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## The role of governance and international norms in managing natural resources

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WIDER Working Paper 2017/203

**The role of governance and international norms  
in managing natural resources**

James Cust\*

December 2017

## Abstract:

The governance of natural resource wealth is widely considered to constitute a key determinant in whether the extraction of natural resources proves to be a blessing or a curse. What is meant by governance can span a wide range of components, while the steps to achieving good governance remain subject to debate and uncertainty.

In response to this challenge, a variety of international initiatives have emerged seeking to support those striving for better governance in their countries. These initiatives range across efforts to promote transparency, to codify successful historical experiences and effective policies; to help guide decision makers in their choices, and, in some cases, to provide external standards that countries can bind themselves to.

These initiatives, such as the Extractives Industry Transparency Initiative, have seen some success in spreading and embedding governance norms, ranging across revenue transparency, contract disclosure, supply chain certification, creation of saving instruments such as resource funds and building institutions for checks and balances such as fiscal rules and accountability bodies.

The paper provides a review of initiatives targeting governments as the key agents of change. We find a mixed picture of success, where uptake has been strong, for example in terms of the number of countries engaging with or signing onto normative frameworks. However, evidence for causal impact remains weak and sometimes limited to anecdotal cases. We offer some critical reflections on challenges faced and potential ways forward to build on the lessons and achievements of the past decade and a half.

**Keywords:** governance, transparency, natural resources, reforms, international public goods, literature survey

**JEL classification:** H87 O10, Q30

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## 1. Introduction

Countries rich in natural resources face a series of development challenges. As custodians of resource wealth they must make difficult policy choices to maximize the benefits for citizens. However, many of these choices are shaped or constrained by the institutional or governance context<sup>1</sup>. The high rents often associated with resource extraction and export place a premium on effective policy but can also act to exacerbate weaknesses in governance. The resource curse describes what can happen when the interaction of governance and resource wealth goes wrong.

Good or bad governance has large repercussions for poverty and inequality within resource rich countries. However, it can also have spillover effects, affecting governments, companies, investors and citizens both inside and outside of producing countries. These externalities give rise to a public goods problem—good governance of natural resources may have a larger benefit than the private benefit captured by any national government or single administration. Further, according to various theories of the resource curse, the private benefits accruing from conducting bad governance may be greater still, for a small group of elites.

In response to these externalities a variety of international norms and initiatives have emerged. They cover a range of aspects of resource governance, but typically have commonality in their aim to codify successful historical experience and best practices around effective policy design and implementation. Further, they may seek to guide decision makers in their choices, and, in some cases, to provide external standards as accountability mechanisms that countries can bind themselves to.

This paper provides a review of different types of governance codes and standards for extractive-sector performance and the role of international efforts to support governance reforms. The paper offers some critical reflections on the conceptual foundations as well as the practical experience of these efforts. Specifically, it examines government targeted approaches including the Extractive Industries Transparency Initiative (EITI), the Kimberly Process, the Natural Resource Charter, and the Africa Mining Vision.

While oil and minerals prices have fallen from the sustained highs of the commodity price super-cycle of the 2000s and first half of the 2010s, the stakes remain high for low-income countries (LICs) and middle-income countries (MICs). Historically almost 90 per cent of mineral and oil investments have taken place in upper-middle and high-income countries. However, by 2030 an estimated US\$11-17 trillion of new investment is needed in mineral, oil and gas projects in LICs (McKinsey 2013). Research suggests that as investment has moved towards the Global South, the role of institutional quality has increasingly come to the forefront of investors' minds and has shaped the pattern of investments around the world (Cust and Harding 2015; Arezki et al. 2016). As well as shaping investment choices, governance and the quality of institutions also shapes outcomes; and is generally considered to be the crucial determinant in whether a country succumbs to the resource curse or not (Mehlum et al. 2006 and Robinson et al. 2006).

The paper provides a critical review of governance initiatives targeting governments as the key agents of change. We find a mixed picture of success, where uptake has been strong, for example

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<sup>1</sup> This paper follows the definition of institutions and governance used by much of the literature on this topic, from North (1990); as institutions defined as the rule of the game in a society, constituting laws, norms, policies and codes of conduct.

in terms of the number of countries engaging with or signing onto normative frameworks. However, evidence for causal impact remains weak and sometimes limited to anecdotal evidence. We offer some critical reflections on challenges faced and potential ways forward to build on the lessons and achievements of the past decade.

## 2. What is the rationale for improving governance in resource-rich economies?

Natural resources such as oil, gas, and mining, present a unique set of policy dilemmas to government. The potential for large revenues or rents arising from their extraction mean that big government, in a fiscal sense, is hard to avoid. In nearly all countries, governments are charged by their citizens to manage resource wealth on their behalf, which invariably entails contracting resource companies and taxing the revenues derived from the extraction process. Governments receiving these sizeable tax receipts must then navigate a series of policy choices on how to manage and distribute these revenues to maximize economic development gains, while minimizing the risks of misappropriation, patronage and plunder. Getting it wrong can mean countries succumbing to the so-called resource curse (Ross 2014, van der Ploeg 2011 and also Dietsche 2017).

Getting it right, and creating outcomes that are robust to politics, has proven challenging. Putting the right rules and government institutions in place is a difficult task, and one that is exacerbated by the challenge of doing so in a highly politicized context. Political cycles can often endanger reform agendas, and populist politics can create pressures for wasteful spending or inequitable distribution strategies, see Collier 2017 and Bawumia and Halland 2017. The record in recent years has not been good (Venables, 2016).

However, governance does matter: a wide range of empirical studies demonstrate the important role for institutional setting, policy choices and good governance in shaping the risks and rewards associated with resource wealth (for examples, see Mehlum et al. 2006 and Robinson et al. 2006). This can operate via private sector channels, whereby good governance can reduce the risks or lower the operating costs faced by investors (Cust and Harding, 2014). Similarly, good governance can ensure prudence and efficiency in the managing of resource revenues for the ultimate benefit of citizens, such as via fiscal rules, sovereign wealth funds or expenditure policies. Countries that have successfully navigated these challenges include Chile with fiscal rules, Norway with its savings fund, and Botswana with its promotion of broad based human development in spending choices.

How we should define good governance, and what actions matter in this regard, are widely debated.<sup>2</sup> A definition taken from the Worldwide Governance Indicators provides an expansive basis for understanding governance: ‘the traditions and institutions by which authority in a country is exercised. This includes (a) the process by which governments are selected, monitored and replaced; (b) the capacity of the government to effectively formulate and implement sound policies; and (c) the respect of citizens and the state for the institutions that govern economic and social interactions among them.’<sup>3</sup>

Countries with relatively weak governance—such as a lack of constraints on executive power—run the heightened risk of various resource curse challenges. First, elite capture prior to deals or signing poor deals with extractives companies, can limit the overall scope for revenues received by

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<sup>2</sup>This is an issue discussed in greater detail in Dietsche 2017.

<sup>3</sup><http://info.worldbank.org/governance/WGI/#faq> (accessed on 26 October 2017)

government. This in turn will limit spending options and otherwise implicitly subsidize extraction by private agents. Upon receipt of revenues governments may be at additional risk of elite capture, myopic fiscal policies, and dilemmas regarding the inter-generational equity of spending and saving decisions. In the worst cases, resource wealth in the context of poor governance can exacerbate corruption and drive conflict.

There is a growing consensus in the academic literature of a *conditional* resource curse (Torvik 2002, Mehlum et al. 2006; Robinson et al. 2006), moving beyond the earlier unconditional view of the resource curse (Sachs and Warner 1997, 2001; Auty 1994, 2001). By this, it is meant that conditional on the overall level of governance in a country, resources can result in either a curse or a blessing. This stands in sharp contrast to the conventional resource curse hypothesis, where the impact of resources is attributed unconditional blame for the economic under-performance of the average country.

According to the conditional variant of the resource curse hypothesis, below some critical governance threshold, resources may be more likely to lead to negative outcomes relative to a counterfactual of no-resource discovery. On the other hand, countries enjoying strong prior institutions are more likely to be able to harness resource wealth for long term prosperity. For example, Collier and Goderis (2007) show that while the first few years of commodity-price booms benefit resource-rich African countries, the long-term effects reduce output by around 25 per cent relative to the counterfactual. They estimate that for a resource rich country to benefit from its newfound wealth, it must possess the governance levels and institutional quality equivalent to Portugal in the late 1980s. The alternative scenario increases the prospect of plunder and mismanagement. Indeed, recent empirical work has argued that critical thresholds exist in policies and institutions that determine whether resource abundance leads to perverse political choices (Casselli and Tesei 2016) and whether major oil discoveries lead to short-run growth disappointments or not (Cust and Mihalyi 2017).

## **2.1 The emergence of governance initiatives**

The international community has built various rules and guidelines, with notable successes originating from the challenges faced in OECD countries such as the Basel standards for banking, and the WTO for trade. Recent years have seen the wider creation and adoption of codes and standards that are more obviously of relevance to the specific challenges faced in development and by developing countries. Examples include the International Court of Justice, the international monitoring of elections, as well as environmental codes and more recently best practice guidelines for the extractives sector.

Since the beginning of the most recent commodity-price super-cycle, starting in roughly 2002, a multitude of guidelines, codes, best practice manuals, scorecards and assessment tools have been proposed.<sup>4</sup> Many of these have explicitly targeted the governments of resource-rich countries, seeking to provide them with additional tools to navigate policy choices and otherwise act to improve governance in the resource sector.

A pioneer in the extractives sector was the Kimberly Process Certification Scheme (KPCS). This international certification and monitoring initiative emerged in response to concerns around resources being used to trigger and sustain violent conflict, in the hope of regulating the trade of so-called blood diamonds.

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<sup>4</sup>An extensive list of these is included in Hodge (2017).

Subsequent to KPCS, the most widely adopted has been the Extractive Industries Transparency Initiative (EITI), initiated in 2002, which encourages action by both government and companies to release information about the tax revenues received and paid in the course of extraction.

Since KPCS and EITI, others have followed such the Natural Resource Charter, the African Mining Vision, the US legislation in section 1504 of the Dodd Frank Act, as well as private sector efforts such as the ICMM principles laying out good practice guidelines for mining companies.

### **3. What are the governance challenges posed by resource wealth?**

Resource wealth creates several additional challenges for developing countries and their governments. First, the presence of resource wealth may make aspects of governance harder, regardless of the institutions the country inherits prior to discovery. Drivers of this challenge arise from the rents or revenue windfalls associated with resource extraction. Such rents can often be a magnet for elevated public expectations of public service delivery. These expectations may be hard to fulfil, particularly within time frames that may not align closely to the production lifecycle of the extractive sectors. Further, resource extraction and rents raise difficult challenges of balancing inter-temporal and inter-generational priorities. The non-renewable nature of such resources makes the inter-temporal trade-offs much sharper than is the case with the proceeds from other public assets. Finally, populist policies can become more tempting and viable when large revenue windfalls are available for distribution, even at the expense of these inter-temporal trade-offs. Combating such populist tendencies is a difficult task for governments of all stripes and competencies.

Second, improving institutions is made more challenging, in the face of resource wealth, especially for countries possessing relatively weak institutions at the time of discovery. This can be due to vested interests, their inherent reluctance to give up power and the fact that it can become harder to dislodge incumbents who now possess extensive rents to support their campaigning; for example, see Bawumia and Halland 2017.

Third, resource wealth can serve to undermine the very institutions that need to be strong and strengthened during the period of resource exploitation. Governments seeking to meet public expectations or political commitments for increased spending, including on public goods, may be tempted to pressure Central Banks to play a more political role- such as occurred in Ghana after its discovery of oil in 2007; see Bawumia and Halland 2017. Such pressure can undermine the independence of such institutions, weakening their strength to pursue their main objectives of monetary prudence and price stability more generally. Similarly, resource windfalls can create pressure to flout fiscal rules and other checks and balances on government spending that might not otherwise have been tested. In the extreme cases, institutional quality can actually deteriorate in the face of resource wealth.

Finally, resource wealth can make governance reforms harder to implement and ultimately less likely to succeed or survive political cycles and changes of government. This is due to the increased vested interests around current ways of managing the sector, compounded by the scale of rents available to those engaged in the sector - either via the private or public sector. Furthermore, any reforms that seek to disrupt these vested interests may face forceful challenges and ultimately be overturned when governments change (or, in the worst cases, are overthrown).

#### 4. What is the rationale for codes and standards?

The resource sector—and the various challenges discussed above—exemplifies why there is a potential role for standards and codes that are overseen by various external agencies such as the EITI. The special characteristics of the resource sector means that the potential usefulness of codes and standards is higher than elsewhere in the economy.

First, due to the scale of government revenues in resource-dependent countries, the demand for ODA (Overseas Development Assistance) may be lower than for countries otherwise similar in income or poverty characteristics. Aid tends to be associated with institution-building—at least in its intent with respect to multilateral aid and bilateral aid from OECD-DAC donors. By contrast, inflows of resource revenues have little institution-building imperative (including better regulation of the sector itself) and therefore may be more open to abuse and less likely to generate such outcomes.<sup>5</sup>

Second, the governance challenges and risks posed by resource extraction mean that there is likely to be a premium on getting in place rules and safeguards early (and preferably prior to exploration and exploitation) when policy decisions may already have been made that influence whether the resource-sector has a positive or negative economic (and social) impact over the longer-term. Making a bad rather than a good deal in the very early stages of developing a resource sector, can cast a long shadow – with negative consequences persisting into the far future.

Third, the process of exploiting resource wealth is far from smooth: the number and size of deposits discovered and then exploited is ‘lumpy’; many years may elapse between investments, so that current policy makers have little experience. Such timeframes are compounded by the number of economic agents involved (who may have considerably more experience than governments), all implying that governments may have very few ‘rounds of the game’ in which to ‘experiment’ and get policy right. This limits the opportunities for learning by doing, and for mid-course corrections based on experience. These characteristics of the sector magnify the *ex-ante* value of peer learning as well as drawing from international and historical experience.

Finally, good or bad resource governance has spillovers- both internationally and inter-generationally. The social benefits to good national resource governance may exceed the gains to any individual government administration. Meanwhile bad governance can lead to regional instability, expropriation of international investors, or disruption in resource supply chains relied upon by resource importing countries and consumers worldwide. Such features create a case for provision of global public goods in the form of efforts to bolster strong governance in resource exporting countries.

##### 4.1 The policy maker’s dilemmas

Policy makers also face a series of dilemmas. Policy mistakes during a boom are costly, but with slow feedback loops. For example, the policy lessons from the 1970s commodity boom only emerged once that boom was over in the 1980s. Likewise, the full implications and lessons from the recent commodity price super-cycle may not be fully known for several years, limiting the ability for governments to react and respond in a timely manner. This is especially the case in those

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<sup>5</sup>It is important to note that both resource revenues and ODA as sources of external finance may be seen to delay or deter governments building a tax base among the general population, which in turn may weaken the social contract. Authors such as Besley and Persson (2013) argue for such mechanisms.



countries where the resources profile is limited in duration to a decade or two. Strengthening governance is a slow process. The payoff to reforms likely exceeds the length of the political cycles of many countries under the normal conditions of multi-party democracy, leading to delay and underinvestment in the necessary institution-building.

Furthermore, the needs of the private sector may run counter to citizen priorities. Decision makers must grapple with how to balance this trade-off. For example, the trade-off over the speed of the investment and the jobs and revenue it brings, versus the need to protect the rights of the community as well as the natural environment and future generations.

Given this context, external codes can bring credibility and rigor. They can provide a general reference for best practice. This in turn can lower the costs of understanding and information by helpfully collating experience and viewpoints into a single location, for governments to then draw upon. This can be particularly valuable for governments in countries with weak technical capacity in key ministries; they do not have to start from scratch when a well-developed body of knowledge and practice and associated technical guidance is available to them.

Furthermore, by providing a general reference that draws on international expertise and experience, these external codes can provide a credible source for best practice - thereby cutting through politicized domestic arguments and allowing every country to benefit from countries who have followed a similar but earlier path.

In addition to providing a useful point of reference, external codes can also provide a potential anchor for political commitment. Decision makers can 'bind themselves to the mast' of an external code, or codes, thus restricting their own governments', or successive governments' ability to deviate from particular policy choices. In technical jargon this can help overcome the time-inconsistency associated with many policy dimensions of resource management.

External codes that require changes in behaviour - such as the EITI which requires countries to make transparent the tax receipts and other information associated with the extractives sector - may have, or appear to have, costs for politicians. However, such costliness can operate as a positive feature rather than as a limitation; it acts as a signal of 'type', whereby the cost is greater for politicians engaged in corruption, compared to the honest politicians who are not. This may help build political coalitions that support honest politicians leading to real improvements over time.

## **5. What is at stake?**

The governance challenges of harnessing non-renewable resources begin with the decision to open the country for exploration and prospecting, and then span all the way through to choices around the spending of revenues and to the development path of the country beyond the lifetime of the resource wealth. Furthermore, the challenges relate to the public sector, to the private sector as well as to the role of international companies and to cross-border challenges. Guides such as the Natural Resource Charter discuss the trade-offs and choices countries face. Historical experience points to both successes and failures at each stage of the so-called 'decision chain' spanning from the decisions by a country to explore and extract, through to how it uses the proceeds to support sustainable development.

First, normative guides typically point to the high cost of failure. Policy missteps and mismanagement of extractive wealth has carried a significant price for some developing countries.

Between 1997 and 2002, for example, around US\$4.2bn of revenue ‘disappeared’ in Angola—more than the country’s total ODA receipts for that decade (IMF 2012). For the period 2007–10, the IMF found US\$32 billion in unaccounted government funds, equivalent to a quarter of Angola’s annual GDP. Despite its oil wealth, Angola ranks 148th on the Human Development Index. Similarly, numerous reports of missing money emerge from Nigeria on a regular basis. Between 2010 and 2012 the Africa Progress Panel (2013) reported a missing US\$6.8 billion lost because of corruption and mismanagement of fuel subsidies. Meanwhile, the Petroleum Revenue Special Task Force identified losses of US\$29 billion (FMPR 2012). On the other hand, key policy levers can yield big benefits when they are implemented well. In Papua New Guinea, for example, a US\$10m World Bank loan combined with support for governance reforms leveraged over US\$1.2bn in private investment over the subsequent decade.

The opportunities for gains are no less significant in revenue and public expenditure management. Mexico was able to save \$5bn in potentially lost revenues during a price dip in 2009 by means of careful hedging against future oil prices (FT 2012). This amount was equivalent to 7 per cent of government revenue, and just under half of total foreign direct investment (US\$11.4bn). Nigeria’s reform of public procurement delivered similarly major benefits in the efficiency of public spending. Prior to 1999 the government lost an average of about US\$300 million each year from corrupt practices in public procurement (Okonjo-Iweala and Osafo-Kwaako 2007). Since the reform of the procurement system the federal government has saved an estimated US\$1.5 billion over the period 2001–07 in the form of better contract prices, while the initial prices quoted by various government contractors have also declined significantly.

The stakes are high but the potential gains can be higher. Between the late 1960s and 2000, Botswana, for example, has recorded an average growth rate of 7 per cent per annum. That has supported average growth in primary school enrolment of 4.8 per cent per year, every year. In contrast, the Democratic Republic of the Congo (DRC) collected only US\$92 million in minerals taxes and tariffs on estimated mineral exports of \$2 billion in 2008 (Bauer and Quiroz 2013). Cameroon has been estimated to collect roughly 12 cents on the dollar for its oil; Norway 78 cents on the dollar (*ibid.*). Such gaps may emerge from different hidden costs to companies, arising from political risk or instability. On the other hand, governments may be able to catch more revenue via better negotiated deals or fiscal terms.

## **6. Examples of codes and standards**

During the recent commodity super-cycle a wide range of external codes, standards and best practice guides were created and recommended for adoption by resource-rich counties. Some have focused on economic policy making, such as the Africa Mining Vision or Natural Resource Charter. Others have focused on anti-corruption and transparency such as EITI, while a final category such as the International Council on Mining and Metals (ICMM) principles or the International Finance Corporation (IFC) Performance Standards have concentrated on the private sector’s role and responsibilities as an effective development partner to government. Our focus in this paper are those addressed primarily to governments and those engaged in policy making and design.

### **6.1 The benefits of transparency**

Transparency’s benefits as a potential pathway to increased accountability are widely espoused. Indeed, much effort has been put into changing the transparency behaviours of key actors in the resource sector such as governments and operating companies. There is good evidence that

behaviour change has occurred. However, scientific evidence for the impact of changing transparency—such as the role it may play in delivering reduction in corruption, conflict or increased accountability—has proven elusive.

International voluntary standards such as the Extractive Industries Transparency Initiatives have proved effective in changing practices around the disclosure by governments and companies of payments made for resources. Between 2003 and 2008, over 150 companies and their affiliates reported under the EITI process in Africa, covering over US\$130bn in revenues paid to governments. Such efforts have spurred binding 'publish what you pay' legislation now passed in Norway, Canada and the EU and new listing requirements now required on the Hong Kong Stock Exchange. The Dodd Frank initiative (section 1504) which (before its repeal in 2017) required disaggregated reporting of payments would have applied to 90 per cent of the world's largest internationally operating oil and gas companies, as well as eight of the world's ten largest mining companies.

Some of the best evidence we have is related to transparency and the cost of capital. Glennerster and Shin (2008) find that countries that choose to become more transparent experience lower borrowing costs. Henisz et al. (2011) find that close to two-thirds of the market capitalization of 26 publicly traded gold mining companies are a function of on-the-ground stakeholder engagement practices and political risk, whereas only 37 per cent is a function of the value of gold they control.

## **6.2 Extractive Industries Transparency Initiative**

EITI was created on the back of growing civil society pressure for transparency in the resource sector. The idea was first floated by Tony Blair, the UK prime minister at a conference on sustainable development. A coalition of international and domestic non-governmental organizations (NGOs) took shape in 2003, and operated under the name of Publish What You Pay. The formation of EITI followed soon after. EITI's original mission and mandate was to help alleviate corruption, both perceived and real, in the extractive sector, by revealing to the public the amount companies were paying in taxes to government and to reconcile those numbers against what governments reported receiving.

The first countries announcing their intention to join EITI came in 2003. To achieve EITI 'compliance' countries had to successfully complete Reconciliation Reports which compiled both company disclosures with government reported receipts and reconcile the two sets of information. This was conducted by an independent administrator.

In 2013 a new EITI Standard was adopted which updated the rules of the initiative, broadening the focus to encompass a wider set of transparency measures. The initiative has seen a broadening of focus to include transparency on other dimensions of resource sectors including more contextual information about sectors, production, contracts, beneficial ownership of licenses and so forth.<sup>6</sup>

Between 2003 and 2017, some 52 countries announced implementation; and are at various stages towards compliance with the rules of EITI.<sup>7</sup> Of those, 46 have published revenue numbers in some form, while the number of fully 'compliant' countries stood at 26 in 2016.

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<sup>6</sup><https://eiti.org/document/standard> (accessed on 26 October 2017)

<sup>7</sup> The withdrawal of the US from EITI in late 2017 has subsequently reduced this number to 51- see <https://eiti.org/explore-data-portal> (accessed December 16, 2017).

### *Has EITI had a positive impact?*

Measured in terms of uptake EITI has become a widespread standard for resource-rich countries. This has led to behaviour change in many as EITI reports contain published revenue numbers that would otherwise not be available in the public domain in the same form.

While setbacks such as the 2017 withdrawal of Azerbaijan and the United States demonstrate that backsliding can occur, new countries continue to join. The swelling number of members indicates a strong appetite and momentum for signing up to EITI's goals. The number of countries publishing revenue numbers is also high reflecting more than mere tokenism in the intentions to implement EITI rules. However, evaluating positive attributable impacts to EITI is a tricky task and one that a burgeoning number of evaluations are attempting to take on.

There are several examples of potentially attributable impacts of EITI membership—i.e. those that would not have occurred in EITI's absence. For example, Nigeria's 2005 EITI report shows that over US\$500 million in oil taxes had not been collected or had gone missing; this is more than seven times the amount the government spent on agriculture that year (EITI 2005). In 2012, a Nigerian EITI report uncovered \$800 million in discrepancies between what companies said they paid and what the government received, an amount exceeding the individual budgets of the ministries of health and education. Of the US\$800 million, US\$560 million proved to be a shortfall in company payments (EITI 2012). According to De Sa (2013) EITI reports between 1999-2008 identified a loss of US\$2.6 billion in revenues and a failure by oil companies to pay US\$9.9 billion in royalties. These findings have enabled Nigeria to recover US\$2.4 billion to date. In Tanzania, the EITI analysis showed that companies paid lower taxes for extraction than the withholding tax paid on income payments to employees in 2008.

These findings are supported by other anecdotal stories. For example, the interest spread on Nigerian government bonds (above US Treasury bonds) dropped from 13 to 6.9 per cent between 2002 and 2003 and continued to decline steadily through 2006 as Nigeria implemented the EITI and adopted strong transparency measures.

EITI's supporters argue that examples of discovered discrepancies—which are potentially recoverable—may alone justify EITI's financial expense, as well as the political capital it entails. However, such isolated cases are hard to falsify or evaluate scientifically—for example how much of these discrepancies could and would have been found by other means remains unknown. A further challenge posed for those seeking to evaluate the impact and success of EITI is the lack of a clearly articulated theory of change—an expression of how EITI might be expected to make its impact and therefore to identify some measures of success or failure more rigorously.

A useful activity would be to ground future EITI activities and strategy in a framework that facilitates both rigorous testing of impact, but also the potential for falsification of the underlying and implicit theories of impact. The expansion of the EITI Standard may offer opportunity to stagger rollout of certain reporting features, allowing for an experimental testing of impact between countries.

### *Has EITI improved the availability of information about public revenue from extractive resources?*

One metric by which EITI might reasonably be evaluated is a proximate operational measure of success such as the actual availability of published government revenue data from extractives. A metric such as this may not connect directly to impacts or outcomes, but might be a good gauge of the healthiness of the initiative, especially in a sector where policy impacts and desired outcomes,

such as reduced corruption are likely to be very hard to measure directly and may in any case take a long time to manifest themselves.

The availability of published government revenue data from countries adopting EITI is one of EITI's core requirements, and a chief mechanism by which EITI may, in principle, achieve its impact. As noted earlier 46 countries had by 2015 published government revenue numbers in some form during the period under review. A key question is whether this is a big number or a small number relative to what information may already be available via other means? Other questions are: what additional value such publishing might bring, if any and whether it is likely that such additional disclosures may have an impact on behaviour.

The case of Africa is a good example to examine in addressing these question since this is a continent characterized by relative opacity in the extractives sector and poor data collection systems in some countries (Jerven 2013). Taking 2010 as a sample year, for which there is coverage from three different sources, we see resource revenue figures within sub-Saharan Africa from 21 countries in EITI reports, 18 countries in IMF research, and 12 in the International Centre for Tax and Development (ICTD) database, with only limited overlaps.<sup>8</sup> For additional analysis, including comparisons for 2014, please also see Mihalyi and Fleming (2017).

This implies that EITI is reaching countries that otherwise do not have available data. Additionally, it improves our picture of government revenue data for the Africa region as a whole. However, there are several caveats to consider. First, these revenue numbers remain non-comparable across countries due to inconsistencies in the EITI reporting formats. Steps are now being taken to align reporting fields with the IMF GFS (Government Finance Statistics) methodology and may yield greater consistency across countries and time.<sup>9</sup> The second challenge is data quality, which remains a challenge in EITI reporting countries due to the approach of self-reporting and reconciliation; this does not align to IMF data collection standards that would make such data suitable for inclusion in official statistics. Finally, the reporting is too infrequent and unpredictable to lend itself to time-series analysis or comparison for EITI reporting countries, although progress is being made to reduce the time lag of reporting.

The IMF and World Bank are yet to include EITI reported numbers in their statistical databases, while few governments currently report EITI revenues as part of their official government statistics. It is hoped that improvements to methodological consistency and alignment, alongside improvements in timeliness and data quality can elevate EITI data to a status equivalent to that of the data from international institutions.

#### *How has good governance evolved in EITI adopting countries?*

Adoption of EITI does not occur in a vacuum. As such it is worth reflecting on the wider governance environment surrounding EITI. Various hypotheses around EITI adoption have been considered. For example, it might be argued that adoption is associated with a reforming government, in which case we might expect to observe other governance indicators improving concurrently to EITI. This would not necessarily imply causality from EITI, but may be reflective of the more positive governance steps being taken at the same time. In contrast, we might hypothesize that EITI implementation could be accompanied by backsliding on other governance indicators, whereby governments use such initiatives as an international 'fig-leaf' of reform,

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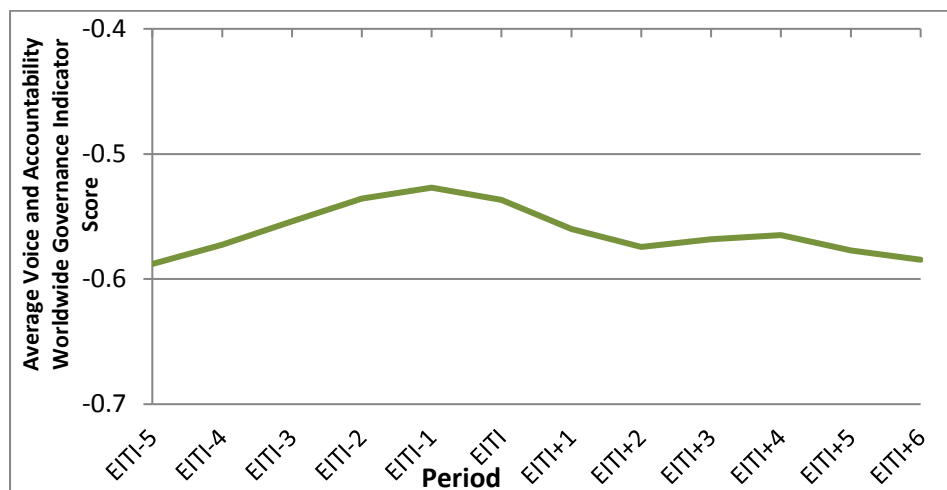
<sup>8</sup><http://www.ictd.ac/datasets/the-ictd-government-revenue-dataset> (accessed on 26 October 2017)

<sup>9</sup><https://eiti.org/document/eiti-summary-data-template> (accessed on 26 October 2017)

meanwhile neglecting more impactful or costly reforms, or even reversing good governance progress.

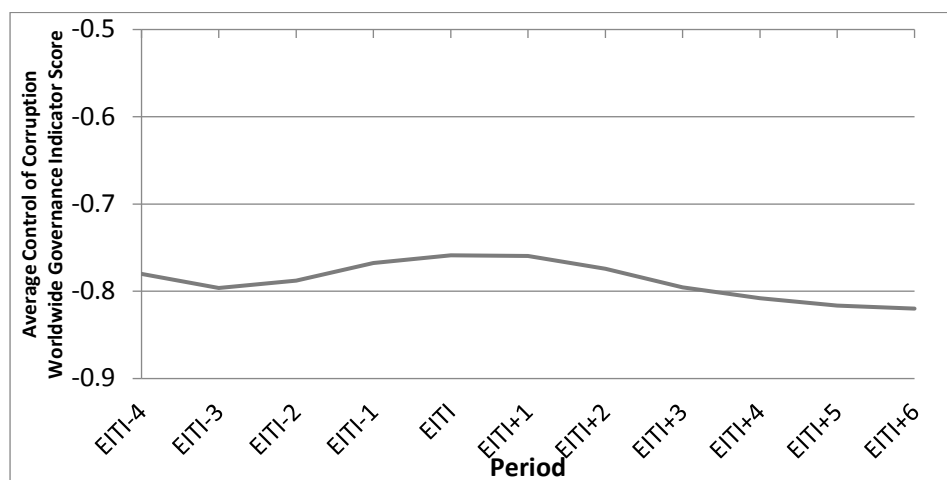
Figure 1 and Figure 2 plot the evolution of other measures of good governance before and after accession to the EITI initiative, drawn from material by Kaufmann (2014).

Figure 1: Evolution of Voice & Accountability Indicator for countries in EITI (pre- and post-accession)



Notes: Calculations performed with 35 countries in EITI with data following EITI accession; all are emerging/developing countries (excl. Norway). Conservative assumptions regarding trend in recent years. Source: Kaufmann 2014, adapted from World Bank Worldwide Governance Indicators.

Figure 2: Control of Corruption for EITI countries



Notes: Calculations performed with 35 countries in EITI with data following EITI accession; all are emerging/developing countries (excl. Norway). Conservative assumptions regarding trend in recent years. Source: Kaufmann 2014, adapted from World Bank Worldwide Governance Indicators.

While the observed trends do not show any strong evidence for backsliding, nor do they show significant improvement in two other broad-based measures of governance such as the control of corruption. If anything, this provides more support for the hypothesis that EITI adoption is not part of a broader reform package but may even be used domestically to delay or substitute for alternative domestic reforms. This in turn may give cause for reflection on the way EITI may complement or substitute for other reforms and whether one might expect improvement in other indicators to be associated with its adoption as a broader metric of success.

## *Reflecting on the first decade of EITI*

Various studies have been conducted with the objective of evaluating the success and impact of EITI. These have ranged from qualitative studies with a focus on operational and managerial performance, through to quantitative studies seeking to identify evidence for cross-country trends or impacts resulting from EITI's adoption.

Most recently, Rustad et al. (2016) have examined the objectives and successes of EITI. They note that '*..in many ways the EITI has succeeded in terms of reaching its institutional goals and some of its operational goals, in particular when it comes to producing annual reports. The EITI has through several measures engaged the civil society groups, particularly through the Multi-Stakeholder Group, but seems to have failed to empower the public to hold the governments and companies to account.*' However, they caution that evaluations of EITI may not have thus far used the right criteria to measure success.

As noted in a recent GIZ review of EITI (GIZ 2016) a number of authors express concern regarding the lack of results-based monitoring and evaluation systems and/or demand their improvement (e.g. EITI Scanteam 2011, MSI Integrity 2013 and Scanteam 2015). The same GIZ study concludes that it was difficult to establish the views held by stakeholders outside of those directly participating in the initiative. Supporting evidence for the EITI's impact is largely either anecdotal or based on the perceptions of stakeholders belonging to the 'in-group' – those NGOs, donors, private sector actors and other experts involved either via the EITI board, membership of EITI multi-stakeholder groups, or otherwise engaged in extractives transparency directly.

As noted earlier, over the period 2003-17, 52 countries announced implementation and have reached various stages towards compliance with the rules of EITI. Of those, 46 have published revenue numbers in some form, while the number of fully 'compliant' countries stands at 26 in 2015. This constitutes a significant scaling up of the initiative as a truly global effort, spanning fragile states, LICs and MICs, as well as high-income OECD countries. EITI's spread accompanies, and may in part be responsible for, a spreading norm of transparency in the extractives sector. For example, contracts are increasingly being disclosed. This trend began before its inclusion in the new EITI Standard as a reporting recommendation. While it remains only a recommendation rather than a requirement under EITI, many hope that its inclusion may further raise the profile of this emerging norm and help it spread to other jurisdictions.

Furthermore, many evaluations and commentators praise EITI for its role in providing a platform for dialogue among stakeholders in countries where other avenues for such dialogue may have been difficult or even impossible. This is certainly not the primary aim of EITI, nor where the bulk of the political or financial capital is expended, however it may constitute a valuable ancillary benefit.

An emphasis on promoting transparency in poor governance environments may be risky according to leading academics researching the role of governance in economic development. Acemoglu and Robinson (2013) note that marginal reforms of the resource sectors such as EITI might even make things worse. One issue they point to is that the feasible path out of poverty for most countries with poor institutions is a messy one involving much compromise and many bargains. In such circumstances, a feasible model of developmental patrimonialism may well involve tolerating some amount of extraction of resource rents and other aspects of patrimonialism by the elite in exchange for allowing institution building elsewhere in the state, for example, allowing the development of other fiscal bases such as a value-added tax and perhaps the building of the bureaucracy that can

be a constraint on worse abuses in the future. In certain circumstances Acemoglu and Robinson argue that an obsession with the application of EITI might be counter-productive.<sup>10</sup>

Looking ahead, experts are now increasingly pointing to the challenge of ‘managing expectations’ and to the task of building an informed citizenry (Collier 2017) to hold government accountable and to demand good governance in resource rich countries. Here a norm of transparency, platforms for dialogue, and a vibrant civil society that can help citizens understand choices made in their extractives sector may all prove invaluable tools in the challenges ahead.

However, as noted in various evaluations of the initiative, EITI has thus far fallen short of engaging the wider citizenry in taking steps to hold decision makers to account. It finds a significant political and financial capital expended on the production of complex reports with a significant time lag. While EITI has been successful in terms of widespread adoption and significant shifts in resource sector transparency, it remains to be seen whether EITI can prove itself an effective tool in building an informed citizenry around natural resource revenues and practice, and whether that can help create an effective bulwark against corruption and populism.

### **6.3 The regulation of conflict minerals**

One of the resource curse mechanisms identified in the research literature is the role of conflict. Here resources may act as a trigger but also as a means of sustaining the financing of conflict, thus contributing both to conflict incidence and duration (Berman et al. 2016; Collier and Hoeffler 2004; Ross 2014).

Valuable minerals produced by small-scale mines, so-called point source minerals, can be easily appropriated by despotic governments, warlords, and militia, compared to resources such as oil which require more capital-intensive and technically sophisticated extraction, or agricultural products which have relatively few rents associated with them, and where any rents are more geographically disbursed. Furthermore, minerals with high value to weight ratios are also well-suited to illicit trade and can be used to buy arms. As such certain minerals are particularly susceptible to being connected to conflict (Lujala et al. 2005). These include gold, diamonds, silver, coltan, gemstones and some other precious metals. Most famously, ‘blood diamonds’ financed armed conflicts in West Africa and led to the establishment of the Kimberley Process, a cooperative venture between governments, the diamond trade, and NGOs, under which the conflict free origin is certified.

The Kimberly Process Certification Scheme (KPCS) was established by the UN in 2003. It is supposed to ensure that revenues from the diamond trade are not financing violence by rebel movements and undermining legitimate governments. KPCS also requires member countries to collect and publish data on mining and international trade in diamonds.

In addition to the Kimberly Process, governments and the international community have sought other means to decouple resources and conflict via a variety of policy mechanism and market instruments. The United States was the first to legislate (the Dodd Frank Act); but the EU is following closely behind. In 2010 the US passed with Dodd-Frank Act or Wall Street Reform Act which included provision 1502 aimed at stemming the trade in conflict minerals (a broader

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<sup>10</sup><http://whynationsfail.com/blog/2013/9/12/what-could-be-wrong-with-extractive-industries-transparency.html> (accessed on 26 October 2017)



definition than the diamonds covered under Kimberly). Here the rules put the onus on companies rather than via a certification scheme, with the objective to improve supply-chain management to ensure minerals were not being sourced from conflict affected regions, in particular the Eastern DRC and neighbouring countries.

What has happened? Since the introduction of these schemes the buyers of valuable minerals have been deterred from sourcing their raw materials from the DRC and neighbouring countries. This has reduced demand in these countries which has impacted the ability to finance conflict, but may have also harmed livelihoods for miners and their families. Further consequences have included a deterrence effect for sourcing from artisanal miners, who may be less able to validate their supply chains compared to larger-scale mines or traders. Debate continues as to whether the improvement in security has been significant, and if it has, whether it exceeds the damage to livelihoods of some of the poorest people in the world (Seay 2012 and Parker et al. 2016). The OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas may also support efforts to mitigate the trade in illicit minerals and conflict minerals.

#### **6.4 Best practices and economic policy guides for policy makers**

Several initiatives have focused on the challenges faced by policy makers with particular reference to the economic governance of resources. Here in brief are some further examples.

##### *Africa Mining Vision*

Created by the members of the African Union in 2009, the AMV<sup>11</sup> is a policy framework designed to lay down principles for individual countries to harness their mineral wealth for economic development.<sup>12</sup> It is intended to provide a rubric for promoting broad-based benefits from mineral exploitation, and to help shift the sector beyond enclave development to becoming a more integrated sector to the rest of the economy. An action plan followed in 2011 that laid down the need for a specialist agency to oversee continental implementation of the AMV and nine clusters of activity across different policy priorities.

The AMV covers various policy considerations along the mineral value chain, from issues around exploration and project development, through taxation, safeguards, to revenue management, downstream value addition and linkages to the rest of the economy. The AMV emphasizes resource-driven development, pointing to the potential positive benefits from resource exploitation in contrast to the more pessimistic view of resources impact on prosperity identified in the academic literature on the resource curse. The AMV does however note the centrality of good governance to achieving the goals laid out, including support for transparency and certification schemes, thus internalizing the conclusions of the conditional resource curse thesis; namely that conditional on getting governance right, resource wealth can be a blessing (van der Ploeg 2011; Ross 2014).

Country Mining Visions are the mechanism by which the AMV is intended to be translated into practical policy prescriptions at the country level. Intended to bring together dialogue among different stakeholders (government, industry, and civil society), the CMVs are intended to be an

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<sup>11</sup><http://www.africaminingvision.org/> (accessed on 26 October 2017)

<sup>12</sup>The AMV was developed by the United Nations Economic Commission for Africa on behalf of the African Union Commission and was universally adopted by AU Heads of State.

inclusive and deliberative policy setting process. The African Mineral Development Center was created to support the implementation of CMVs.

Eight years after its inception, questions remain over the slow pace of implementation, and whether it is meeting the purposes for which it was created (Oxfam 2017). Despite being endorsed by all 54 member states of the AU, by early 2017 only one country, Lesotho, has fully adopted the AMV through the development of a Country Mining Vision. Oxfam point to the lack of engagement with civil society as one of the shortcomings of the approach.

### *Natural Resource Charter*

The Natural Resource Charter<sup>13</sup>, launched in 2009, is an exercise to synthesize best practice lessons from country experience and academic research. The twelve precepts of the NRC identified the key ‘links in the chain’ countries needed to get right to successfully transform subsoil resources into economic prosperity, without compromising sustainability.<sup>14</sup> The Charter recognizes the fragility of the process of resource exploitation and that any weak link in the chain could push countries onto a pathway towards the resource curse. It therefore emphasizes a holistic policy perspective to addressing gaps and key shortcomings to ensure the whole process is managed carefully (Cust 2013).<sup>15</sup> In addition, it emphasizes the important role of an authorizing environment that spans traditional government ministries, noting that the challenges of resource wealth spans ministries of energy, minerals, finances, and environmental agencies, tax administration and those responsible for national development strategies.

Spanning issues from exploration, contract negotiation, taxation, revenue management and investing for sustainable development, the Charter identifies key recommendations as well as policy trade-offs that countries need to consider. It does not provide a one-size-fits-all prescription, but rather a compilation of the policy ingredients that had proved successful in different country contexts. The precepts capture the high level general principles of successful resource management that can be achieved via different means.

The Natural Resource Charter empathizes the role for both careful policy design and engagement with an informed citizenry. It recognizes the need for governments to get decision right early and continuously, but that the only longer-term protection against the resource curse would come from an environment of accountability to citizen demands and responsiveness of the state.

The implementation of the Natural Resource Charter at the country level is applied via the NRC Benchmarking Framework. This toolkit provides the means for countries to self-assess against the twelve precepts of the NRC to identify policy gaps and shortfalls. This then allows the formulation of a policy action plan that can help countries lay out the policy priorities. The NRC benchmarking framework has now been applied in a range of resource-rich countries—including Nigeria, Tanzania, Sierra Leone, and Myanmar. In 2013, the Natural Resource Charter was merged with the Revenue Watch Institute to form the Natural Resource Governance Institute—NRGI is now

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<sup>13</sup><https://resourcegovernance.org/approach/natural-resource-charter> (accessed on 26 October 2017)

<sup>14</sup>The Charter was led by a distinguished Oversight Board, chaired by Ernesto Zedillo, the former President of Mexico, and accompanied by Mo Ibrahim, Shengman Zhang, Luisa Diogo and Abdulatif Al-Hamad. Its content and recommendations were developed and maintained by a Technical Advisory Committee chaired by Michael Spence, Nobel Laureate in Economics, and joined by leading academics and practitioners including Paul Collier, Tony Venables, Karin Lissakers, Joseph Bell, Bob Conrad, and Michael Ross.

<sup>15</sup> In the interests of full disclosure, it should be noted the author of this chapter served as the founding staff member and led the secretariat of the Natural Resource Charter.

a leading organization in the field of improving the governance of natural resource wealth in developing countries. It is also the main implementing agent for the NRC, however it also provides an open license for other NGOs and governments to use the benchmarking toolkit independently.<sup>16</sup>

## 7. Critical reflections

The purpose of the international codes, standards and initiatives discussed here is to foster and support the adoption, implementation and embodiment of policies and institutions for the good governance of extractive resources.

The role of good governance is widely agreed to play a fundamental role in determining the economic performance of countries; however, less is known regarding the steps and time it takes for a country to move from a situation of weak governance to one of stronger governance. In the case of resource-rich countries this challenge is exacerbated by the role such resources play in shaping and distorting economic and political incentives. Indeed, extractive resources can fuel a situation where governing well is made harder by the rents they provide to governments. This in turn can create incentives that serve to undermine or weaken institutions, such as circumventing checks and balances, or fostering a culture of corruption and patronage. In turn, the resources that are hard to govern may also make other political and economic reforms harder and less likely to succeed.

Various proposals have been advanced for normative measures that may help countries strengthen governance of the resource wealth, while avoiding policy missteps made historically in other countries. These include increasing transparency in the resource sector (EITI), creating supply chain checks against minerals sourced from conflict (Kimberly Process), and by pursuing policy choices and development strategies that have proved robust in other settings (Natural Resource Charter, African Mining Vision).

It might be unreasonable to expect good governance initiatives such as the EITI to yield large and observable effects in a relatively short space of time. It might even be unreasonable to expect them to succeed with a high degree of probability. Neither factor invalidates the importance of their pursuit; the payoffs might be slow to emerge but potentially large when realized even with a low probability of success in any given country. However, the extent of the challenge, or the pace of underlying change should also not preclude a rigorous approach towards measuring and reporting impact, as well as articulating a testable and falsifiable theory of change.

While tangible success on changing policy and embedding best practice has been hard to identify this does not imply the focus is incorrect. Given the time profile of extraction—requiring upfront policy choices that determine the path for years to come—the need for urgency is inherent. The policy choices made by governments today can have long-lasting repercussions for current and future generations. Therefore, efforts to support improved policy making today, even in the context of other institutional weaknesses, may be justified on the grounds of these long tails of effect and the magnitudes of money involved.

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<sup>16</sup><https://resourcegovernance.org/analysis-tools/tools/natural-resource-charter-benchmarking-framework> (accessed on 26 October 2017)

## 7.1 Downsides of codes and standards

However, such external guides can have downside risks too. Successful policies and institutions as operated in one setting are not always straightforward to replicate in other contexts; indeed, in some cases what has proven successful in one country may prove inappropriate or unsuccessful in another. Countries must carefully navigate the path between what lessons can reasonably be drawn from international experience and what is likely to be feasible and effective in a domestic setting. Doing so in the face of strong political and populist pressures unleashed by resource-wealth can be especially difficult.

Learning what works, and what does not, also takes time. Given the uncertainty associated with any given reform or policy action to improve governance, a learning process is likely to play an important role. There is however a high opportunity cost to initiatives that require significant investment of money and political will.

A recurring concern regarding successful governance initiatives is their ability to learn, adapt and respond to emerging evidence and changing circumstances on the ground. The Kimberley Process has struggled with controversy around its effectiveness in stemming the flow of conflict diamonds, but also its struggle to update definitions of conflict diamonds given the evolving role of diamonds that may be profiting state actors engaged in conflict. The Extractive Industries Transparency Initiative has likewise faced challenges in terms of expanding scope and whether reforms to the standard agreed centrally are feasible or desirable for all member countries to adopt. The link from some improvements in transparency to better development outcomes or increased accountability remains tenuous and hard to identify.

## 7.2 Looking ahead

Norms ranging across transparency, competitive license allocation, getting the right saving-spending balance and building strong institutions for checks and balances such as fiscal rules and accountability bodies, are spreading internationally. The pace of their adoption and retention can feel slow, but such governance reforms are likely to take time and are at constant risk of backsliding and being undermined in the face of price declines such as those seen after 2011 and rising populism.

In addition, the gradual spread of the ‘good governance’ norms, the process of learning about what works and what does not, is well underway. Several countries have recently experienced resource booms for the first time, and some of these are learning their own lessons of what to avoid in the future. Similarly, international initiatives have the advantage of being able to share and spread lessons and experiences with relatively low transaction costs; as such reforms to the global approach can permeate quickly to the country level: an example is the new EITI Standard.<sup>17</sup>

Finally, the end of the recent super cycle of commodity prices, and the prospect of potentially permanently lower prices for fossil fuels due to global decarbonization, creates potential positive opportunities for improved governance. First, low prices reduce the rents that have fuelled rent-seeking, supported vested interests and spurred populist promises and elevated expectations. Second, fiscal budgets are squeezed so there is increased incentive to tighten governance loopholes and crackdown on corruption and other forms of waste. Further, many governments are now

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<sup>17</sup>This centralized reform of EITI rules had almost immediate implications for all 50+ participating countries, who would now be expected to work towards compliance with the new, more expansive, reporting requirements rather than the rules they originally signed up to.

looking to take steps to end fuel subsidies and to correct other ‘poor’ governance choices during high price periods, such as a lack of savings provisions and bad deal-making. The pause in new foreign investment into extractives in some countries buys those countries time to continue the process of institution-building to prepare for future new investments, extraction and revenues.

The future may, however, look quite different from the past when it comes to the governance of extractive resources. First, commodity prices may not recover to the same highs seen during the super-cycle, or the length of such price cycles may not match the recent one. Second, the opportunity for greenfield developments (in terms of non-resource-rich countries entering resource richness) is shrinking as many new producers entered the market during the recent boom. This may have led to the locking-in of poor policy choices and weak institutions that may be harder to fix for next time, not least since vested interest groups have had the chance to entrench their positions. Finally, the urgent threat of climate change and technological breakthrough in carbon-zero technologies, mean that the demand and hence the price for fossil fuels (coal, but also oil and gas) may never recover, or the period of higher prices may be curtailed in the near future by technology substitution<sup>18</sup>. Similarly, depletion of resources during this boom may mean that some countries have few new deposits left to develop.<sup>19</sup>

As such, developing countries may have to prepare themselves for a post-extractive future, one where the diversification of the economy and a strengthening of governance may be no less vital, and may even prove easier in the absence of such large resource rents. For those countries rich in fossil fuel resources, the gradual decarbonization of the global economy may have long-term implications for their economies. While those specialized in minerals and metals may see strong demand extending long into the future. The temporary slowdown in demand across some of these commodities may create a prime opportunity for reflection, lesson-learning and ultimately an opportunity to strengthen governance.

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<sup>18</sup>The link between the climate change agenda and the situation facing extractive industries (both mining and oil and gas) is discussed in detail in *Ouedraogo, Drexhage and Addison (forthcoming, 2017)*, who also explain the important differences that are likely to apply to minerals as opposed to fossil fuels.

<sup>19</sup>However, many have significant resources left untapped. Among fossil fuel rich developing countries, the median time to depletion exceeds 45 years at current rates of production.

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