

Lifting the Resource Curse

How poor people can and should benefit from the revenues of extractive industries

In countries rich in minerals and hydrocarbons, it is often the case that a small number of private companies benefit from the exploitation of these resources, while public revenues are small or misused and local populations remain poor. The way to fight the ‘curse’ of natural resources is by sharing the benefits fairly between private and public sectors and by better allocating public budgets to improve spending on basic health care and education, tackling inequality and generating employment for poor people. Transparency and accountability are essential throughout the process, and particularly in relation to public spending plans for all levels of government. It is time for a new, fair deal for poor people in countries rich in natural resources. The current global economic crisis makes it even more urgent that this happens.

Summary

For countries rich in minerals and hydrocarbons, such natural resources should provide an essential source of financing for development. Against all logic, however, it seems that in many cases exploitation of such resources is linked to poverty, inequality, poor public services,¹ and stunted economic growth.² This apparent paradox is known as the ‘resource curse’.³

Some features of the extractive exploitation model help to explain this paradox. On the one hand, significant foreign investment and technology are generally required to exploit natural resources (many resource-rich countries lack these means). On the other, state revenues from the sale of such resources on international markets are very considerable compared with revenues from other productive activities. Both these circumstances, combined with little public monitoring, mean that multinational corporations, producing country governments,⁴ and specific interest groups within producing countries tend to pursue their own interests, to the detriment of the majority.

The ‘resource curse’ is reinforced by a model of economic growth based on extractive activities that very frequently have negative social, environmental, financial, and institutional impacts. These are all consequences of exploitation contracts agreed between producing states and multinational corporations which are harmful to the common good. In many cases, such a model has contributed to bad public policies and low levels or bad quality of public spending in producing countries.

There is ample evidence to show that many resource-rich countries have lost golden development opportunities by agreeing to harmful contracts. Unfair contract conditions serve to explain why the Zambian government received an estimated sum of only \$6.1m (0.61 per cent of a total income of \$1bn) from Konkola Copper Mines for copper extraction in 2006–07. It was reported that net profits for Konkola Copper Mines in the same period were approximately \$301m.⁵

There is also strong evidence to show that producing country governments sometimes lack the right capacity and the necessary political will to manage revenues from extractive industries in a way that meets social goals and promotes development in a sustainable and efficient manner. In addition to the difficulties faced by governments in managing volatile incomes, countries rich in natural resources are particularly vulnerable to problems such as corruption, populism, patronage or political clientelism, and lack of transparency and accountability have limited the achievement of development goals.

Angola's oil revenues (which represent 80 per cent of national income) are estimated at \$10bn per year, and in recent years high oil prices have enabled the country to maintain one of the highest rates of economic growth in the world. However, ordinary Angolans have not benefited from the oil boom: 70 per cent of the population live on less than \$2 per day.⁶ The non-government organisation Human Rights Watch estimates that between 1997 and 2002 more than \$4bn in state oil revenues 'disappeared' from the Angolan treasury; an amount almost equal to total government spending on social services in the same period.⁷

This situation should, and can, change. For those countries that depend on extractives industries,⁸ the income generated by this sector could be transformed into an opportunity if it is used properly. According to estimates by Intermón Oxfam (see Table 3, Annex 2⁹), countries such as Angola, Chad, Nigeria, Ecuador, and Venezuela could use hydrocarbon exports to significantly increase their public spending per capita on education and health by 2015, investing 20 per cent of estimated tax revenues in education and 16 per cent in health. Angola for example, could multiply its spending on health by a factor of between eight and ten.

Fiscal tools – taxes and public spending – are the main instruments that governments can use to improve the share of benefits accruing to the state and thus the sums available for public use. Fair systems of taxation and spending allocation policies that focus on universalising health care and improving the quality of education are necessary in countries with rich natural resources. Bolivia saw oil and gas revenues rise from \$448m in 2004 to \$1.531bn in 2006, due to the redistribution of profits agreed in contracts after 2005,¹⁰ although the revenues still needed to be allocated to increase social spending. Indonesia and Norway are good examples of countries with significant revenue from natural resource extraction, where public spending is aligned coherently with long-term development goals.

Oxfam's research highlights some key factors for improving the opportunities offered by revenues from extractive industries: upgrading legal and fiscal frameworks in poor countries with natural resources; renegotiating contracts with big extractive companies; and putting in place or reinforcing public financial management systems. These systems should prioritise the use of extractive revenues for social spending, as well as for setting the foundations for the diversification of production, for job creation, and to mitigate the social and environmental impacts of exploitation.

A cornerstone of such policies should be the promotion of transparency throughout the extractive industry supply chain, from the agreement of contracts to the allocation of revenues through public budgets. The active involvement of civil society is essential to track both the origins and uses of revenues from extractive exploitation. It is also of crucial importance to have public institutions which can support this process of participation and which are efficient in their control, monitoring, and enforcement of it.

Any effort to reduce the negative impacts of extractive models must include these elements if it is to be successful in improving the living standards of poor populations in resource-rich countries.

Governments of countries rich in natural resources should:

- Set legal and fiscal frameworks for the extractive industry (EI) sector in order to protect the interests of the country's people. Existing frameworks or contracts which do not meet this principle and go against the public interest must be revoked or amended, to ensure a fair deal between companies and national governments.
- Sign up to the Extractive Industries Transparency Initiative (EITI) and impose maximum transparency throughout the sector's value chain, from licensing and the award of contracts stipulating the government's share of revenues, to the point of reinvestment of such revenues in social spending. Governments should also provide forums for accountability, and promote mechanisms of checks and balances through national parliaments and civil society organisations (CSOs).
- Include civil society and community representatives in decision making about EI policy;
- Publish details of their EI revenues on a regular basis and avoid the inclusion of confidentiality clauses in new contracts;
- Detail the use of fiscal incomes from extractive industries within national and local budgets and development plans, in both the short and medium terms (i.e. for mitigating health and education or environmental impacts in exploited areas) and the long term (i.e. for productive diversification and to reconstruct sources of livelihood in exploited areas). Governments should also ensure equity criteria in the distribution of EI revenues at both national and sub-national levels, and should develop counter-cyclical management mechanisms to ensure the sustainability of public investment in the event of significant, sudden, or volatile flows.
- Establish/enact and implement appropriate regulatory

mechanisms that protect affected communities and conduct independent impact assessment prior to approving EI projects;

- Establish mechanisms for communities in affected areas to participate in decision making and for protecting the right to free, prior, and informed consent (FPIC);
- Promote agreements with tax havens included in OECD lists to automatically receive information on inflows of companies with activities within the country.

Governments in countries with recent natural resource discoveries:

The production model mainly based on extractive industries can undermine pro-poor, inclusive, and socially and environmentally sustainable development. For this reason, governments in countries with recent natural resource discoveries should carefully evaluate different options and consider possible alternatives to an economy highly dependent on extractive industries, promoting a national debate among all actors likely to be involved or affected. This debate, prior to the decision on the exploitation of the resources, should include at a minimum:

Analysis of benefits vs. real costs

- Study the likely social impacts (displacement of populations, destruction of livelihood resources) and environmental impacts in the areas to be exploited;
- Analyse the possible impacts of the distribution of revenues among different regions, anticipating problems and establishing redistribution norms before projects begin;
- Identify 'no-go' areas – zones that are established as being of environmental and/or cultural importance for the nation.

Analysis of control mechanisms on the 'resource curse'

- Evaluate the quality and the capacity of public financial management systems to plan and manage incomes from extractive industries (which are usually volatile and difficult to estimate with accuracy), undertaking necessary improvements before initiating the process;
- Evaluate the quality and capacity of institutional and regulatory mechanisms for the control of corruption, clientelism, and opportunism in both the public and private spheres and throughout the entire chain of the extractive business, at both the national and local levels;
- Evaluate the degree of responsibility of non-government actors (civil society, media, and others) in monitoring both the generation and exploitation of public resources obtained from extractive industries, especially at the local level.

Analysis of opportunities

- Assess the level of public and private resources that could be used in

other areas of development and their potential to generate employment in more sustainable ways;

- Assess the possibility of integrating extractive projects into a wider development strategy at the national and local levels.

Civil society organisations should:

- Reclaim their key role of defending the public interest in the planning, management, and use of EI revenues;
- Demand transparency and the setting up of forums to ensure government accountability in respect of extractive revenue spending and to monitor private sector behaviour during exploration and exploitation projects. In this context, a role for civil society is to ensure governments are meeting the Millennium Development Goals.
- Strengthen alliances between CSOs monitoring EI revenues, those working on budget tracking, and other actors involved, such as national parliaments, progressive private investors, and international NGOs;
- Build their capacity to monitor and influence the EI value chain, as well as to monitor and control tax evasion and potentially corrupt practices. A number of non-government organisations (Publish What You Pay, the Revenue Watch Institute, the International Budget Project) and donors as UK Department for International Development (DFID), Norwegian Agency for Development Cooperation (NORAD), the World Bank and the EITI (multi-donor fund) are willing to support CSOs in such areas.

OECD countries and international donors should:

- Promote transparency throughout the EI sector and, in particular, advocate for transparency in agreements between multinational companies and governments of resource-rich countries;
- Promote mandatory disclosure regulations for companies listing shares on stock exchanges in OECD countries – for example, the Extractive Industries Transparency legislation in the USA (the proposed ‘American Law’);¹¹
- Establish and apply transparency and corporate responsibility criteria for the companies they support through their export credit agencies (ECAs). They must demand that such companies comply with the highest international standards in the social, humanitarian, and environmental spheres;¹² respect and adhere to OECD guidelines and UN standards for multinational companies, as well as the OECD Anti-Bribery Convention and the UN Convention against Corruption; and consider the possible proposal of an OECD convention on transparency and reporting for multinational companies. ECAs should have in place policies requiring FPIC, disclosure of payments and contracts, independent monitoring of projects, and assurance of minimum governance conditions before financing projects.
- Encourage and support governments of resource-rich countries to

use EI revenues to achieve the Millennium Development Goals (MDGs) and for productive diversification. Support with ODA (Official Development Assistance) to partner countries that ratify the EITI; establish fair legal and tax frameworks; fight corruption; and show commitment to improve public financial systems and to promote a system of checks and balances through formal and informal mechanisms (parliaments and CSOs). Donors must support programmes to improve capacity to manage public resources, for example, as the principles of the Paris Declaration establish for ODA funds.¹³

- Support programmes to strengthen the capacity of governments to monitor existing contracts and to collect taxes in an effective way;
- Support national parliaments and CSOs working at local, national, or international levels to promote sound management of EI revenues as part of a true EITI implementation;
- Promote a minimum level of taxation on all extractives industries that guarantees that countries keep for the future of their citizens a major share of the benefits obtained;
- Promote and support a national debate to analyse impacts before embarking on extractive projects in non-dependent countries.

The private sector should:

- Comply with the highest international standards in the social, humanitarian, and environmental spheres. It should welcome and apply OECD guidelines and UN standards for multinational companies, as well as the OECD Anti-Bribery Convention and the United Nations Convention against Corruption, and possible new conventions/initiatives on transparency and accountability that may be put in place.
- Agree to apply transparency in contract negotiations. Renounce the inclusion of confidentiality clauses in contracts;
- Accept fair terms of agreement, instead of taking advantage of their own negotiating capacity with fragile states to ensure they benefit disproportionately and unfairly;
- Publish their payments for access to resources on an individual, country-by-country, project-by-project basis and implement transparent contractual and licensing arrangements;
- Demonstrate commitment to human rights and sustainable development principles and maintain a respectful dialogue with communities. In line with this, undertake human rights and environmental impact assessments and establish complaints and reparation mechanisms;
- Disclose meaningful information about EI impacts and benefits, apply mitigation measures, and compensate adequately communities that are physically and economically affected.

International financial institutions:

- The World Bank should support the development of strategies

aimed at gradually reducing the economic dependence of developing countries on extractive industries. It should further develop policy measures regarding common requirements for such countries, in order to ensure that national resources are properly targeted towards sustainable social investment.

- The World Bank and the IMF should promote policies conducive to achieving the MDGs, including through fair taxes on extractive industries and improved public management.
- The World Bank and the IMF should not accept extractive projects as 'the model of development' and should only encourage and support poor countries' extractive projects if there is clear evidence for a positive and sustainable impact on poverty alleviation and no relevant environmental damages.
- The World Bank should make poverty reduction a priority over the interests of producing countries, large corporations and developed countries when dealing with potential conflicts of interest which may arise in future.
- Regional development banks should establish payment disclosure mechanisms for projects, as the International Finance Corporation (IFC) currently does.
- IFIs should have in place policies requiring FPIC, disclosure of payments and contracts, independent monitoring of projects, and the assurance of minimum governance conditions before financing projects.

Other institutions:

- Regional economic blocks could have a key role to play in ensuring fair deals for individual countries, providing negotiating strength.
- In particular, Pan African institutions like the African Union Commission and the Pan African Parliament can play a relevant role in terms of accountability through peer-review mechanisms, helping to ensure that national governments are held accountable.

Notes

- ¹ It has also been shown that the inverse relationship between abundant natural resources and economic development is linked to worsening poverty indicators, fragile health systems, child mortality, and low levels of education (Karl 2007).
- ² Between 1970 and 1993, economic and social development in countries lacking natural resources was four times more rapid than in countries rich in such resources and with twice the public income (Auty, 1997). The International Monetary Fund and World Bank conclude from their own experiences that countries which rely most on extractive industries show the worst results in development and economic growth (Gary, 2003).
- ³ Generally in economic literature, the term 'resource curse' is used to talk about the negative effect on development and economic growth that results from economic dependence on natural resources.
- ⁴ 'Only large and powerful global and state actors can get into the oil game. Only those who control political power can grant the opportunity to make money from oil, and only those who receive this opportunity can provide the revenues to keep regimes in power.' (Gary and Lynn 2003)
- ⁵ Action for South Africa (ACTSA), Christian Aid, and Scottish Catholic International Aid Fund (SCIAF) (2007) 'Undermining development? Copper mining in Zambia', [www.actsa.org/Pictures/Uplimages/pdf/Undermining development report.pdf](http://www.actsa.org/Pictures/Uplimages/pdf/Undermining%20development%20report.pdf)
- ⁶ UNDP (2008), *Human Development Report 2008*.
- ⁷ Human Rights Watch (2004) 'Some Transparency, No Accountability: The Use of Oil Revenue in Angola and Its Impact on Human Rights', www.hrw.org/en/reports/2004/01/12/some-transparency-no-accountability
- ⁸ For purposes of this report, a country depends economically on oil or minerals (extractive industries), when it receives as a main source of public income the product of the sale of these resources on the internal market. According to the World Bank, a country depends on oil or minerals when the share of the extractive industries in the total exports of a country exceeds 35%.
- ⁹ Calculations are based on projected tax revenues for 2015 from the sale of oil and oil derivatives on the international market. Fiscal revenues are calculated as the product of a percentage of export revenues, after deducting internal domestic consumption (international sales price times amount produced, minus amounts of oil and derivatives for domestic consumption).
- ¹⁰ Source: CEDLA, based on official numbers from the 'Unidad de Política Fiscal' of the Bolivian government, www.cedla.org
- ¹¹ The Extractive Industries Transparency Disclosure (EITD) Act (S. 3389) in the USA. www.publishwhatyoupay.org/en/resources/senate-hearings-natural-resources-highlight-need-extractive-industries-transparency-legisl
- ¹² For example, the United Nations Declaration on the Rights of Indigenous Peoples of September 2007 and ILO Convention 169.
- ¹³ International commitment on aid effectiveness. Donor countries and members signing the agreement set objectives for 12 indicators. Indicator 5-A states that donors shall use and therefore contribute to strengthening the public finance management structures in the beneficiary country to channel international aid flows.

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