publicly held companies;
3. Parliament needs to make sure that the NOC's contribution to national development goals is made clear, and that the distribution of economic benefits reflects the national priorities set under the strategic framework;
4. NOCs can sometimes become political instruments. Parliament can make sure there is no conflict of interest between the state and the NOCs (see next paragraph)

Examples of Parliamentary oversight of national oil/mining companies

Zambia

In November 2000 the highly damaging report of the Parliamentary Economic Affairs and Labour Committee on the privatization of Zambia Consolidated Copper Mines came out. The executive strongly objected the report and used its majority in the House to vote against adoption. (Source: P. Burnel, *Legislative-Executive Relations in Zambia: Parliamentary Reform on the Agenda*, *Journal of Contemporary African Studies*, Volume 21, Issue 1, January 2003, pages 47-68)

Tanzania

Some senior officials acted inappropriately in giving oil exploration rights to China Sonangol International Holding Ltd in exchange for the latter's purchase of 49 per cent shares in the national airline. The officials acted against the government procurement regulations and procedures by in effect granting three oil exploration licenses on the soil of Tanzania as a sweetener to induce the Hong Kong-based firm to purchase the shares in the troubled Air Tanzania Corporation (ATCL). The Parliamentary Parastatal Organisations Accounts Committee (POAC) has found serious discrepancies that undermine performance of several public utilities, including ATCL, and the government is expected to give a detailed account to parliament this week on what transpired during the signing of the agreement. "Parliament needs to know how oil exploration rights can be exchanged for an airline," said the chairman of POAC. The chairman said for the better oversight of investments with public interests, which the government jointly operates with a private investor, parliament has agreed to extend its scope into public institutions. Under the current system, oversight powers are limited to parastatal organisations and companies in which the government owns more than 50 per cent of shares. Under the new arrangement, POAC will be called the Public Investment Committee, which will also be responsible for policy oversight of parastatals and investments. (Source: "Chinese firm 'gifted' oil licenses" *the East African* - <http://www.theeastafrican.co.ke/news/-/2558/522146/-/view/printVersion/-/80q7nm/-/index.html>)

Conflict of Interest

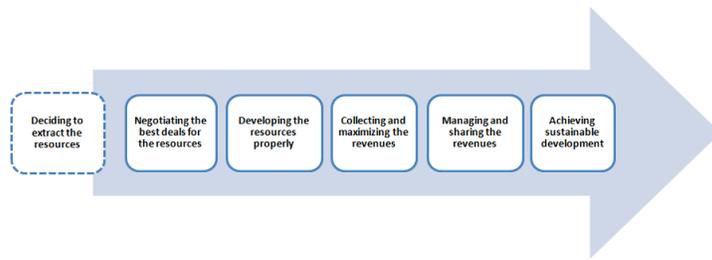
Corruption can occur when there is a known conflict of interest between a decision-maker's policy duties and his or her personal self-interest. Even if there is no evidence of improper actions, a perceived conflict of interest can create an appearance of impropriety that can undermine confidence in the 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).

Actions for Parliament: Code of Conduct

- Parliament should adopt a comprehensive code of conduct/ethics with an asset disclosure register and clear provisions related to the role of MPs and their staff with respect to NOCs and the EI sector more generally. This will help enhance the legitimacy of parliament to act as an effective oversight institution and build public confidence in the institution.

Value Chain Stage 3: Monitoring of Operations



Topics: Environment, Poverty, Indigenous Peoples, Local Communities, Land Concession, Land Management, Artisanal Mining, Gender, Unsafe Working Conditions, Closing Mines and Operations, Link to Domestic Economy, Contract Implementation, Infrastructure, National Oil/Mining Company, Operations, Private Sector Oil, Gas and Mining Companies

Once the legislative and regulatory framework is in place, and contracts and licenses are signed, operations can begin. EI operations generally require close compliance monitoring, which comprises both technical and environmental monitoring. If contracts are made public, it is essential for Parliament to make sure that both the government and the contracted company have complied with contract provisions, including existing rules and regulations. If contracts are not made public, it is essential for Parliament to make sure that both the government and the contracted party comply with existing rules and regulations, for example regarding environmental and social regulations. In most cases, extractives companies write quarterly or semi-annual compliance reports for the government.

Good practice encompasses enforcement of adequate environmental and social regulations as well as the establishment of an independent, competent authority charged with approving and monitoring environmental and social impact assessments and management plans and enforcing compliance. In accordance with good practice, the separation of roles among the ministry of environment or environmental agency, the environmental unit of the sector ministry and the state-owned company needs to be clearly established to avoid institutional conflicts and poor environmental monitoring. The environment ministry (or the environmental agency) usually retains full ownership of the clearance/permitting process. However, many countries have adopted the “one-stop-shop” approach, in which investors’ point of contact for all matters related to the implementation of petroleum and mining contracts or licenses is the sector ministry, which in turn secures the clearance for the relevant environmental authority. This arrangement can be effective in simplifying compliance monitoring and reducing investors’ cost of doing business.

Parliamentary debate over presidential commission report regarding extractive industries in Tanzania

Tanzanians have raised concerns on how natural resources are extracted and at doesn't bring benefits to the people. The presidential commission appointed by President Kikwete and chaired by Judge Mark Bomani (also known as the Bomani Commission), set up to probe the accusations of 'theft' of natural resources and gross human rights violations, found that Tanzania does not benefit sufficiently from the multitude of natural resources in the land. The Bomani report states that, 'Despite the presence of such a huge amount of mineral reserves, the contribution of this sector to the national economy and community development seems not to be meeting citizens' expectations compared to other sectors of the economy.' The Bomani report recommends changes, including enacting new mineral legislations, reserving mining of gemstones to local people only, abolishing tax exemptions on imported fuel and urged mining companies t list at the Dar es Salaam Stock Exchange to facilitate their public ownership.

In October 2008 the report was debated in Parliament. MPs urged the Tanzanian government to implement to the letter all recommendations on the review of mining activities in the country. The Bomani report was the first review of the sector that was released to the public and debated by parliament.

Source: "Tanzania: MPs Want Govt to Implement Mining Team's Report in Full" <http://allafrica.com/stories/200810300253.html>, "Mining and colonial practices in Tanzania" <http://www.pambazuka.org/en/category/comment/52093>

MPs inspect London Mining facilities in Sierra Leone

The parliamentary committee on mining and minerals, Monday paid a snap visit to the London Mining site in Lunsar, northern Sierra Leone to examine the company's operations and activities in that part of the country.

The committee had sent an official letter to the company prior to the visit so that parliamentarians would have firsthand information on issues that deal with safety methods, environmental protection, land policies, environmental impact assessment (EPA), and the company's corporate social responsibility.

Chairman of the committee, Hon. Chernor Maju Bah said it was their responsibility to know what is happening in communities where mining activities were taking place and that a lot of research has been made to ensure that proper accounts were given by the company. "We are concerned because we were elected by the people to seek their welfare, it is based on these facts that we've decided to come and see for ourselves," Hon. Bah said.

Source: "MPs Inspect London Mining Facilities" <http://allafrica.com/stories/201006300204.html>

Actions for Parliament: Monitoring of Operations

5. In case contracts are available to the public, it is essential for Parliament to make sure that both the government and the contracted company have complied with contract provisions, including existing rules and regulations. Parliament can use hearings and field visits to collect evidence and to get its questions answered.
6. In case contracts are not available to the public, it is essential for Parliament to make sure that both the government and the contracted party comply with existing rules and regulations. Parliament can use hearings and field visits to collect evidence and to get its questions answered.
7. Parliament needs to liaise on a regular basis with the administrative agencies that monitor the implementation of the contracts. This will allow a constant feedback loop of information to flow from these agencies. This way parliament will be able to determine when companies and government have deviated from contractual terms.
8. 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 to encourage the government to act on an issue
9. 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.
10. Coordinate efforts with local civil society organizations and local think tanks: 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 actors such as the World Bank, the African Development Bank, the Revenue Watch Institute, Publish What You Pay, etc. may also be able to provide information on request.
11. 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.
12. 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.
13. Establish select (investigative) committees to examine major 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.
14. Seek government clarification and 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. In some countries, government is not responsive to parliamentary requests. In this case, one of the options is for parliament to reform its standing orders and the constitution to give parliament the authority to censure or sanction ministers who withhold information.

Value Chain Stage 4: Collection of Revenues



Topics: Actual Revenue Collection, Actual Revenue Spending, Extractive Industries Transparency Initiative (EITI), Central Bank, Tax Authority, National Oil and Mining Companies, Regional Government, Local Government, Royalties, Bonuses, Payments, Receipts, Budget 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. By having this information, 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.

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. 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).

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 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).

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 section 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).

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. 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 or mining company (parastatals);
- 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. 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. Revenue streams can be collected in cash or in kind (Revenue Watch, 2008). Indirect benefits such as 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:** governments earn income through various kinds of taxes. The most common ones are taxes on profits, corporate tax, local income tax, value added tax, import and export tax, excess profit taxes, windfall revenues, and dividend withholding tax.
- **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 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.

- Dividend: 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.

Actions for Parliament: Revenue Collection

- Members of Parliament or the relevant parliamentary committee should compare estimated revenues in the approved budget with actual received revenues, and flag major differences. This can be done by writing a report on the findings and providing recommendations to the government to address discrepancies. MPs or committees can engage with the media to highlight the discrepancies and generate public debate about it. Committees can also conduct investigations into the cause for the discrepancies.

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 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.

For a country to become an EITI "candidate," the government must publicly commit to the Initiative and complete the Sign Up phase. 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.

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.

Actions for Parliament: EITI

1. Be informed about how the multi-stakeholder group (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?
2. 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.
3. 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.
4. 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.
5. 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.
6. 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.
7. 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.

The East African Legislative Assembly (EALA)

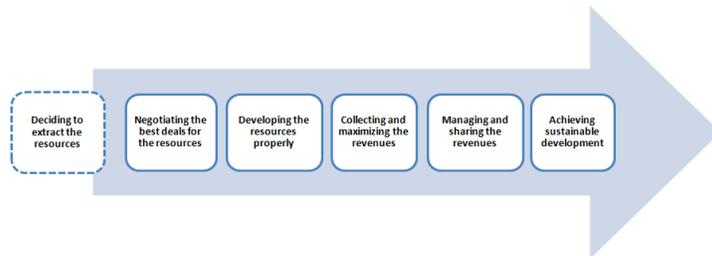
Members of the legislative body of the East African Community (EAC), EALA, have begun to promote resource revenue transparency at a regional level and in their member countries of Burundi, Kenya, Rwanda, Tanzania and Uganda. In early 2008, EALA held an initial workshop convening EALA members and member 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.

In May 2008, EALA established an ad-hoc committee to organize its efforts on extractive industries. Among the committee's first official activities were site visits to mines in Tanzania and an oil site in Uganda. The committee also conducted a comparative analysis of Tanzania's 1998 and 2010 Mining Act. The analysis will inform the eventual development of regional model legislation, model contracts and contract clauses. EALA will also develop similar standards and benchmarks for the oil industry. Once developed, they will serve as best practices that the five East African Community (EAC) partner states can draw from to improve extractive governance and management at the country level.

Subsequent to the site visits the committee developed and submitted two reports to the parliaments of Tanzania and Uganda that outlined recommendations for improved governance and management of the mining and oil industries in the respective countries. Some key recommendations featured in the reports called for improvements in the area of revenue and contract transparency, a greater role for parliament in contracting and bidding and finally improved access to industry specific information for the public.

Source: EITI handbook and program update from NDI, 2011

Value Chain Stage 5: Revenue Spending



Topics: Strategic Framework, Budget, Spending, Local Government, Regional Government, National Oil/Mining Company Audit, Audit of Stabilization Fund, Audit of National Accounts, Public Accounts Committee, Supreme Audit Institution, Policy Implementation

If the revenues of extractive industries are used well, the resources can create long-term economic growth and development. This section 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 section 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 expenditure of extractive revenues should not occur on an ad hoc basis, rather it should occur within a clearly outlined **strategic framework**, as well as in the annual and medium-term **budget**. For example, revenues a government can choose to set aside a certain amount of revenue into a Stabilization Fund, to be used for long-term sustainable investments or 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** on 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.

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 down to the end users. 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).

Actions for Parliament: Revenue Spending

1. 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.
2. In this respect, parliamentarians might want to hold consultations and meetings with their constituents in order to verify the completion of infrastructure and proper delivery of commissioned investments. These consultations 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.
3. In addition, parliamentarians might want to verify how annual spending has contributed to long-term development goals, and if the budget has been spent according to best practice policies specified on page 23.

Audit

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.

After receiving an **audit report**, committee hearings are the principal mechanism by which officials from departments, agencies or other relevant bodies answer to the Parliament (through the Audit Committee, which is sometimes called the **Public Accounts Committee** or PAC). 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.

To fulfill its role, the Audit Committee is given additional and more specific powers, such as the power to examine the public accounts, the comments on the public accounts, and all the reports drafted by the **Supreme Audit Institution** (sometimes called the **Auditor General**). The PAC also has the power to conduct investigations; to receive all the documentation that it considers necessary to adequately perform its functions; to invite government members to attend PAC meetings and to respond to questions; to give publicity to the PACs conclusions; to report to the Parliament; and to present the PAC's recommendations to the government. It's necessary to have effective follow-up procedures in place to increase the likelihood of implementation of the PAC's recommendations.

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).

Monitoring development funds for communities affected by mining activities

With help of Senator Franklin Siakor a county development committee has been set up to supervise or monitor the application of the Mittal Steel funds in Bong County in Liberia. Mittal Steel plans to invest billions of US\$ into the iron ore industry in Liberia. To tackle the environmental and other impact of the company's activities on communities and to ensure that communities directly affected benefit from the exploitation of natural resources from their area, two million US\$ will be provided to the three counties affected for community development purposes. Bong County will benefit half a million US\$ from this amount. With help of the Senator, a county development committee will monitor the application of the Mittal Steel funds.

Source: "End of Year 2007 Report on Community-Based Self-Help Development Initiatives in Bong County in partnership with the office of Senator Franklin Obed Siakor"

Action for Parliament: Auditing Government Spending

1. Request that an Audit be conducted. There are several audits that can be conducted: an audit on the awarding process of contracts, the implementation of contracts, an audit of government spending, an audit of the stabilization fund, or an audit of the national oil/mining company. 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.
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.
3. 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.

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)

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.

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

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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 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.
Populism	Populism refers to the political doctrine that supports the rights and powers of the common people in their struggle with the privileged elite.
Exploration license	An exploration license is a license to explore for oil or gas in a particular area issued to a company by the state.
Exploitation license	An exploitation license is a license to exploit discovered oil or gas sources and is issued to a company by the state.
Revenue Stream	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.
Production Sharing Agreements/ Production Sharing Contract (PSA/PSC)	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.
Investment and expenditure smoothing	Smoothing is an economic concept which refers to balancing out and/or 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.