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Using non-renewable resource revenues for sustainable local development

This brief discusses the performance and impacts on the ground of activities financed by revenues from natural resources in selected countries of Africa and Latin America. It identifies problem trends and provides some ideas on how to progress towards a more efficient and equitable use of such revenues for sustainable development.

The past several years have witnessed a sustained increase in oil, gas and mineral prices. For many countries that produce and export such products, this upward trend in prices has generated substantial windfall revenues. Given the importance of such resources in many developing countries and their non-renewable character, it is crucial to improve the understanding of how such revenues are used at the local level and to what extent they contribute to sustainable development. This Brief aims to shed light on these issues.

Much of the research related to extractive industries has put a heavy emphasis on macro-economic impacts. But development impacts of the use of oil and mineral revenues at the local level remain largely unknown. There are a number of reasons for this. First, initiatives aimed at transparency improvements promoted by international instruments such as the Extractive Industries Transparency Initiative (EITI, see Box 1) are not prescriptive about the use of revenues within signatory countries. Second, information is generally lacking about all the intermediate steps between revenue flows to the government

Box 1

Some International initiatives regarding transparency in natural resources activities

While interest in the sound use of natural resource revenues is longstanding, recent years have witnessed a renewed interest by the international community. Various international multi-stakeholder initiatives have been launched since 2002, targeting more transparency by both companies and governments. These include: the creation of the Kimberley Process Certification Scheme, which imposes stringent requirements on trade in so-called "conflict diamonds"; the Publish What You Pay (PWYP) Campaign, an international campaign led by a coalition of NGOs calling for the mandatory disclosure of tax, fee and royalty payments made by companies to governments for the extraction of minerals; and the Extractive Industries Transparency Initiative (EITI). EITI supports improved governance in resource-rich countries through the verification and full publication of company payments and government revenues from oil, gas, and mining. The Initiative works to build multi-stakeholder partnerships in developing countries in order to increase the accountability of governments. Some twenty countries have either committed to, or are now actively implementing EITI—in Africa, Asia, Europe, and South America.

This brief was written by David Le Blanc and Mónica Kjöllerström from the United Nations.
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budget and execution of projects on the ground. Lastly, evaluations of the development impact of such projects are not systematically undertaken.

The use of natural resource revenues for sustainable development at the local level: problem trends from a micro-level perspective

Legal frameworks and institutional settings relevant to the allocation and use of the revenues from oil and mineral resources differ markedly across countries. In some countries, revenues collected through royalties and different taxes may be directly transferred to the State budget and become indistinguishable from other revenue sources, in which case it is not possible to trace back uses of specific revenues. In other cases, the totality or a portion of the revenues from oil or minerals is set aside in a special fund, such as in Norway or in Botswana. Still in many countries, the law clearly spells out how a portion of the revenues from the exploitation of natural resources should be allocated between sub-national levels. There is generally a distinction made between the localities where production takes place and other localities, the former receiving higher transfers in order to take into account the environmental and social consequences of the mining activities (see Box 2).

In spite of these differences, a number of trends can be identified from the evaluation of the use of

Box 2

Redistribution of income from oil and minerals to the local level: some examples

Chad *(oil)* — Before the start of the exploitation of oil from the Doba field with the support of the World Bank, Chad established a legal framework for the management of oil revenues (Law 001 of 1999 and subsequent amendments and decrees). The law earmarked money for priority sectors and created a joint government-civil society supervisory body (*Collège de Contrôle et de Surveillance des Ressources Pétrolières*) to ensure the transparent management of the country's oil wealth.

Five per cent of the revenues was to go to the oil-producing region, comprising four *départements*. The revenues should have been managed by the decentralized institutions envisioned in the 1996 constitution. However, those institutions have not been put in place. Instead, a Provisional Committee for the Management of the revenues has been put in place, comprising representatives of the main Ministries involved, as well as representatives from the local level.

Peru *(minerals)* — The share of revenues from mineral resource-derived income tax allocated directly to local and regional governments in Peru is called "Canon Minero". In the first semester of 2007, transfers from the Canon Minero accounted for 84% of all transfers to sub-regional governments (municipalities, provinces, and regions). The distribution between regions, provinces and districts is defined in Law Nº 2756 (2001), and its subsequent amendments. The latest amendment (Law Nº 28322, of 2004) establishes that, on the basis of population and unsatisfied basic needs:

(i) 10% be allocated to the municipalities where the natural resource is being extracted;

(ii) 25% be divided among the local government authorities of the province where the natural resource is being extracted;

(iii) 40% be divided among the local government authorities of the region where the natural resource is being extracted; and

(iv) 25% go to the regional government, of which 20% is for universities in the region.

Finally, it establishes that districts hosting extractive activities should allocate 30% of Canon funds to investments that promote sustainable local development.

Other transfers benefiting sub-regional governments in Peru include "derechos de vigencia" (annual payments to the government by mining and mineral prospecting concerns) and royalty charges imposed on mineral companies on the basis of gross sales, established in 2004 and allocated with a structure similar to that of the "Canon".

Mali *(gold mining)* — Gold mining currently represents more than 60% of Mali's exports, and has recently replaced cotton as Mali's major export sector. A Mining Code, composed of six different laws and regulations, governs the taxes and fees levied on mining companies. The distribution of mining taxes to regional and municipal levels is governed by a separate law, No 00-044 of 2000. According to this law:

(i) municipalities where production takes place are to receive 60% of the local tax (*patente*) paid by mining firms, and 80% of the fees and taxes collected for artisanal mining permits;

(ii) *cercles* (the level of government above municipalities) are to receive 25% of the *patente* and 15% of the fees and taxes collected for artisanal mining permits;

(iii) regions are to receive 15% of the *patente* and 5% of the fees and taxes collected for artisanal mining permits.

oil and minerals revenues for local development.

Inconsistency between national development plans and actual investments is a general concern. Sometimes, investment plans for local development do not exist. In Peru, planning institutions able to elaborate such plans were dismantled and have not been replaced. In other contexts, development plans may be too general. In Nigeria, for instance, the Niger Delta Development Plan establishes adequate development goals, but is not an action plan, as it does not contain concrete targets or timelines. This results in some of the investments undertaken being either not useful or redundant. Lack of information-sharing and cooperation between sectors and levels of government can reinforce these inconsistencies.

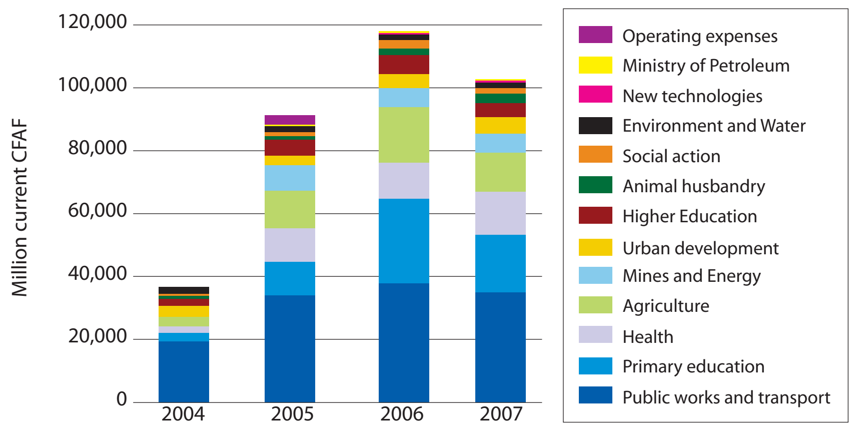
There seems to be a tendency to allocate most of the resources to infrastructure and construction projects. This is linked to the high visibility of and political rewards to such projects, to the capacity of these sectors to disburse quickly, and to opportunities for relatively easy diversion of money. This bias can result in inefficient projects such as buildings that will not be staffed or maintained, or resorts that will remain vacant due to lack of market analysis. At the same time, projects with significant impact on long-term development, e.g. in health or education, which are generally identified as priorities in national development plans, receive lower priority in budget allocations. In Chad, roughly half of the 2005 oil revenues for priority sectors was allocated to public works, transport and mines, and energy — the latter initially not even considered as a priority sector under the country's revenue management law (see Figure 1).

Local community priorities and government investment priorities are sometimes in tension. In oil producing regions of Chad, for instance, smaller projects with direct impact on household well-being such as water provision are favoured by communities, but the projects financed so far are relatively large construction projects (see Figure 2 and Box 3). By contrast, in Peru, the choice seems to be biased towards small projects, perhaps due to legal and regulatory issues, such as the fact that projects with a budget below a given amount face less scrutiny (see Figure 3). These projects have been found to have a limited impact on development and limited spillover effects. In Ghana, there is reportedly a tension between traditional rulers (who tend to spend based on private good criteria, or for prestige activities which are traditionally associated with their role) and district assemblies (which tend to spend for broader community development, e.g. schools or hospitals). There have been conflicts within districts over what projects should be financed and who the beneficiaries should be. These findings point to a tension which seems to be present to some degree in many countries between national development priorities and local priorities. These are not always consistent and pose a genuine dilemma for the allocation of revenues.

Execution rates remain very low. In Peru, execution rates have been low, although improving on average as a result of changes in legislation allowing regional and local government authorities to approve projects below a certain threshold (Figure 4). Overall in Chad, execution rates for projects

Figure 1

Oil revenue budget allocation to priority sectors in Chad, 2004-2007



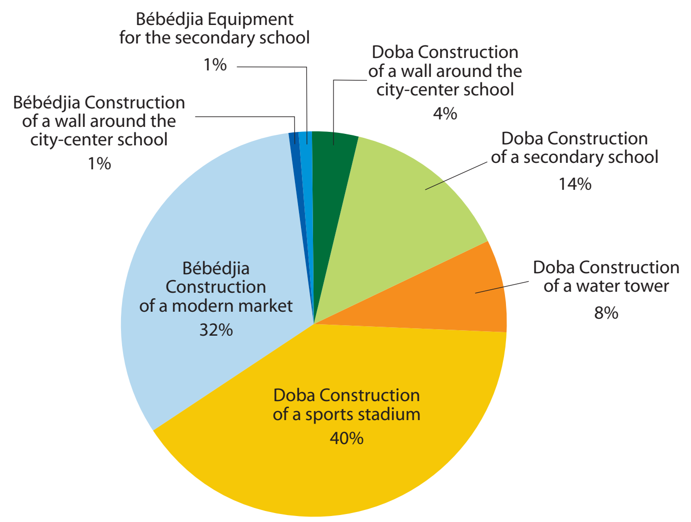
Source: Maoundonodji (2007), on the basis of data published by the Collège de Contrôle et de Surveillance des Ressources Pétrolières du Tchad.

budgeted on direct oil revenues (those subject to the legal framework first adopted in 1999 and amended in 2006, see Box 2) have been as low as 30-40% in some sectors, according to the reports published by the Oil Revenue Oversight Committee (*Collège de Contrôle et de Surveillance des Ressources Pétrolières*). The Ministry of Public Health, for instance, spent only one-fourth of its 2004 oil revenue allocation. The same has been observed in the case of the 5% of revenues allocated directly to the oil-producing region, with only around one-third of 18 billion CFA francs accrued for this purpose between 2005 and May 2007 disbursed by end-June 2007.

The inability of certain sectors to spend quickly has sometimes been used as a justification for shifting funds from priority sectors to others with higher capacity to disburse quickly, such as construction or roads.

Figure 2

Chad: Allocation of funds in the oil producing region with financing from 5% of direct oil revenues (share of total, May 2005-February 2007)



Source: World Bank Chad-Cameroon Pipeline Project website, http://go.worldbank.org/Y25GCS8NN0.

The social and economic costs of extractive activities to host communities are high. Host communities bear most of the environmental and social impacts of oil and minerals extraction. Those activities often result in a net wealth and/or income depletion that are typically not accounted for, and thus can be seen as a virtual tax for the communities where those activities are based. The social and environmental effects are however quite tangible and sometimes irreversible. They include community displacements, loss of productive agricultural land, land erosion due to mining activities, loss of ecosystems due to pollution, as well as oil spills and gas flaring that directly affect the livelihoods of resident communities. In Nigeria, over 5,000 oil spill incidents have been officially recorded in the 2000-2004 period alone.

The high externalities borne by host communities are often not appropriately dealt with in the context of revenue management discussions. In Mali, observers note that the current legal and regulatory provisions do not contemplate setting aside a part of the revenues from gold mining to allow for mine cleanup and environmental restoration once the mines close. As another illustration, in Peru, even though mining activities might represent an income opportunity, even in poor and only marginally productive agricultural areas communities are mostly refusing to host new projects, for fear of environmental damages.

Box 3

The "5%" Fund in Chad's oil-producing region: some accomplishments and remaining challenges

A proportion of 5% of oil revenues accruing to Chad from the exploitation of oil in the Doba and Bebedja fields was earmarked for the region of production by Law 001 of 1999. In the absence of the decentralised structures envisioned in the Constitution of 1996, a Provisional Committee was put in place in 2005 to manage this resource. Since then, the first projects have been completed and more are in progress, including a modern market in Bebedja, schools, school equipment, and expansion of the drinking water supply system in Doba.

However, a number of challenges remain. The autonomy of the Committee with respect to central ministries, and in particular the Ministry of Infrastructure and Public Works, has been questioned. Civil society actors also dispute the social and economic impacts of the projects that have been selected. Local residents seem to be little informed of ongoing and future projects. Lastly, the use of contractor firms from outside the production region has limited local employment generation opportunities.

Obstacles to an efficient use of the revenues for sustainable development at the local level

Obstacles to an efficient use of the revenues are many. A first category of obstacles relates to the broader governance context. Transparency regarding the revenues generated by extractive activities tends to be low. One factor is the lack of transparency of exploitation contracts signed between governments and companies. The proliferation of project-specific investment agreements, in contrast with a general framework for sharing of revenues between companies and the government, reinforces the opacity of the revenues for the public. The EITI has contributed to improving the situation, by allowing figures on the amounts paid by companies to governments to be made public. Another factor is the mere complexity of the tax regime applying to oil or mining companies. For example, in Mali, companies mining gold are subject to 27 different taxes.

Transparency over the allocation and use of revenues is even more difficult to achieve. Once revenues from natural resources enter the budget, their use is submitted to various regimes governing the degree of scrutiny to which they are exposed and the degree of control the public has over their use. The laws or regulations covering the use of the revenues may be at the source of this problem. For example, in Chad the main institution put in place for the transparency and control of the use of revenues (*Collège de Contrôle et de Surveillance des Ressources Pétrolières*) only monitors a small fraction of total revenues. In Ghana, the law and regulations governing the Mineral Development Fund did not include reporting and monitoring requirements, resulting in a lack of accountability and transparency.

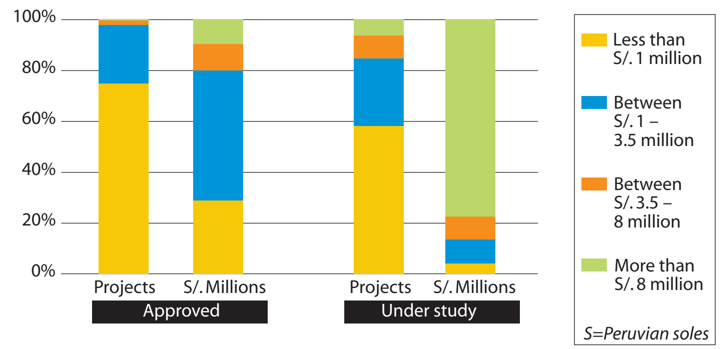
Lack of information on budgets at all levels of society is also a major limiting factor. There is often a lack of communication mechanisms between institutions involved in revenue management. This problem is even more evident at the local level. Lack of budget information within the country often generates uncertainties at the local level over how much revenue should be received from the government. In Mali, local governments are entitled to varying portions of some of the taxes paid by mining companies. However, no detailed tally of the various taxes is published by the government. As a result, it is impossible for local governments, NGOs, and communities to assess what they should receive.

Local officials and even more so local communities and NGOs also often lack information on what is required of companies, by contract, in terms of contribution to local development. As a result, at the local level there is often confusion over which funds come from the government and which come through extractive companies' philanthropy budgets. This has been mentioned for example in Mali and in Nigeria.

Lack of adequate information channels and institutions for participatory decentralized government may result in problems in project selection and implementation. There is often a lack of appropriate channels for conveying priorities and demands of local communities to the level where spending decisions are taken. The disconnect between local priorities and projects implemented with oil and mineral revenues, resulting in a low sense of ownership of those projects by local communities, has been repeatedly mentioned as one of the main causes of the lack of sustainability of such projects.

Figure 3

Peru, transfers to local and regional governments: Projects approved and under study by number and size, 2004-2006



Source: Propuesta Ciudadana (2007).

In many countries, there is still a gap between the legal framework for decentralisation that has been put in place and what exists on the ground. Sometimes the institutions supposed to accompany decentralization do not exist, like in Chad where decentralization is inscribed in the Constitution of 1996 but has not been fully implemented (see Box 2). In Nigeria, a crucial issue is to reconcile traditional local community leadership structures with local government structures appointed from the centre. In all cases, management capacity can be a problem, especially in newly created institutions. This in turn relates to the absence of proper monitoring and control mechanisms.

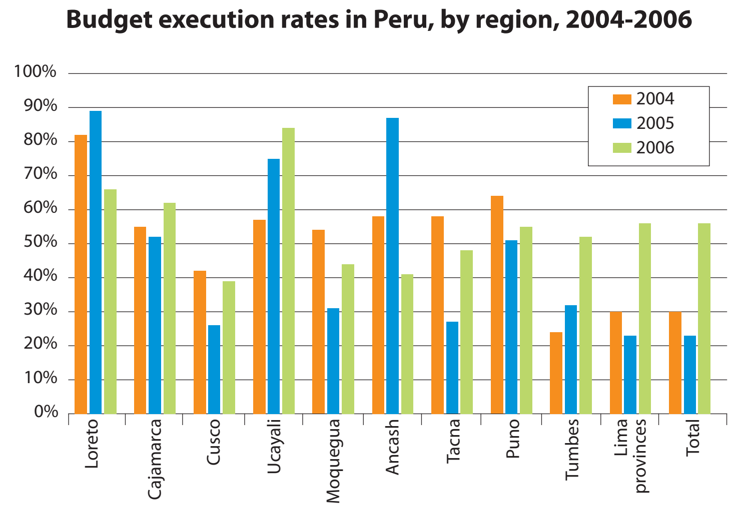
Lack of capacity of local actors is a serious hurdle. An often mentioned problem is the resource imbalance between multinational companies (MNCs) and local communities. The latter do not have the financial, legal and technical means to deal on a fair basis with powerful companies. Moreover, often the government is unable to provide support to local communities in their dealing with MNCs. This is reinforced by the fact that oil and mineral activities often take place in the most remote areas, where the government has little or no presence (e.g. the Peruvian Amazon and Doba region in Chad).

Lack of capacity also affects local governments or local branches of the central government. Especially where the decentralization is incomplete, local governments may not possess adequate structures and capacities to plan and execute budgets. Other deficiencies include lack of capacity to devise development strategies and action plans as well as to manage and monitor projects, and lack of education on environmental issues.

Local enterprises, which could in principle provide services to the oil and mining companies, often do not meet the standards that those require. Local firms may also have insufficient capacity to deal with the process required to bid for and participate in local development projects.

Finally, in some contexts concerns have emerged regarding the development impact of private initiatives undertaken by companies operating in the oil and mining sectors

Figure 3



Source: Propuesta Ciudadana (2007).
Note: Includes only regions where non-renewable resource revenues finance more than 50% of the total budget.

through their corporate social responsibility (CSR) agenda (see Box 4). A frequent criticism of such activities is that multinational corporations (MNCs) are not the best placed to drive development projects. MNCs have responded to this by partnering with institutions specialised in development issues, very often local and global non-governmental organizations (NGOs). But the most serious criticism of CSR initiatives in the oil industry in some countries is linked to a governance issue. First, CSR initiatives by private firms may act as a substitute for government investment in development in the producing regions, even though the amounts invested by companies through CSR initiatives are dwarfed by the revenues that accrue to the central government, a share of which should go back to the producing region. Second, broadly publicized CSR approaches by oil and mining firms have been criticized as masking the companies' unwillingness to recognize their obligations to keep the environment clean, or at least compensate those directly affected by their activities.

Signs of Progress — A Tentative Way Forward

Whereas a number of significant challenges remain to reach more efficient and equitable uses of the revenues from oil and mineral resources for local development, a number of positive experiences exist. Some of these experiences, as well as some of the roles that various actors can play, are briefly touched upon in the remainder of this Brief.

The international community has a clear role to play to facilitate progress on the transparency and accountability agenda regarding the use of natural resource revenues. Sending a clear message of support to EITI and other international initiatives on transparency would be a first step. In addition, the international community could support actions aimed at producing a binding code of conduct for multinational companies operating in the natural resources sector. Providing assistance for implementation of effective decentralization on the ground, where decentralization can be used as a means to achieve better governance, could also be beneficial to greater accountability.

Increasing transparency, however, has to be done mostly from the bottom up. In order to implement transparency and accountability in day-to-day action, the right institutional structures are needed (i.e. those which best correspond to local cultural practices). In addition, information sharing mechanisms must be put in place. For example, there is a need for much more coordination between actors, both between government levels and between different sector ministries and other institutions. A role of the international community in that respect could be to contribute to widening the policy space whenever the opportunity arises. Simple actions which can make a difference include: supporting local radio stations in vernacular languages, both as a means to reinforce the voice of local communities (by providing channels for conveying priorities and needs) and for education purposes (sharing budget information); promoting a better dissemination of budget information; and promoting communication between institutions (e.g. by support for printing budget sheets and distributing them).

Providing capacity-building to developing countries to implement development projects effectively would address some of the critical implementation bottlenecks. Efforts should be directed at local governments, in order to allow them to acquire basic training and education on environmental issues; to better integrate spending decisions into coherent development plans; and to increase budget execution rates. Capacity building efforts should also target NGOs and local communities, in order to allow them to negotiate with local government officials and private companies on a more equal basis. In parallel, technical assistance programmes should be targeted at small and medium-sized enterprises which could provide services to MNCs operating in the oil or mining fields, to bring them

Box 4

Development projects by oil companies in Nigeria: some issues

Nigeria's oil production, the country's major source of export revenue, is concentrated in the Niger Delta. Oil is exploited by large companies, which are subsidiaries of multinational oil corporations. In this conflict-prone region, oil companies have supported local projects aimed at addressing material deprivation, poor health and low education. The quality of these projects is reported to have increased over time. In particular, a transition from an assistance approach to one of partnerships involving the recipient communities more fully has allowed a better correspondence between local needs and priorities and projects implemented.

However, the limitations of such partnership approaches have been apparent. The quality and adequacy of the projects have been criticized and it is often mentioned that poor corporate-community communications have resulted in supporting projects that are not well adapted to local social standards, or whose benefits are unevenly distributed between communities, creating or exacerbating the potential for local conflicts.

More broadly, two issues have arisen. First, CSR initiatives by private firms in the Niger Delta region have occurred in a context of chronic underinvestment by central and local governments. The portion of oil revenues that goes back to the producing region has decreased from 50% in 1960 to 3% from 1992 to 1999, before rising somewhat in the subsequent period. There is a danger that corporate social investment becomes a substitute for governments' increased investment.

Second, CSR initiatives in the Niger Delta have happened even though environmental laws are weakly enforced, and companies often refuse to comply with judicial decisions ordering financial compensation to populations affected by oil spills or gas flaring, often in amounts far in excess of what industry-led projects bring to the communities. CSR initiatives have therefore been described by some as an inexpensive way for oil companies to skirt their environmental and social duties.

to a level where they can access deals with the MNCs, thereby allowing wider interactions and spillovers between the extractive activities and the local economy. Technical assistance programmes would also be needed for local firms to bring them up to required standards and allow them to compete for development project contracts (see Box 5).

Better addressing the environmental and social costs of extractive activities in host communities remains a critical challenge. Many experts agree that a greater part of the resource revenues needs to be directed to addressing the depletion of environmental wealth of host communities (e.g. projects need to consider not only building schools but tackling land degradation, oil spills, etc.). Revenue-sharing schemes often tend to redistribute revenues over wider communities than those directly affected, which can lead to perceptions of unfairness if the environmental costs are not addressed by a separate mechanism.

In order to make a difference to development outcomes, revenues from natural resources need to be able to generate additional and sustainable incomes, beginning with replacing income sources or opportunities that have been destroyed by the mining activities such as farming and fishing. Projects which create links between mineral extraction and the local economy are very important in that context.

Box 5

Building local capacity to improve the use of revenues earmarked to the production region: the example of Chad

In Chad, the first assessments of the functioning of the 5% of oil revenues going back to the production region made clear that lack of information constituted a critical bottleneck. With support from local NGOs, the Provisional Committee for the management of the producing region's oil revenues (CPGRP) organised a multi-level information campaign, whose main objectives were:

(i) to disclose information on ongoing projects undertaken with the revenue pool;

(ii) to explain the management procedures of the revenue to the various actors involved. This included the eligibility criteria of the projects, the process of drafting project documents, and the procedures for submitting bids;

(iii) to confront the Committee with local communities, thus allowing for a real exchange and feedback in terms of local priorities and needs;

(iv) to build a partnership between the Committee and local civil society organisations.

A national meeting held in the capital city further contributed to bringing priorities and concerns from oil-producing regions to the central level.

The communication campaign was deemed highly successful and is expected to facilitate and expedite the selection and realisation of projects in the future.

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United Nations Department of Economic and Social Affairs
Division for Sustainable Development
Policy Integration and Analysis Branch
2 UN Plaza
New York, NY 10017

Voice: (1-917) 367-3269
Fax: (1-212) 963-1267
E-mail: djobo@un.org
http://www.un.org/esa/sustdev/publications/innovationbriefs/index.htm

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