

**Global Initiative for Fiscal Transparency (GIFT) Coordination Team:**

**Comments on the draft Resource Revenue Management Pillar of the IMF's Fiscal Transparency Code<sup>1</sup>**

**Summary**

The Global Initiative for Fiscal Transparency (GIFT) is pleased to have the opportunity to comment on the IMF's draft of Pillar IV of the Fiscal Transparency Code covering transparency of natural resource management. Transparency, participation and accountability are particularly important in resource-rich economies, and the IMF's continued recognition of this is both important and welcome.<sup>2</sup>

The perspective in this submission reflects GIFT's role in promoting significant advances in practices around the world in major part by working to bring about more coherence and consistency across standards with respect to fiscal transparency, participation and accountability.<sup>3</sup>

The submission first maps the principles and practices in the draft Pillar IV against the GIFT High Level Principles. It then discusses the degree of alignment between the two instruments as well as some distinctive and welcome features of the draft Pillar IV. The submission then puts forward two significant areas for consideration for additions to the draft, as well as a number of other more detailed observations and drafting suggestions.

Transparency is a necessary condition for accountability, but not a sufficient condition. It is increasingly accepted that direct public participation in fiscal policy can help to translate disclosure of information into effective accountability. This is particularly important in resource rich countries due to the weaker link between governments and citizens (because resource revenues substitute for taxation) that is well documented.

Thus, the first significant suggested addition to Pillar IV is with respect to the need for the inclusion of specific practices on public participation in the implementation of fiscal policies. We specifically suggest additions to the principle on natural resource funds (Principle 4.3.3) and on social and environmental risks (Principle 4.4.1) to provide for mechanisms of civil

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<sup>2</sup> It is recognized that resource-rich and resource-dependent are not the same thing. However, for ease of exposition the terms are used somewhat inter-changeably in this note.

<sup>3</sup> For more information on GIFT see [www.fiscaltransparency.net](http://www.fiscaltransparency.net)

society input and oversight. These additions reflect international conventions establishing public participation as a right, as well as the increasing recognition of the instrumental value of public participation in international fiscal transparency standards.

The second significant suggested addition to the draft is with respect to the need for a new principle covering the activities of National Resource Companies. Given their size, complexity and scope for rent-seeking, it may be difficult to adequately capture all the necessary transparency, participation and accountability elements through relying on the relevant provisions in Pillars I-III.

#### **A. Introduction**

GIFT is pleased to have the opportunity to comment on the draft of Pillar IV of the new Fiscal Transparency Code (FTC), covering transparency of management of revenues from natural resources. Transparency, participation and accountability are particularly important in resource-rich economies, and the IMF's continued recognition of this, building on the impressive and influential 2007 *Guide on Resource Revenue Transparency*, is both important and welcome.

The IMF is seeking comments on the draft by 15 March. The Fund has specifically requested feedback on:

- i.* Whether the most important aspects of resource revenue transparency are reflected and whether the new Pillar complements other resource revenue initiatives and standards.
- ii.* Whether the descriptions of basic/good/advanced practices are well sequenced, calibrated and differentiated.

In August 2014 the Fund released Pillars I to III of the revised FTC, covering fiscal reporting (Pillar I), fiscal forecasting and budgeting (Pillar II), and fiscal risk analysis and management (Pillar III). Pillar IV will complete the FTC. It is designed to complement Pillars I-III, rather than being a stand-alone instrument. That is, it sets out resource revenue elements and practices that are not already covered by the other pillars. In conducting Fiscal Transparency Evaluations in resource-rich countries the Fund has indicated that all four pillars will be used, with the relevant Pillar I-III principles also applied in the context of natural resources.

The resource revenue management pillar will be accompanied by a *Guide on Resource Revenue Transparency and Accountability* (which will comprise Volume 2 of a revised Fiscal Transparency Manual).

It is worth noting that commenting on the draft Principles is necessarily a high-level exercise because the consultation is at the principle stage and because the broader Fiscal Transparency Principles (i.e. Pillars I-III) have yet to be developed into a full fiscal transparency manual. Because of this it is difficult to know at this stage to what degree

principles and associated practices from Pillars I-III will be cross-referenced in Volume 2 of the Fiscal Transparency Manual on Resource Revenue Transparency or linkages established in some other way between the four Pillars.

It is also worth observing that the decision to design Pillar IV as a supplement to Pillars I-III, rather than as a stand-alone instrument, means it is less easy to obtain a comprehensive picture of requirements for resource rich countries – of the kind contained in the 2007 Guide.

This note first maps Pillar IV against the GIFT High Level Principles – which are reproduced in an Annex to this note - and discusses the overall alignment between the two instruments. It then discusses some distinctive features of the resource revenue management pillar and puts forward some suggested additions and amendments to the draft. The perspective reflects GIFT's role in promoting progressive strengthening in standards and practices with respect to fiscal transparency, participation and accountability, and working to bring about more coherence and consistency across standards.

### ***B. Mapping the draft Resource Revenue Management practices against the GIFT High Level Principles***

At the outset it must be noted that the GIFT High Level Principles (HLPs) were drafted to be a statement of principles, not of specific practices. The principles provide an umbrella framework for all the existing normative instruments. They are intended to help promote improvements in the coverage, consistency, and coherence of the existing standards and norms for fiscal transparency. There is therefore something of a mismatch, in the level of detail and specificity, between the GIFT HLPs and any specific normative instrument that specifies good practices.

It is, however, informative to compare the scope and coverage of the GIFT HLPs against the draft Resource Revenue Management principles and practices in order to discern and assess patterns of relative emphasis and to identify any potential gaps in Pillar IV.

There are a total of 12 discrete elements in the draft of Pillar IV. Of these:

- Four practices are in Part I on the Legal and Fiscal Regime.
- Three practices are in Part 2 on fiscal reporting.
- Three practices are in Part 3 on fiscal forecasting and budgeting.
- Two practices are in Part 4 on fiscal risk analysis and management.

Table 1 on page 4 shows the pattern of alignment between the 12 resource revenue management practices (together with their associated basic/good/advanced practices), and the GIFT HLPs.

**Table 1: Mapping the draft IMF Resource Revenue Management Pillar to the GIFT High Level Principles on Fiscal Transparency, Participation and Accountability**

<b>HLP 1: A Right to Information</b>	<b>HLP 2: Macro-fiscal policy</b>	<b>HLP 3: High quality data</b>	<b>HLP 4: Outputs and outcomes</b>	<b>HLP 5: Rule of law</b>	<b>HLP 6: Government and private sector</b>	<b>HLP 7: Clarity of roles and responsibilities</b>	<b>HLP 8: Legislative oversight</b>	<b>HLP 9: Supreme Audit Institution</b>	<b>HLP 10: Right to direct participation</b>
No provisions	4.3.1	4.1.2 4.1.4 4.2.1 4.2.2 4.2.3 4.3.2 4.4.2 4.3.1 4.3.3 4.4.1	4.4.1	4.1.1 4.1.3 4.1.4 4.3.2	4.1.1 4.1.2 4.1.3 4.2.1 4.2.2 4.2.3 4.4.1	4.3.2 4.3.3	4.3.2	4.1.4 <sup>4</sup> 4.3.3 <sup>5</sup>	No provisions

<sup>4</sup> As discussed in paragraph F (ii) of this submission, principle 4.1.2 (in advanced practices) refers to ‘independent verification of the final awards’ of natural resource rights, but it is not clear whether this is referring to auditing by a Supreme Audit Institution or some other independent verification mechanism.

<sup>5</sup> As discussed in paragraph F (ix) it is not clear that the reference in 4.3.3 to ‘independent auditing’ is a reference to the SAI or to some other form of independent audit.

Note that while a specific principle may not itself contain a reference to or appear to be relevant to a GIFT High Level Principle, one or more of the associated basic/good/advanced practices may be relevant.

***C. Some observations on the draft Pillar IV compared to the GIFT High Level Principles***

Pillar IV contains a large number of practices relating to the relationship between the government and the private sector. This is appropriate given the key role such relationships play in resource extraction – for example, contracting for resource extraction, taxing resource companies, taking equity positions in extraction projects, verifying company expenses under production sharing arrangements, and auditing and independently verifying company reports on payments to government. This level of coverage is also appropriate given the political economy of states dependent on natural resource revenues (discussed further in Section D).

Most of the provisions in Pillar IV fall within GIFT HLP 3 - ‘The public should be presented with high quality financial and non-financial information on past, present and forecast fiscal activities....’ This reflects the fact that GIFT HLP 3 covers a lot of core territory in fiscal transparency.

There is only limited reference in the draft of Pillar IV to the role legislatures and of Supreme Audit Institutions (SAIs). These are critically important accountability institutions with distinct but mutually reinforcing functions, particularly in resource-dependent economies where the executive branch is often dominant. While legislatures can be a source of rent-seeking as much as executives, they also provide a potential source of restraint and discipline – especially if legislative proceedings are open to the public and provide opportunities for testimony from the public (as suggested in Section D below).

With respect to the role of SAIs, it is important that their position is not compromised through promotion of alternative accountability mechanisms such as private sector audits. This issue is picked up in Section F (paragraphs F (ii) and F (ix)).

The draft of Pillar IV does not include any references that reflect the two ‘rights’ principles in the GIFT HLPs: the public right to fiscal information (HLP 1); and the public right to direct participation in fiscal policy-making and implementation (HLP 10). These two HLPs are based in extant international law on civil and political rights. They were viewed by the founding GIFT Lead Stewards as foundational, as they intended the HLPs to galvanise a renewed, reinvigorated and broader movement for fiscal transparency, participation and accountability. This is particularly relevant to transparency of natural resource revenue management, where political economy considerations will often outweigh narrower technical considerations. This issue is discussed further in section D.

There are some distinctive and welcome features of the draft of Pillar IV. For instance, the draft resource revenue principles and practices contain:

- i. A provision requiring the disclosure not just of all holders of natural resource rights but also of the beneficial owners of those rights (4.2.1, advanced practices). This is consistent with the 2013 Extractive Industries Transparency Initiative (EITI) standard where such disclosure is encouraged.
- ii. Provisions requiring reporting by domestically domiciled or listed resource companies on their worldwide natural resource and trading activity (4.2.2, basic/good/advanced practices), which is consistent with recent disclosure requirements in the USA and the EU.<sup>6</sup>
- iii. Provisions requiring transparency of the social and environmental impacts of natural resource exploitation (4.4.1, basic/good/advanced practices) – but see further discussion of this in the next section.

#### ***D. Public Participation in the Implementation of Fiscal Policy***

Transparency is a necessary condition for accountability, but not a sufficient condition. It is increasingly accepted that direct public participation in fiscal policy can help to translate disclosure of information into effective accountability. More specifically, direct participation can strengthen the efficiency, equity, effectiveness, stability, legitimacy and sustainability of fiscal policies, thereby improving fiscal performance and enhancing the likelihood of positive economic, social and environmental outcomes.

This is reflected in the increasing incorporation of public participation principles and practices in international fiscal transparency standards and norms, including in Principle 2.3.3 in the IMF's 2014 Fiscal Transparency Code, the EITI, the Natural Resource Charter, the International Budget Partnership's Open Budget Survey<sup>7</sup>, and the 2014 OECD Principles of Budgetary Governance.

Direct public participation in fiscal policy is of course also established as a citizen right in the GIFT High Level Principles, which was endorsed by the United Nations General Assembly in 2012.<sup>8</sup>

<sup>6</sup> For example, the U.S. Dodd-Frank Act Section 1054, and the amendment to the EU Accounting and Transparency Directives 2013.

<sup>7</sup> From the 2012 Open Budget Survey the OBS includes questions on opportunities provided by the legislature and the Supreme Audit Institution for public presence and participation.

<sup>8</sup> See <http://fiscaltransparency.net/2013/01/united-nations-adopts-transparency-resolution/>

#### ***Public participation elements in other standards and guides***

##### EITI:

- Requirement 1: Effective oversight by the multi-stakeholder group.
- Requirement 6: EITI reports that are comprehensible, actively promoted, publicly accessible and contribute to public debate.
- Requirement 7: The multi-stakeholder group takes steps on lessons learned and reviews the outcomes and impact of EITI implementation.

##### Natural Resource Charter

- Precept 2: Resource governance requires decision makers to be accountable to an informed public.
- Precept 5: The government should pursue opportunities for local benefits and account for, mitigate and offset the environmental and social costs of resource extraction projects. The precept further defines this as involving local communities in decisions and in making assessments.

At the same time, developments in information and communications technology have dramatically lowered the cost of direct interaction between citizens, non-state actors and governments, while also creating entirely new spaces for citizen input and deliberation.

In considering the issue of public participation with respect to Pillar IV, it is recognized that principle 2.3.3, in Pillar II, provides that the government should provide citizens with an opportunity to take part in budget deliberations. In resource rich economies this would apply to opportunities for public engagement over the allocation of revenues from natural resources, the choice between saving and consumption, the role of Natural Resource Funds, and so on. These are critically important issues that we are sure the Fiscal Transparency Manual (Volume II) will discuss in detail.

However, public participation is also very pertinent to the implementation of fiscal policies, and is even more so in resource rich countries due to the weaker link between governments and citizens in many such states. This is because of the stylized features of the political economy of resource rich economies, which include:

- *Resource rich states are rentier states.* Natural resources generate economic rents that accrue to whoever controls them. Rentier states do not need to rely on taxing their own citizens, and this weakens domestic accountability and legitimacy.<sup>9</sup>
- *Resource dependent states are dominated by the executive branch of government.* Because in most countries ownership of natural resources is vested in the state, the majority of the financial returns to resource extraction typically flow to a State-Owned Enterprise (SOE) or the central government's coffers. This results in disproportionately large earnings (relative to the size of the economy) for those controlling the relevant assets, and an ability to 'loot' the state. It also creates an ability to distribute favours and patronage narrowly to shore up support. Accountability institutions may be co-opted. Political incumbents are favoured, although there are also strong incentives for political opposition to gain control of the state, which can contribute to instability and civil war.
- *Oil dependent states in particular tend to be enclave states.* Because oil revenues largely originate from outside the country, there are typically only limited linkages between the sector and the rest of the economy. There is reduced reliance on a national taxation system and less incentive to provide public goods e.g. mass education and health services to foster economic growth and therefore growth of the non-resource tax base.

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<sup>9</sup> Karl, T, *The Paradox of Plenty*, Berkeley: UC Press, 1997. Ross, M, *The Political Economy of The Resource Curse*, World Politics, 1999. Karl, T, 2007, *Ensuring Fairness: The Case for a Transparent Fiscal Social Contract*. Chapter 10 in Humphreys, M, J. Sachs, and J. Stiglitz, eds, 2007, *Escaping the Resource Curse*, Columbia University Press, New York, pp. 261-262.

- *Resource dependent states experience finite and highly volatile resource revenues, creating difficult political economy choices over the rate of exploitation, and how much and where to invest the proceeds.*
- *Natural resources can exacerbate conflict* because of their uneven regional location within a country, location-specific infrastructure needs and environmental and social impacts, and political pressures for revenues to be retained or spent in the regions in which they originate.
- *Resource dependent states have attracted unusually high levels of external intervention.* The competition amongst major economic powers for access to natural resources, and the need to seek foreign capital and technology for resource extraction, has historically resulted in a ‘marriage of convenience’ between international companies (backed by their governments) and the rulers of resource states.<sup>10</sup> This has contributed to the centralisation of the state, and to an entrenched culture of non-transparency and corruption.

Recognition of these considerations was reflected in the EITI initiative, including the emphasis placed in the EITI Standard on direct public participation; specifically the requirement to establish a national multi-stakeholder group to oversee the process and to stimulate public debate about how natural resources should be managed. The strengthening of the EITI Standard in 2013 included an increased emphasis on the role of each country’s multi-stakeholder group, not only with regard to resource revenue transparency but also with respect to a wide range of important sector information including transparency of the resource allocation regime and permits/licenses/contracts awarded under that regime.

In principle 4.2.3 in Pillar IV on the integrity of resource revenue data, the reference to reconciliation of company payments and government receipts being ‘independently validated in line with international standards’, is presumably a reference to EITI. If so, then this is appropriate.

There are however two further principles in the draft of Pillar IV where incorporation of public participation should be considered.

The first is Principle 4.4.1 on social and environmental risks. At the moment one of the three draft practices covers obligations for resource rights holders to regularly analyse and report on environmental and social impacts. The practice does not refer to mechanisms for direct public input to environmental and social impact analysis. Given that resource extraction can have major environmental and social impacts in the localities in which it takes place, and the political economy factors discussed previously, provision for direct public engagement would seem to be important to attempt to introduce a potential additional element of

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<sup>10</sup> Karl, T, 2007, op. cit., pp. 262-263.



restraint and accountability. In addition to reflecting GIFT High Level Principle 10, it would also reflect a number of other international conventions and norms, including:

- The 1992 United Nations Conference on Environment and Development's 'Rio Declaration on Environment and Development,' Principle 10 of which declared that, 'Environmental issues are best handled with participation of all concerned citizens, at the relevant level.'<sup>11</sup>
- The Aarhus Convention adopted by the United Nations Economic Commission for Europe, which contains core principles on the public's 'right to participate in environmental decision-making', and 'right to review procedures and to challenge public decisions.'<sup>12</sup>
- International Labor Organization (ILO) Convention Number 169 provides indigenous communities with the 'right of prior informed consent' regarding development in their territories.<sup>13</sup> This right of prior informed consent was endorsed by the World Commission on Dams and the Mining, Minerals and Sustainable Development Initiative.

One amendment that should be considered, therefore, would be to introduce the following italicized addition to Principle 4.4.1:

*'conditions of natural resource rights holdings include obligations for regular analysis and reporting on potential and actual environmental and social impacts, as well as obligations to seek, and mechanisms to provide for and respond to, direct inputs from the affected public and the general public.'*

Mechanisms to provide direct input would include mechanisms for the general public to be consulted in natural resource decision-making, to engage in deliberations on social and environmental impact assessments, as well as judicial review of resource extraction planning and implementation decisions by the affected public, which are standard practices in these fields. Consideration should be given to specifying the above as a basic level of practice.<sup>14</sup>

Also with respect to the wording of 4.4.1, the drafting of practice (iii) appears to confine its scope to management of the fiscal risks from environmental and social impacts. There are two separate issues here – one is what impacts resource extraction is having on communities and the environment; the second is what impact this has on government finances (both central government and sub-national governments) and thus the country's

<sup>11</sup> <http://www.unep.org/Documents.Multilingual/Default.asp?documentid=78&articleid=1163>

<sup>12</sup> The United Nations Economic Commission for Europe (UNECE) Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters. <http://www.unece.org/fileadmin/DAM/env/pp/documents/cep43e.pdf>

<sup>13</sup> <http://www.ilo.org/indigenous/Conventions/no169/lang--en/index.htm>

<sup>14</sup> This would require redesigning the structure of the practices for this principle, to one based on basic/good/advanced practices. When it comes to the detailed recommendations in the proposed guide it will be important, however, to differentiate participation practices for different stages of resource development – what is required at prospecting, exploration and mining/extraction stages will necessarily be quite different.

economic development more broadly. Of course, fiscal risks can be reduced by allocating or shifting the social and environmental costs associated with resource extraction to other parties. While it is likely to be appropriate for extractive companies to bear costs such as site remediation expenses at the end of a project, it will often be inappropriate to minimise the central government's fiscal costs by shifting or allowing other costs to rest with local communities or sub-national governments.

We therefore suggest a revision to the wording as follows:

‘the government reports annually on its management of environmental and social impacts and on fiscal risks from natural resource exploitation.’

The second principle in the draft of Pillar IV where incorporation of public participation should be considered is in Principle 4.3.3 on Natural Resource Funds (NRFs). Given the sheer size of many NRFs, there is a need for additional oversight mechanisms, as information on a Fund may not be incorporated in budget documents, and a Fund may not be covered by opportunities to participate in national government budget preparation. NRFs may operate at least somewhat in parallel to the government's budget, and may escape scrutiny.

In addition, NRFs play a key role in macro-fiscal policy, and are also in part designed to address intergenerational equity issues. It is therefore particularly important that their policies and activities are the subject of broad public debate. A further issue is that in countries at earlier stages of the resource cycle, wide public debate over the prospective or actual size of NRFs could help to manage excessive expectations over the volume of revenues and unrealistic pressures to ramp up spending unsustainably.

A number of observers have discussed the desirability of broader stakeholder representation on the Board of an NRF to provide an opportunity for public participation in setting and/or monitoring fiscal policies.<sup>15</sup> Promoting and supporting the oversight role of the legislature, and of the wider civil society could help to reduce the concentration of power in the executive. This could in turn help to promote more sustainable fiscal policy, a more pro-poor and pro-growth allocation of spending, and less corruption. It could ‘help counterbalance conflicting political interests, by broadening society's participation in the decision-making process (e.g., by allowing for consultation of civil society, eminent citizens, etc.).’<sup>16</sup> Humphreys and Sandbu suggest that governance of an NRF might be broadened beyond the government of the day by involving other actors in its decision-making such as

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<sup>15</sup> Humphreys and Sandbu, 2007, *The Political Economy of Natural Resource Funds*, in Humphreys, M, Sachs, J, and Stiglitz, J., eds. *Escaping the Resource Curse*, New York, Columbia University Press; Dabán and Héris, *A Public Financial Management Framework for Resource-Producing Countries*, IMF Working Paper WP/10/72. See Bell, J. and Faria, T, 2007, *Critical Issues for a Revenue Management Law*, in Humphreys et al, op. cit., pp. 300-303 for a discussion of country practice with respect to oversight groups to monitor the executive's use of natural resource revenues.

<sup>16</sup>Dabán and Héris, p. 29.

the legislature (as is the case in Norway), members of opposition parties (as in Alaska), or new technical bodies that include civil society representatives (as in Sao Tome and Principe).

We therefore suggest that serious consideration be given to inserting words in practice 4.3.3 specifying, as a good practice, that public hearings in the legislature, and at the local level where resource extraction takes place, are held on the annual report of an NRF. Advanced practice could include the existence of special mechanisms for civil society engagement and oversight of the activities of an NRF. While no-one argues that broader participation in oversight will *ensure* better performance, and while some of those cited above also see risks in such approaches, there are so many observations of the resource curse in the absence of these mechanisms, and so few instances where these have been tried, that they should surely be part of a 21<sup>st</sup> century approach to natural resource governance.

Furthermore, as noted, public participation is established as a right, beyond its positive instrumental effects.

#### ***E. The Role of State-Owned Enterprises in the Natural Resources Sector***

International experience has demonstrated that there are particular challenges to transparency and good governance from the operations of natural resource SOEs – referred to in this note as National Resource Companies (NRCs).

Many NRCs are very large in the context of the economies in which they operate, and indeed some are very large by any measure. The Natural Resource Governance Institute has observed that the sale of crude oil by national oil companies (NOCs) generates more than two-thirds of total government income in Angola, Azerbaijan, Congo-Brazzaville, Iraq, Saudi Arabia and Yemen. Globally a majority of oil production comes from NOCs.<sup>17</sup> And while much attention has been paid to state ownership in the oil sector, it is also prevalent in the mining sector with global supplies of coal, aluminium and tin being dominated by state owned enterprises, and with high levels of state participation in other commodities.<sup>18</sup>

Because of their sheer size and complexity, NRCs are often surrounded by rent-seeking behaviour, and have often become alternative means of implementing fiscal policies in a non-transparent and unaccountable manner, or of being used for corruption or state capture. ‘At this scale, suboptimal processes, small leakages or the unauthorized retention of funds by the NOC can reduce the resources available for public goods and services.’<sup>19</sup>

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<sup>17</sup> Energy Information Administration (EIA), Who are the major players supplying the world oil market?, Energy in Brief article, September 2012.

<sup>18</sup> World Bank, Overview of State Ownership in the Global Minerals Industry, 2011.

<sup>19</sup> Selling the Citizen’s Oil: The Case for Transparency in National Oil Company Crude Sales.

Alexandra Gillies, Revenue Watch Institute, April 2012, p. 1.

<http://www.resourcegovernance.org/sites/default/files/OilSales-Transparency.pdf>

Experience also strongly suggests that transparency needs to be comprehensive if rent-seeking is not to shift to areas less open to scrutiny or control. If greater transparency and accountability are introduced with respect to government budgets and NRFs, rent-seeking may simply shift to NRCs. While Principle 3.3.2 covers the activities of SOEs, NRCs are arguably sufficiently complex and large to warrant coverage in a dedicated principle in Pillar IV (as was the case in the IMF's 2007 Guide).<sup>20</sup>

For instance, NRCs can be used to borrow against future resource sales, sidestepping the usual legislative oversight of public borrowing; they can be used to finance state participation in resource extraction through non-transparent arrangements that may escape the scrutiny usually applied to public investment; they are often used to conduct quasi-fiscal activities on behalf of government outside the budget; they are often tasked with achieving multiple objectives (sometimes including conflicting functions such as regulating the industry in which they also operate), which makes it difficult to measure their performance and hold them accountable;<sup>21</sup> there can be an unclear boundary between the NRC's revenues and government revenues, for example with respect to the taxes and royalties they may receive from private resource companies on behalf of government; and they often receive some taxes in-kind (e.g. in the form of oil or gas) which creates opportunities for abuse.

This unusually complex and large scale combination of activities suggests that consideration should be given to adding a principle to Pillar IV specifically on transparency of NRCs. It seems likely to be difficult to adequately capture the complexity of NRCs through application of Principle 3.3.2 together with the other principles in Pillars I-III of the Code that would also need to be applied.

Similar to the point in Section D above regarding public participation, the unique challenges posed by NRCs are specifically recognised in the EITI Standard and in the Natural Resource Charter. Under the EITI Standard,<sup>22</sup> EITI reports should include:

- An explanation of the prevailing rules and practices regarding the financial relationship between the government and state-owned enterprises.
- Disclosures from SOEs on their quasi-fiscal expenditures.
- Disclosures on their level of beneficial ownership in companies participating in the sector.

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<sup>20</sup> A similar argument could perhaps be made that sub-national governments also raise a complex range of issues that cut across Pillars I-III. For instance, SNGs sometimes act as resource allocator; commonly receive a portion of taxes and royalties; commonly act as a land use and environmental regulator; typically provide local infrastructure; and are the most vulnerable to environmental and social risks. Consideration could therefore be given to adding a new principle to Pillar IV devoted to sub-national government. However the need for a separate principle is perhaps less clear than with respect to NRCs, and might be dealt with through detailed discussion in Volume 2 of the Manual.

<sup>21</sup> See for instance 'National Oil Companies and Value Creation', Silvana Tordo with Brandon Tracy and Noora Arfaa, World Bank Working Paper No. 218, 2011.

<sup>22</sup> See EITI Standard requirements 3.6, 4.1(c), 4.2(c) and Guidance Note 18: SOE participation in EITI reporting.

- Details of the sale of the state's share of production or other revenue that is collected in-kind.

The Natural Resource Charter's Precept 6 is devoted to the role of NRCs – '[n]ationally owned companies should be accountable, with well-defined mandates and an objective of commercial efficiency. The Charter highlights in particular the need for:

- The operational roles (i.e. direct participation in prospecting, exploration and/or production) to be distinct from governance roles (i.e. management of the resource allocation regime);
- Clear checks and balances to be established (including selecting board members who are politically autonomous and have appropriate expertise);
- NRCs to be subject to the same disclosure arrangements as other companies; and
- Independent oversight of the company e.g. from the legislature or an appropriate oversight agency.

Drawing on and extending Principle 3.3.2 in the Code that covers public corporations, a new principle on NRCs could be as follows:

*Basic practices:* An NRC publishes an Annual Report disclosing details of all interests and holdings in the sector, resource sales (buyer, volume, resource grade, price and date of cargoes),<sup>23</sup> all payments to and from government including details of sales of the government's share of production collected in kind, and audited financial statements compiled according to international accounting and auditing standards with an unqualified audit opinion.

*Good practices:* Above, plus the Annual Report contains details of all direct and indirect support from government, quantification of any quasi-fiscal activities;<sup>24</sup> the government publishes an ownership policy; and the Report is discussed in a legislative committee at which testimony from the public is heard.

*Advanced practices:* Above, plus the Annual Report contains key details of governance and senior management arrangements, and there are low-cost mechanisms for redress available to members of the public with respect to the NRC's operational activities.<sup>25</sup>

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<sup>23</sup> Gillies, Revenue Watch Institute, op. cit, 2012, p. 1.

<sup>24</sup> In Pillar III, principle 3.3.2 specifies as an advanced practice that estimates of any quasi-fiscal activities undertaken is published on at least an annual basis. Given both the size of quasi-fiscal activities conducted by a number of NRCs, and their capacity for financial management and cost estimation relative to many other SOEs, it seems appropriate to specify quantification of quasi-fiscal activities as a good practice.

<sup>25</sup> For example, Petrobras in Brazil has established an office of Ombudsman.

**F. Detailed comments on the specification of basic/good/advanced practices**

- i. In 4.1.1, publication of regulations is not a requirement for basic practices, but only of good practices. It is difficult to see why publication of regulations is other than basic to the rule of law. Publication of regulations provides additional assurance to those subject to the regulations that they are promulgated under due process and that they will be applied equally to all. Elevating this to basic practice would better reflect GIFT HLP 5.
- ii. Principle 4.1.2 (in advanced practices) refers to ‘independent verification of the final awards’ of natural resource rights. It is not clear whether this is referring to auditing by a Supreme Audit Institution, or to some other independent verification mechanism. There should be a presumption that the SAI’s mandate allows it to audit any resource tenders it wishes to audit, and therefore it would seem more appropriate for independent verification of contract awards to be a requirement for basic practice. If the reference to ‘independent verification’ is to verification in addition to audit by the SAI, this should be made clear. Finally, a new requirement could usefully be added to ‘advanced practice’ that requires the independent audit of a random selection of all small licenses/contracts and any changes to those licenses/contracts awarded under a predetermined threshold for materiality.<sup>26</sup>
- iii. The importance of the ownership and stewardship of geological data seems to be missing from 4.1 in general and consideration should be given to either the addition of a new principle or inclusion of new material within 4.1 on this issue. Properly managed geological data can be one of the more valuable assets that a government possesses.<sup>27</sup> The starting point for much exploration is the gathering, interpretation and reinterpretation of historic data in order to improve the likelihood of a commercially viable discovery. Effective government stewardship of this data can potentially speed up resource development as well as enable governments to demand higher minimum work programmes from exploration companies. It also assists with the management of environmental risks.

Basic practice could require the existence of legislation requiring regular reporting and surrendering of geological data to the government; good practice could add the

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<sup>26</sup> In some countries there may be a substantial number of awards of resource rights that are small and not material on an individual basis. On the other hand, this issue might be covered in the Manual rather than in the Code.

<sup>27</sup> See Natural Resource Charter Precept 3 – governments should ‘build and maintain a good understanding of the resource base. This information is key to building the government’s geological understanding, which will serve to strengthen its negotiating position with investors and better enable it to optimize the licensing regime. To this end, the government should ensure that investors provide all technical information in an understandable format.’

construction of an online exploration database; advanced practice could include regulatory activities to ensure company compliance with data reporting requirements.

- iv. In 4.2.1, advanced practice is to publish ‘the full text of terms and conditions associated with their natural resource rights...’ While this is certainly appropriate, it would also be worth considering adding the words ‘together with an accessible summary of key terms’. In the absence of a summary it is likely to be difficult for many citizens, CSOs, journalists and others to make sense of long and complex legal documents, reducing the ability to translate transparency into public scrutiny, debate, and accountability.

4.2.1 also seems to omit the importance of including the disclosure of any variations or changes to permits/licenses/contracts. Disclosing only the original or most recent documentation can sometimes conceal a significant pattern of post-award changes to a resource right. For this reason the good practice definition for this section could be changed to read ‘...and the full text of terms and conditions associated with their natural resource rights, *as well as a full history of any changes or variations made to the resource right since it was first awarded.*’

- v. In 4.2.2 on reporting by resource companies, basic practice is to report ‘summary information’, good practice is to report ‘country-level information’ and advanced practice is to report ‘project-level information’. Summary level information is of limited value, as users are not able to discern which entities received payments, which projects they relate to, or what type of payment is involved. Project level reporting is increasingly the norm, with it being a requirement of the EITI Standard (requirement 5.2.e).

A recommendation for an alternative approach would be to specify country-level, project-level, and payment type and public entity recipient as basic/good/advanced practice respectively. Payment-type refers to whether payments are taxes, royalties or other types and which type of tax. This additional level of detail helps to match payments with specific individual recipient government institutions.

Consideration could also be given to adding reference to social expenditures by companies to the description of good or advanced practice. Such reporting is a new disclosure requirement in the revised 2013 EITI standard. Social expenditures by public corporations will be covered by principle 3.3.2 in Pillar III, which refers to quasi-fiscal activities by public corporations. However, principle 3.3.2 does not capture quasi-fiscal activities by private corporations, which in the field of resource extraction can be significant.

Finally, 4.2.2 refers to ‘payments to and from government’. It is not clear whether this would include payments to public corporations, which are not part of the ‘government sector’ as defined in international statistical standards. Some taxes, royalties or other government revenues are often paid by private companies in the first instance to NRCs, which then remit them to a government ministry. In order to clearly capture such payments, principle 4.2.2 could refer to ‘payments to government-owned or controlled entities’. ‘Payments’ would also need to cover payments in kind – for example, the transfer of oil or gas from an NRC to a separate state-owned refining or energy company.

- vi. In the definition of basic practices in 4.2.3, it would be worth considering adding the words ‘by company’, so that a single summary reconciliation of aggregate payments against aggregate receipts would clearly not meet basic practice (although it is also a necessary integrity check). The wording would therefore be: ‘Government reports annually on resource revenue collections *by company*’.
- vii. In 4.3.1 governments are required to report performance against their objectives only for advanced practices. In general, reporting performance against announced objectives is fundamental to accountability and from that perspective would be better incorporated in basic, or perhaps good practices.

If this is removed from advanced practices, the latter could be differentiated from good practices by confining the latter to a medium term numerical objective (as opposed to a medium-to-long term objective), or by adding to advanced practices a requirement to place the numerical objective for resource revenues in the context of fiscal sustainability analysis.

- viii. In 4.3.2, ‘public expenditure or saving of resource revenues *which itself is clearly defined in scope*’ is required only for advanced practices. A clear definition of what constitutes resource revenues is fundamental to much of Pillar IV, and should be a basic practice – especially as there is no internationally agreed definition of resource revenues at present.<sup>28</sup> The classification of resource revenues is therefore probably not covered in Pillar I of the Code. If there are laws requiring all resource revenues to be paid into an NRF, or if fiscal performance is defined in terms of a non-resource balance, there could be strong incentives on a government to misreport or redefine resource revenues as non-resource revenues or to otherwise game the definition.
- ix. In 4.3.3, reporting of investment performance is required only for good practices, and a statement of the government’s investment objectives and independent

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<sup>28</sup> See Template To Collect Data On Government Revenues From Natural Resources, IMF, January 24, 2014.



auditing are only required for advanced practices. Given the size of NRFs, this is perhaps an understatement of expectations.

First, with respect to auditing, there should be a presumption that any NRF will be subject to audit by the SAI. International auditing standards (ISSAIs) require independence of the SAI. It is not clear if the reference to independent auditing as an advanced practice is a reference to audit by the SAI. If it is, then it is suggested this should be a basic practice.

If the reference is to some other form of independent audit – such as an audit by a private firm, *in addition to* audit by the SAI - then this should be specified in the principle so as not to risk detracting from the mandate of SAIs. This might be achieved by amending the wording from ‘independent auditing’ to ‘additional independent verification mechanisms.’

Secondly, reporting of investment performance would also seem to be a basic requirement of transparency, in order to provide the public with a basic level of assurance that there is accountability for this use of public funds, particularly given their size. If this change were made then a statement of investment objectives should perhaps be a good practice rather than an advanced practice.

Thirdly, the wording of the principle and practices can be read to imply that establishing an NRF is good or accepted practice. Whether setting up an NRF enhances transparency, participation and accountability in comparison to other approaches is context-dependent and country-specific, and is not necessarily desirable. An apparent endorsement of NRFs could be avoided by inserting the word ‘any’ in front of ‘natural resource funds’ in the description of the principle, and in the description of basic/good/advanced practices.

- x. Finally, we would recommend consideration be given to adding some detail under 4.4.2 ‘operational risks’. A significant risk to the overall resource endowment of a country is that particular fields or resources can be developed by a company in a way that maximises short-term production and profitability at the expense of overall resource recovery. Companies which are focusing on short to medium term generation of cash, which face uncertainty in their tenure over a resource, and/or which are facing a period of low commodity prices can be tempted to engage in this practice. At a minimum this can increase the costs of recovery of future resources, at worst it can sterilise (i.e. put beyond use) resources left in the ground, thus depriving a government of significant future revenues.

For this reason we would recommend an addition under ‘good’ practice of this

principle of further wording so that it reads 'The government reports annually on natural resource project status and planned activity, *conducts audits of the development strategies and extraction rates of major projects*, quantifying the main risks to production...'

## Annex

### **The Global Initiative on Fiscal Transparency: High-Level Principles on Fiscal Transparency, Participation, and Accountability**

The Parties to these Principles,

**Recognizing** that fiscal policies – taxing, borrowing, spending, investing, and managing public resources – have critical impacts on economic, social and environmental outcomes in all countries at all levels of development,

**Believing** that access to high quality information, meaningful public participation, and effective accountability mechanisms:

- enhance the integrity, quality and implementation of fiscal policies,
- reduce corruption,
- increase the legitimacy of and trust in government,
- increase willingness to pay taxes and provide financing,
- strengthen the effectiveness of development assistance,
- and thereby strengthen the efficiency, equity, effectiveness, stability and sustainability of fiscal policies and enhance the likelihood that fiscal policies have positive economic, social and environmental impacts,

**Recognizing** that the public has the right to information on fiscal policies and effective opportunities to participate in the design and implementation of fiscal policies,

**Recognizing** also the critical contribution that greater fiscal transparency, participation and accountability can play in facilitating more effective international cooperation in the pursuit of financial stability, poverty reduction, equitable economic growth, and stewardship of the environment and the global commons,

**Recognizing** the important role in setting norms and standards played by initiatives such as the International Monetary Fund's *Code of Good Practices on Fiscal Transparency*, the Organisation for Economic Cooperation and Development's *Best Practices in Budget Transparency*, the International Budget Partnership's *Open Budget Index*, *International Public Sector Accounting Standards* promulgated by the International Public Sector Accounting Standards Board, *International Standards of Supreme Audit Institutions* promulgated by the International Organization of Supreme Audit Institutions, and the multi-agency *Public Expenditure and Financial Accountability* program,

**Acknowledging** that while the range of consensus has grown, there remain gaps and inconsistencies in the existing norms and standards,

**Recalling** that international instruments, both those that are universally applicable, such as *The Universal Declaration of Human Rights*, *The International Covenant on Civil and Political Rights*, and *The International Covenant on Economic, Social and Cultural Rights*, as well as regional instruments, address issues of free speech, access to information, independence of the Supreme Audit Institution, participation, and anti-corruption among others that are relevant to fiscal policy,

**Affirming** the reciprocal relationship between citizens and government, in which citizens provide resources to and entrust governments with stewardship over public resources, and, in turn, expect to receive information on public finances and fiscal policies and to have opportunities to participate in fiscal policy-making,

**Recognizing** that developments in information and communication technologies have greatly lowered the costs of compiling and disseminating information, and facilitate new forms of citizen – government interactions,

**Recognizing** that these Principles will need to be implemented in a manner that is consistent with diverse country circumstances while promoting progress in all countries towards the common goal of transparent, participatory and accountable management of fiscal policies,

**Recognizing** the need for cooperation and information sharing between all stakeholders to assist states to build capacity and learn from experience in the transparent, participatory and accountable management of fiscal policies,

**Inviting** all states and non-state actors, including individuals, civil society groups, non-governmental organizations, community-based organizations, professional associations and the private sector to work together to promote the progressive achievement of these Principles,

**Recognizing** also the desirability of transparency, participation and accountability in all branches of government and inviting legislative and judicial bodies to implement these Principles in their proceedings,

**Declare** these High-Level Principles to guide policy makers and all other stakeholders in fiscal policy in their efforts to improve fiscal transparency, participation and accountability and to help promote improvements in the coverage, consistency and coherence of the existing standards and norms for fiscal transparency:

### *Access to Fiscal Information*

1. Everyone has the right to seek, receive and impart information on fiscal policies. To help guarantee this right, national legal systems should establish a clear presumption in favour of the public availability of fiscal information without discrimination. Exceptions should be limited in nature, clearly set out in the legal framework, and subject to challenge through low-cost, independent and timely review mechanisms.
2. Governments should publish clear and measurable objectives for aggregate fiscal policy, regularly report progress against them, and explain deviations from plans.
3. The public should be presented with high quality financial and non-financial information on past, present, and forecast fiscal activities, performance, fiscal risks, and public assets and liabilities. The presentation of fiscal information in budgets, fiscal reports, financial statements, and National Accounts should be an obligation of government, meet internationally-recognized standards, and should be consistent across the different types of reports or include an explanation and reconciliation of differences. Assurances are required of the integrity of fiscal data and information.
4. Governments should communicate the objectives they are pursuing and the outputs they are producing with the resources entrusted to them, and endeavor to assess and disclose the anticipated and actual social, economic and environmental outcomes.

### *The Governance of Fiscal Policy*

5. All financial transactions of the public sector should have their basis in law. Laws, regulations and administrative procedures regulating public financial management should be available to the public, and their implementation should be subject to independent review.
6. The Government sector should be clearly defined and identified for the purposes of reporting, transparency, and accountability, and government financial relationships with the private sector should be disclosed, conducted in an open manner, and follow clear rules and procedures.
7. Roles and responsibilities for raising revenues, incurring liabilities, consuming resources, investing, and managing public resources should be clearly assigned in legislation between the three branches of government (the legislature, the executive and the judiciary), between national and each sub-national level of government, between the government sector and the rest of the public sector, and within the government sector itself.
8. The authority to raise taxes and incur expenditure on behalf of the public should be vested in the legislature. No government revenue should be raised or expenditure incurred or committed without the approval of the legislature through the budget or other legislation. The legislature should be provided with the authority, resources, and

information required to effectively hold the executive to account for the use of public resources.

9. The Supreme Audit Institution should have statutory independence from the executive, and the mandate, access to information, and appropriate resources to audit and report publicly on the raising and commitment of public funds. It should operate in an independent, accountable and transparent manner.

10. Citizens should have the right and they, and all non-state actors, should have effective opportunities to participate directly in public debate and discussion over the design and implementation of fiscal policies.