

The Challenge of a Transparent Distribution of Natural Resources Revenues as a Step towards Elimination of Poverty and Conflict Outbreaks

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1 Introduction

In many countries, natural resources constitute a substantial part of the total state revenue, bearing a potentially big role in enhancing development and welfare. Particularly in light of rising world prices in oil, gas, and minerals, natural resource endowment at first glance seems to nothing but a blessing for a country.

Despite the high revenues that natural resources generally yield however, many countries have not been able to economically and socially benefit from their natural richness. Academic work has revealed that the abundance of natural resources is indeed negatively linked to a country's development, by harming its economic performance in other sectors, weakening its government, making it more corrupt and less accountable, giving people living in resource rich regions an incentive to form independent states, and finance rebel movements. The risk of political instability in particular increases when the incumbent government is – or is perceived to be – corrupt; a situation that is facilitated or fuelled by the fact that revenues gained from natural resources are often poorly traceable.

However, this adverse impact of resource abundance on economic growth and political stability is by no means an inevitable outcome. Countries such as Norway, Canada, Chile or Botswana prove that – if properly managed – the exploitation of natural resources can indeed serve as a valuable source of funding poverty reduction, economic growth and sustainable development. This study guide shall introduce the delegates into the topic of natural resources, their link to poverty and conflict, as well as national and international transparency approaches for beneficial and sustainable natural resource management. The guide's main purpose is to present a general overview of the subject, facilitating and motivating for further individual research.

2 The Link between Natural Resources, Poverty and Conflict

Natural resources can be generally defined as “any property of the physical environment, such as minerals, or natural vegetation, which humans can use to satisfy their needs”.¹ A distinction is usually made between renewable and non-renewable resources. Renewable resources are properties that generate on a human time scale (i.e. animals and plants), whereas non-renewable resources can only re-evolve over a very long geological time period, so that once being depleted, non-renewable resources will not be available in the medium term future. Although both renewable and non-renewable natural resources may effect a country's economic and social development, this study guide will put a focus on latter, particularly on revenues from hydrocarbons (oil and gas) and minerals like gold and diamonds.

2.1 Natural Resources and Economic Development

It is often believed that the discovery of natural resources will increase a country's wealth and enhance development. However, scholars began to argue in the early 1990s that natural resources can actually have an adverse impact on economic performance – a phenomenon

¹ Oxford Dictionary of Geography

they often referred to as the “paradox of the plenty” or the “resource curse”. Indeed, empirical studies based on the post-World War II period demonstrated that countries with a strong export-driven natural resource sector have economically and socially underperformed compared with resource-deficient countries of similar stages of development, despite the large revenue that the sector created for governments.² A study conducted by Auty (1998), for instance, revealed that between 1960 and 1990 per capita incomes in resource-deficient countries grew at rates that were two to three times faster than countries whose exports were dominated by the (non-renewable) natural resource sector.³ In addition to general poor economic performance, studies also revealed that resource abundance frequently leads to increased income inequality and poor performance in poverty alleviation.⁴

One reason presented by the literature that explains this poor economic performance is that the discovery of natural resources is often followed by a boom of the natural resource sector. Countries tend to heavily concentrate on the exploitation of the respective resource, disregarding necessary investments in other economic sectors, especially in the productive industry (so called “crowding-out effect”).⁵ In addition, vast exports of the resource and high governments spending due to the new revenues cause an appreciation of the exchange rate and an increase in local wages. This, in turn, makes other tradable sectors, particularly agriculture and manufacturing, less competitive in world markets (a phenomenon known as the “Dutch Disease”).⁶ Lastly, many natural resources yield very instable revenue flows to the government, making it hard for governments to design long-term investments and policies. This is because many natural resources, particularly oil, are subject to wide price fluctuations on the international markets so that countries that are heavily dependent on primary commodities periodically suffer from crashes in exports. Studies reveal that such shocks “promote corruption weaken state institutions, and create a host of budget and management problems”.⁷

2.2 Natural Resources and Conflict

In addition to a possible negative impact on growth, natural resource endowment has been seen as a major contributor to social unrest and conflict. In a number of countries, oil, diamonds and other minerals have been associated with causing and financing civil war with all its attendant and social costs. Statistically, a country that has primary commodity exports around 25% of GDP has a 33% risk of civil conflict, but when the export share decreases to 10%, the risk drops to 11%.⁸

Natural resources and civil conflict are interwoven on multiple levels. However, two broad streams of explanation can be distinguished in literature. The first one argues that the driving force between natural resources and civil conflict is the opportunity for economic

² UNDP Cambodia (2006), p. 15.

³ Auty, R.M. (1998).

⁴ UNDP Cambodia (2006), p. 16.

⁵ Sachs & Warner (2001).

⁶ UNDP Cambodia (2006), p. 17.

⁷ Bannon & Collier (2003), p. 10.

⁸ Bannon & Collier (2003), p. 3.

predation. This ‘opportunity’ translates into the use of force by rebel groups to obtain goods or money from their legitimate owners (i.e. through hostage taking, facilitation payments or bribes/corruption).⁹ The other stream of literature suggests that a country’s stage of development – and not its natural resource abundance per se – is the key factor causing civil conflict. When poverty is widespread and unemployment high (which is directly linked to poor economic performance) people are more likely to rise up against their government, while rebel groups find it easier to recruit new members, since it makes the prospect of combat and looting seem more attractive.¹⁰ At the same time, low national income leads to weaker militaries and worse infrastructure, this in turn makes it more difficult for governments to repress insurgencies.¹¹

Whatever the exact direction of the relationship is, the result seems the same: resource-rich countries have an elevated propensity to civil conflict. Explanations and causalities brought forward by academic literature are numerous, extending those just presented above. Michael Ross (2003) attempted to summarize and organize these arguments, concluding that natural resources endowment can increase political instability by:¹²

- harming a country’s economic performance,
- making its government weaker, more corrupt, and less accountable,
- giving people who live in resource-rich regions an incentive to form independent states and
- helping to finance rebel movements.

3 Natural Resources, Governance and the Role of Revenue Transparency

The negative effects of natural resource endowment on economic growth and political stability may be significant in empirical research, yet they are by no means inevitable. While certainly flowing through a variety of channels, most adverse effects are controllable through policies and concerted global action.¹³ The following chapter will give an overview on the role of governance in the natural resource sector, paying a special attention transparency of resource revenue.

3.1 Natural Resources, Governance and Corruption

A strong and effective government should be able to offset some of the economic and social problems caused by resource abundance. Yet, as already mentioned above, resource abundance itself can weaken governments by making them more prone to internal conflicts. Two central mechanisms through which this can occur are reduced government accountability and corruption.¹⁴

Governments that rely on natural resources income rather than on tax collection tend to become less democratic and hence less accountable. This is due to the fact that when

⁹ UNDP Cambodia (2006), p. 25.

¹⁰ Ross (2003), p. 6.

¹¹ UNDP Cambodia (2006), p. 26.

¹² Ross (2003), p. 26.

¹³ Bannon & Collier (2003), p. 7.

¹⁴ Ross (2003), p. 8.

governments have an abundance of revenues, they can use for repressing dissent. As an example, extra revenues from natural resources can be used to strengthen military forces in order to be better able to forcibly suppress political opposition. Studies show that military spending in the oil and mineral-dependent countries is between two and four times greater than in the least oil and mineral dependent countries. However, governments can also use their additional resource revenue to reduce or eliminate taxes: in the absence of taxes, people are less likely to demand accountability and social welfare expenditures from their government. The interdependency between the government and the people is weakened, which in turn induces less democratic political systems.¹⁵

Another important mechanism linking state weakness to natural resources is corruption. *Transparency International*, a leading international anti-corruption watchdog, defines corruption as “the abuse of entrusted power for private gain”.¹⁶ There is strong empirical evidence that when a government gets a great share of its revenue from natural resources, it is more likely to be corrupt.¹⁷ This is particularly the case with so-called “point resources” (such as oil, gas and minerals, which are drawn from a narrow geographical area), as they are extracted at sites that are easily controlled by government actors and typically involve capital intensive processing facilities that require government participation or concession.¹⁸ The political, economic and social consequences of corruption are numerous, including poverty, weak democratic and rule of law norms, international trade distortions, human rights violations, and the unsustainable exploitation of natural resources.¹⁹ Thus, corruption is a central barrier in resource-rich countries to promote economically and socially sustainable development.

3.2 Transparency in Natural Resource Activity

Both the accountability deficit and corruption is exacerbated by the lack of information available to citizens. Indeed, a common feature of countries benefitting from their natural resource endowment (such as Norway, Chile, and Botswana) is a strong institutional capacity and prudent and transparent management practices. Empirical studies confirmed that the adverse impact of natural resource wealth is strongly linked to the institutional quality and fiscal transparency and that little of the effect arises from resource endowment per se.²⁰

Very generally, transparency means “being open to the public about government’s past, present, and future fiscal activities, and about the structure and functions of government that determine fiscal policies and outcomes”.²¹ In light of natural resource revenue, this principally implies openness on how government revenues from natural resources enter the state budget and how they are spent.

There are many ways in which revenues from natural resource extraction are paid to governments. The most important ones usually are payments made by private extraction

¹⁵ Ross (2003a), p. 25.

¹⁶ Transparency International (2012).

¹⁷ Ross (2003), p. 8.

¹⁸ Firger (2010), p. 1056.

¹⁹ Transparency International (2012).

²⁰ IMF (2007).

²¹ IMF (2012).

companies to the government, such as taxes and royalties, unique or periodic payments, such as licensing or concession fees, signature bonuses, and other bonuses related to a particular stage in a project. Other revenue flows can be provided via state-owned extraction companies (such as tariff-payments to state companies with pipeline monopolies or payments related to joint ventures with states owned companies).²² All these flows can generally be traceable through transparent and well-documented reporting systems. This is the case for most OECD countries, yet in developing countries there tends to be much less public information available about revenues from resource extraction. Even academic literature does only poorly cover revenue flow from natural resources in these countries. The reason for this may be both, the lack of administrative capacity or a deliberate strategy to avoid accountability.²³

If hosts governments do not provide information, revenue flows can be indirectly discovered by looking at the extracting companies, for example at their payments to host governments. Practically however, this proves very difficult as host governments can put much pressure on companies to not reveal such information, especially in the oil industry. Many private companies in the oil sector have signed contracts with developing-country governments or state-owned company partners that have confidentiality clauses, which require for example not to reveal taxes to the government.²⁴ In addition, it is important to bear in mind that such reporting would not necessarily cover revenue flows from state-owned extracting companies. In most extractive industries, companies are also required to report some information to their “home government”, i.e. in the country where the company’s headquarter is based; yet these requirements differ significantly across countries and industries.²⁵

The way resource revenues are allocated and used, and how this is reported, also differs widely among countries. In some countries, the resource revenues may be directly transferred to the state budget and become indistinguishable from other sources of state revenue. In these cases, it is not possible to trace back the specific use of those revenues gained from natural resources. In other countries (for example in Norway or Botswana) the total revenue – or a portion of the revenues – is set aside in a special fund. Again in other countries, there are fixed shares of how natural resource revenues should be allocated between sub-national levels.²⁶

4 International Action & the Role of the United Nations

The interest of the international community in the sound use of natural resources is longstanding, yet it has gained renewed interest by the early 2000s, especially in regard of

²² Swanson, Oldgard & Lunde (2003), p. 45.; see this source for a full list of resource related state revenue.

²³ Swanson, Oldgard & Lunde (2003), p. 46.

²⁴ Swanson, Oldgard & Lunde (2003), p. 48.

²⁵ Swanson, Oldgard & Lunde (2003), p. 50.

²⁶ Le Blanc & Kjällerström (2008), p. 2; for an assessment of the impact of the type of revenue allocation and use on overall transparency, see Swanson, Oldgard & Lunde (2003), pp. 51-58.

transparency. Various initiatives have been launched in recent years, and the most important ones shall be briefly presented in the following.

To begin, several IMF initiatives have been introduced to promote transparency revenue flows from natural resource extraction and export. Most notable is the IMF *Guide on Resource Revenue Transparency* adopted in 2005, which applies the principles of the previously conducted *Code of Good Practices on Fiscal Transparency* from 2001 to the specific challenges of natural resources management.²⁷ The Guide provides guidelines and generally recognized best practices for transparency of resource revenue management.

In addition, several multi-stakeholder initiatives have been launched. The *Extractive Industries Transparency Initiative* (EITI), for example, seeks to promote natural resource revenue transparency by requiring that oil, gas and mining companies in participating countries publish what they pay to governments and that governments publish what they receive from companies. It is a voluntary mechanism that includes participants from the government, companies and national and international civil society. Currently, about 60 oil, gas and mining companies (among them the world's biggest companies) and 35 countries have committed to, or are in the process of implementing EITI.²⁸ EITI has established itself as one of the leading measures to foster transparency in developing countries. The UN Security Council recognized the role of EITI in its Presidential Statement of June 2007.²⁹

Another initiative focusing on company reporting of payments to governments is the *Publish What You Pay* (PWYP) campaign. It is a global network of civil society organizations that calls on home-country governments to require "their" companies to reveal payments, by obliging their stock exchanges to demand regular issuance of such information as a condition for listing.

Another initiative, the *Kimberly Process*, focuses on the certification of exploited natural resources rather than on the financial flows related to it. It was launched by the diamond industry and producing countries to ensure transparency about the origins of diamonds in order to stem the flow of "conflict diamonds" (rough diamonds used by rebel movements to finance wars against their governments). Every shipment of diamonds is accompanied by a so-called Kimberley Process Certification Scheme (KPCS); and diamonds lacking such certification cannot be traded in member countries.³⁰ The Kimberly Process has been endorsed by General Assembly and Security Council Resolutions.³¹

The United Nations' core document underlying transparency issues in resource revenue is the *United Nations Convention Against Corruption* from 2003, the first legally binding anti-corruption instrument.³² In addition, the UN Global Compact – a voluntary code of conduct first proposed by former UN Secretary General Kofi Annan in 1999 – may have an impact on

²⁷ IMF (2007)

²⁸ EITI (2011).

²⁹ S/PRST/2007/22, Statement by the President of the Security Council, 25 June 2007.

³⁰ Mason & Muller (2008), p. 85.

³¹ UN General Assembly Resolutions 55/56, 57/302, 58/290, 59/144 and Security Council Resolutions 1459, 1521 and 1579.

³² UN GA (2003): A/58/422; see particularly Article 9 to 14

companies' behaviour on revenue transparency. The Code entails specific recommendations and principles on resource revenue transparency for companies, even though it does not oblige companies to endorse them.

5 Conclusion & Challenge for the GA 2

Reporting standards and campaigns outlined above are important means to enhance transparency in natural resource activities, which itself is a precondition for improving governance by curbing opportunities for corruption and mismanagement of revenues. Increased transparency also provides civil society with information it needs to hold its governments to account. The increasing number of standards and campaigns developed in recent years demonstrates the growing attention devoted by international public and civil society organizations to improve natural resource management as means to enhance economic development and political stability in developing countries.

However, the responsibility for providing citizens with information on revenues received from natural resource extraction ultimately lies in the hands of the host governments. If a government (or the state elites) in a developing country is not willing to disclose information, conditionality (or even sanctions) by the international community is very problematic, as the revenues from natural resources constitute a state income from a legally traded commodity. This is why further attention to the company side of payments is necessary. However, the ultimate focus should still be on the goal of host-country transparency. Some measures the international community could contribute to this aim include:

- Technical assistance to host governments
- Coordination or convergence of home country's reporting rules for international extracting companies
- Support for the issuing credible and publicly available estimates of revenues by NGOs and global organizations such as the World Bank or the IMF
- Support for sustainable use of revenues and evaluation of such.

It will be the Second Committee's responsibility to review existing legislation, standards and campaigns and develop new strategies for transparent revenue collection and distribution measures, which contribute to the sustainable use of natural resources and benefit the economic and social development of the country.

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7 Recommended Reading

- IMF Website on Fiscal Transparency (<http://www.imf.org/external/np/fad/trans/index.htm>), particularly the Guide on Resource Revenue Transparency (2007)
- Extractive Industries Transparency Initiative (EITI) Website (<http://eiti.org/>)
- Transparency International (www.transparency-international.org/)
- The Revenue Watch Institute (<http://www.revenuewatch.org/about>)
- The Natural Resource Charter (<http://www.naturalresourcecharter.org/>)