POLICY FRAMEWORK FOR NATURAL RESOURCE GOVERNANCE.

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1 Introduction

In the preceding chapter, we noted the following claims from the literature: that the differences in the quality of governance, and institutions in particular, largely explain the differences in economic performance and democratic consolidation between countries; the structure of incentives that actors in an economy face are determined by government policies and quality of institutions, which in turn determine economic performance; natural resource dependency largely affects incentives as well as the underlying political and economic institutions negatively although this is not inevitable; the magnitude of the impact depends on government policies, the quality of institutions as well as the size of the manufacturing sector prior to the resource boom; that it is in the nature of natural resource economies that they face booms and bursts; whether these cyclical dynamics undermine growth and stability in the long-term or whether booms provide a springboard for economies to take off and industrialise or otherwise collapse into growth failures and perhaps violent conflicts depend ultimately on government actions.

If governments fail to act appropriately to mitigate negative impulses and redirect incentives, according to the "resource curse" literature, we can expect a "winner's curse" represented by catastrophic long-term growth failure, macroeconomic instability, increased commodity exports dependency, widespread poverty and inequality, or even dictatorial governments. If governments act appropriately, resources boom can be harnessed to build human capital in the form of skills to form the basis for industrial development; financial capital can be built in the form of stability funds and hedge funds to mitigate the impacts of inevitable down-turn commodity prices and can use the opportunity brought about by booms to invest in social development, strengthen political institutions and enable a middle class to flourish.

According to this thesis therefore, the single most important determinant of the beneficial effects of natural resource abundance is government – what they do or don't do, and what they are motivated by. As we noted in the previous chapter, the tendency is to fit all developing country governments, especially the African ones, into one box – cliques of self-serving elite whose entire motivation is to hold onto power in perpetuity and enrich themselves corruptly. Natural resource wealth fuels these motivations and end up destabilizing the economy, society and politics. The less rents they have access to, the smaller the size of the state itself relative to the market, the better for economic development and institutional strengthening.

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This dominant, largely negative and minimalist conception of the state as captured in the good governance paradigm is limiting for examining options for governing natural resources to maximize returns for development. One of the main criticisms of the World Bank's influential and commonly referenced Worldwide Governance Indicators (voice and accountability; political stability and absence of violence; government effectiveness; regulatory quality; rule of law and control of corruption) is that it although it measures perceptions rather than the objective reality itself, the claims of the impact of these measures of governance on economic development are far reaching. Important contextual factors are missed out yet the policy reforms recommended by these contested empirical econometric analysis are far reaching .

We will argue that what matters more is a consideration of **state capability to take specific actions .** The state's ability to act is contextual and will vary in respective countries. Factors including **history and social organization** of the state including its stage of economic development, the size of the middle class, political history and quality of human capital among others. Governments' willingness to take specific measures to mitigate potentially harmful effects of natural resource wealth or to harness that wealth for development may also lie in the ideology and discipline of political leaders and the types of states they aspire to bring about.

In outlining possible measures that governments could use to maximise the development outcomes of natural resource wealth and optimize the management of booms and burst cycles, we start from the premise that even the most autocratic of African governments desire a measure of legitimacy which is ultimately derived from services citizens expect from the use of natural resource rents. They also desire a level of public cooperation to rule with minimum violence. This requires a degree of public voice, participation and accountability and aspects of a minimum functioning of the rule of law. We will argue therefore that the challenge lies not in an assumption of the inherent unwillingness of the state to act in the public interest or a denigrating perspective of the state but constraints that relate to specific capabilities. The measures outlined in this chapter therefore point to areas that may enhance these capabilities to act. We address these in the context of planning as well as in relation to specific practical tools.

Section 2.1 addresses the role of planning. Section 2.2 highlights issues related to strengthening the political governance of natural resource wealth. Section 2.3 addresses the economic policy issues whilst the next section highlights some issues related to the international dimension of resource governance. We conclude with reference not to the familiar issue of abundance but their scarcity and degradation and some measures to address them.

2 What needs to be done?

5.2.1 Identifying and strengthening key Governance Capabilities. First whilst the "good governance" thesis suggest that economic development (sustained growth and the human capital accumulation) is possible only with good governance (strong institutions), there is also strong, conclusive evidence that shows that countries have only improved their governance with development and that "good governance" is not a precondition for economic development (Khan 2009. 2010), even if there are inherent benefits other than economic growth and development. Rather than focus on multiple indicators of good governance, it is important instead to identify and strengthen specific governance capabilities that can help countries accelerate economic development which will in turn improve governance sustainably.

The need to identify and target specific capabilities that make the most impact on development rather than target multiple simultaneous institutional reforms as required by the "good governance" framework reflects an approach to reforms spear-headed by Rodrick et al ( ).

Figure 1 below demonstrates the "governance capabilities" approach. It is based on identifying the most important causes of market failure and traces the causal factors which in turn identify the capability gaps that need to be filled. This approach can also be applied to the market failures associated with the natural resource business cycle. The important merit of the approach is its pragmatism and incremental approach.

5.2.2 Transformational Planning: Planning is the first necessary capability for turning natural resource abundance into sustained prosperity for all. *"G*ood governance" of natural resources starts with the development of a shared national strategy/vision. Long-term vision sets the course of travel and where that vision is transformational enables a road map, structural reforms, and economic structures to be highlighted. Long term planning is particularly relevant in oil, gas and solid minerals rich countries as project cycles (exploration, construction, production, beneficiation and closure) span decades. Such national strategies are likely to be more successful if they are inclusive. Key to success are: existence of a coordinating agency that is highly placed, for example within the office of the presidency; a vision of how these resources fit into a development plan; country benchmarking and capacity building, including the identification and strengthening of governance capabilities.

The quality of planning, where there is good implementation enforcement, ultimately affect the development outcomes natural resources. To the extent that resource planning, as a sub-set of broader national plans address the entire commodity cycle, it provides ingredients for managing short-medium term instabilities. Long-term plans that are also spatial in nature provide opportunities for promoting equitable development. Good planning can pre-empt problems before they occur or at the minimum put in place capabilities to mitigate.

Where planning is inclusive, transparent and based on open information, the process offers opportunities for grievance management, for nation-building, for priority setting and for constraining excesses in the use of natural resource rents by the ruling elite.

Planning that ultimate lead to industrial development may create perhaps the single most important condition for sustaining good governance and deepening democracy.

5.2.3 P*olitical issues in resource governance:* In Chapter 4 we detailed the claim that natural resource dependence necessarily leads to autocratic governance and weak political and economic institutions which in turn undermines long term development. The key driver in this claim is the effect of rent-seeking behavior on the transparent management of public resources. The lack of transparency is therefore seen as the key political impact of natural resource dependence. Lack of transparency in turn undermines accountability and result in market failure, among other factors.

The key therefore to transforming natural resources into sustained prosperity is to build in transparency and accountability into the economic decision-making along the entire value chain i.e. deal making; development; extraction/use; downstream value addition and project closure and rehabilitation stages. Ensuring transparency throughout the decision-making chain facilitates government accountability to stakeholders.

Public access to information throughout the project cycle is equally important, including disclosing biddable contracts create a "race to the top rather than a race to the bottom". Tools that can enhance such transparency and accountability include: a contract data base; applying global transparency standards; instituting digitized mining and land cadastral maps; and strengthening the capacities of civil society and oversight actors.

Resource governance is the most effective if it leads to the greatest impact on livelihoods and sustainable development at the local level. Such tools as project level impact assessment; environmental bonds to provide surety against environmental damage; preparation of closure plans; the management of solid and liquid waste; keeping track of water and energy use; accommodating and strengthening artisanal mining; community development (but avoiding duplicating the state); local survey and local content; responsible resettlements guided by human rights principles. Tools to address these challenges include: community development agreements; and, due diligence by lending and export credit agencies.

Good governance of land resources is key to transforming natural resource wealth into to stable, long term development *(*ref. Botswana)- land is both a natural resource that attracts investment itself and at the same time is significantly affected by other natural resource projects. It is integral to the livelihoods of many including small scale farmers and pastoralists. There's need to: ensure transparency in land tenure systems including large scale land acquisitions; manage

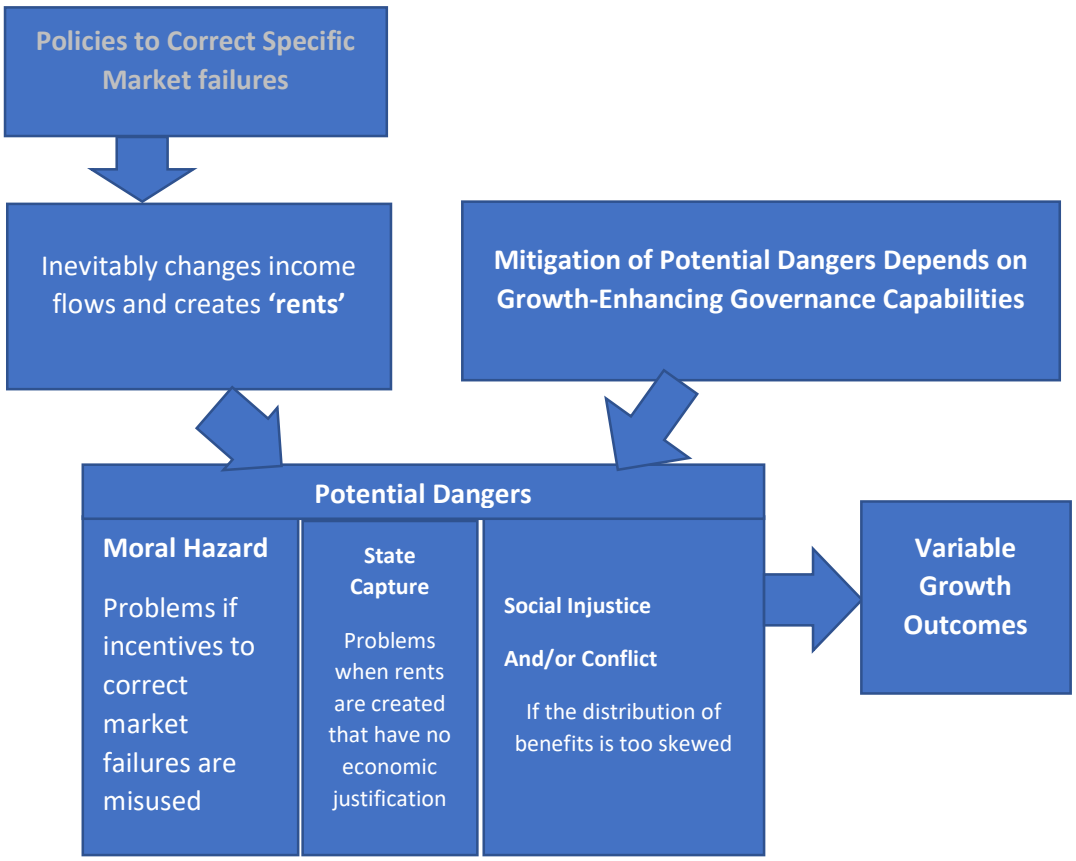
displacements from land including through compensation. Useful tools in this regard include: the voluntary guidelines on the responsible governance of land tenure; fisheries and forests; a technical guide to support the achievement of responsible gender equitable governance of land tenure; World Bank's Land Governance Assessment Framework; Toolkit and Guidance for Preventing and Managing Land and Natural Resources Conflict(European Union/UN Inter agency Framework for Preventive Action); The African Union Framework and Guidelines on Land Policy in Africa and Land Policy Initiative ensuring equitable access.

The effectiveness of a political approach, whether this at a grassroots or a sub-national or national level, depend ultimately on the balance of political forces including the comparative strengths of organized civic groups or political parties compared to the power of corporations and the state. Ensuring accountability in many respects often requires investing significant to strengthen civic groups as a counter balance.

2.5.4 Economic Factors: The previous chapter covered extensively the channels by which natural resource abundance and dependence affect economic development according to the literature. These cover a wide issues including direct impacts on the macroeconomy (growth, stability, revenues, employment) and indirect impacts through their impact on the quality of institutions through rent-seeking behavior, and human capital accumulation.

Kahn (2012) in the diagram below captures these effects using a market failures lense and provides a framework based the notion of "governance capabilities".

Figure 1: Governance Capabilities for addressing market failure



Source: Khan H. M: 'Beyond Good governance: An agenda for developmental governance' in Sundaram K.J., Chowdhury A. (eds) 2012 "Is Good Governance Good for Development" Bloomsbury Academic & United Nations

The negative impacts of natural resource booms and bursts are ultimately the result of market failure. Correcting these failures through policies or institutional reforms creates rents (defined as income flows that would otherwise not have existed without these corrective measures). Rents are thus not "bad things" , i.e. necessarily injurious to welfare or economic growth. The fear is that actions that unleash rents may incentivize rent-seeking of a "wrong sort" or influence its allocation in harmful ways (.e.g. captured by small elite). They may therefore need to be managed in beneficial ways e.g. to increase welfare. The critical determinant is the capabilities of the agencies implementing the policies designed to bring about the desired shifts. In introducing these policies, one must be mindful of other dangers (e.g moral hazards, state capture, inequalities). The critical capabilities are those necessary to mitigate dangers and enhance growth. Examples of crucial capability building instruments include learning and technology acquisition and managing access to land in stable, secure and sustainable manner. Governance capabilities, by their nature can only be developed incrementally.

Other manifestations of market failures and possible mitigations include:

Protecting asset base of natural resource economies: A characteristic of natural resource wealth as explained in an earlier section is that those resources are in fact capital rather than incomes. Their extraction and sale represents a depletion of assets. To mitigate the de-capitalisation of the economy may require investing diversified portfolio, treating only interest on financial assets as income. Mineral assets can also be converted into forms of assets – real estate, technology and skills/education, long-term financial assets etc. taking care that these alternative assets are less volatile and can be accounted for.

Volatility: To mitigate the potential impacts of unavoidable booms and bursts, several measures are possible including selling mineral/oil rights on futures markets; insurance mechanisms and the establishment of stabilization and savings funds, taking steps to balance the portfolio between say financial savings and savings in the forms of skills and economic infrastructure. Pump-priming" through deliberate counter-cyclical government expenditure policies can also smoothen macroeconomic impacts of booms and burst, minding to avoid unsustainable debt in the event of prolonged down-turn.

In the past. Price shocks were also managed by a combination of domestic marketing Boards, buffer stocks, international stabilization funds and International Commodity Agreements.

Avoiding Dutch Disease: Mitigating measures include: rather than sell foreign exchange earnings in the domestic market to fund public expenditure, use the wealth to cover foreign exchange needs and mobilise local taxes to fund local expenditure. Alternatively, expenditures made in the local market could also be sterilized through central bank open market operations. In the long-run, the Dutch Disease is best managed by a strong and focused policy in favour export diversification, the manufacturing sector, especially the development of upstream and downstream industries and other non-resource tradeables.

Maximising Revenue: Getting a good deal- negotiation and taxation- sound, competitive and predictable legal regime is a pre-requisite for optimal revenue capture. Government can also maximize revenue by creating structural competition and providing transparent award processes e.g by auctioning concessions. Better designed and negotiated contracts are also key. Tools that are handy here include: increasing geological information; strengthening availability of negotiation assistance for developing countries; expert commission and peer review analysis (e.g. the Bomani Commission, Tanzania) and regional and global cooperation.

Maximising revenues may also require utilizing more transparent wealth sharing formulas such as royalties compared to say production sharing agreements; that there is full knowledge by governments and the public of the full range of payments to be expected from companies and received by government; that that the payment mechanisms are transparent, verifiable and regularly audited and that illegal transfer pricing mechanisms, secrecy jurisdictions and tax havens are not used by companies, and officials to conceal transfer of capital abroad illegal or aggressively avoid taxes. There is strong evidence that the natural resource sector is most heavily prone to illicit financial outflow of capital from Africa. The growing global outrage of tax dodging and illicit financial flows including by the report of the Thabo Mbeki Commission outlr of mitigating measures.

Leveraging resources for development- value addition and diversification

This should be articulated in *national visions and strategies*. There is a strong case for developing downstream industries with less readily tradeable and low value resources (e.g. gas and non-precious minerals) than with tradeable ones (e.g. oil and precious minerals).

Creating jobs- using resource based investments to leverage other investments as well as multi-purpose and multi-use infrastructure. Invest in infrastructure corridors and link to regional trade; invest in non-tradeable and provide and enabling environment for business. Tools here include: digital mapping (GIS) of infrastructure; ten-year infrastructure maps and scoping studies; strong government institutions to partner with the private sector in leveraging and expanding

infrastructure; one-stop shops for information and linkage. Local Content Policies are also often used as mechanisms to expand benefit sharing between foreign companies and local economies. Employment, sub-contracting, and the reservation of downstream services for local companies are examples of such local content initiatives. With the local content policies of more and more countries failing to achieve their stated purposes countries are shifting more and more towards prioritizing their own transformational plans and addressing the role foreign in that context, including those in the natural resource sector.

International dimensions of natural resource governance: Most of the international initiatives, whether they address tax issues or conflict issues; the OECD seek to address transparency issues trough reporting, tracking information access or similar safeguard measures. Publish What You Pay; the OECD's Best Practices for Budget Transparency, the IMF's Code of Good Practices on Fiscal Transparency and the OECD's Register of Beneficiary Ownership of Companies are largely voluntary codes, except to some extent the IMF. They all aim to make information available either to encourage self-restraint or to aide third parties to ask questions. Transitioning to more automatic and universal reporting arrangements can significantly strengthen the value of these mechanisms.

Conclusion: The policy measures necessary for countries to convert the export of these resources into sustainable development are vast and context specific. In this chapter we provide a framework borrowed from Kahn (2012) to Guide the governance capacity development needs that will enable governments to ask the right questions and consider all the risks. This is an incremental process and finessed through learning by doing. Countries have learnt enormously since the commodity super-cycle which began at the dawn of the 21st century driven largely by China's economic expansion. The fact that macroeconomic imbalances are today not out of control in spite of the current down turn testifies to this learning by governments. This, more than anything else, gives support to the view that it is in the power of African governments to manage relatively prudently risks associated with natural resource booms and bursts to maximise development outcomes. Thee challenge remains how to industrialise irrespective of natural resource wealth. The answer to discussion may lie in the recent elevation of agriculture as a priority sector across the continent.