U4 Expert Answer

Good practice in mitigating corruption risks in the extractives sector

Query

What examples are there of good practice in mitigating the risk of corruption in the extractives sector (oil, gas and mining) in resource-rich developed and emerging economies, which could be considered by developing countries or which have an impact on reducing corruption in developing countries? We are particularly interested in examples from Argentina, Brazil, India, Indonesia, Mexico, Russia, South Africa, Australia, Canada, China, Germany, Saudi Arabia, Turkey, US and the UK.

Purpose

We would like to prepare our approach to the issue.

Content

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Summary

With large volumes of revenue at stake, the extractives sector is often associated with poor governance and corruption. Corruption risks can occur at every step of the value chain, from awarding of contracts and licenses to determining how to spend revenues. Many governments and companies in resource-rich developed and emerging economies have therefore taken steps to combat corruption and ensure revenues are adequately used.

Practices include (a) ensuring fair awarding procedures through criminalisation of bribery, clear and transparent awarding procedures, contract transparency; (b) mechanisms for monitoring operations (also at state-owned enterprises) that include audits, parliamentary oversight, civil society and media monitoring, as well as corporate transparency and monitoring; (c) systems for collecting revenues in a transparent

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and accountable manner through sound fiscal regimes and transparent reporting; and (d) determining accountable ways to manage, invest and spend revenues such as through sovereign wealth funds and strategic planning processes.

1 Curbing corruption in the extractives sector

Corruption in the extractives sector

The extractives sector, namely, oil, gas and mining, are often associated with poor governance and corruption. In fact, many researchers have argued that the presence of natural resources can be a curse rather than a blessing (IMF 2007).

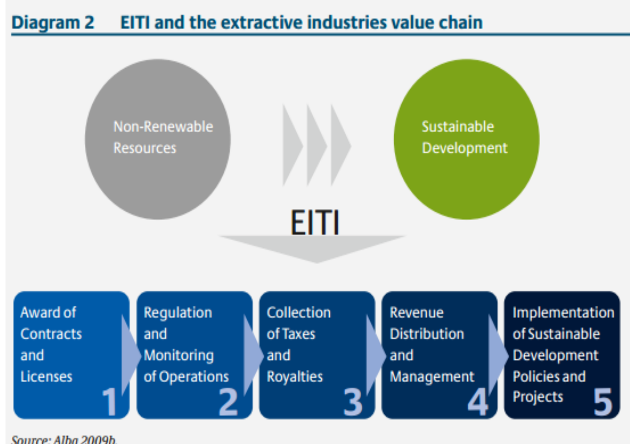
For one, the presence of natural resource endowments means large volumes of revenues which many groups may compete for (Kolstad et al. 2008) and can thus result in rent-seeking behaviour or intense competition to control or influence state institutions. The ability to rely on resource rents, rather than on income from taxation of their citizens, can also make it easier for governments to act in unaccountable ways. Moreover, corruption may occur directly within the natural resource governance system. This can lead to poor use of resources and poor development outcomes in terms of economic growth and poverty reduction (Kolstad et al. 2008).

Extractives sectors are usually technically and structurally complex, including related legal, commercial and fiscal arrangements, making it easy for those who manipulate revenue flows for political or personal gain to conceal their activities (World Bank 2007).

Since extractives operations are often environmentally and socially very sensitive, the sector requires extensive regulation, thus presenting new corruption risks – for companies to pay for cutting corners with regard to environmental rules and for officials to create additional red-tape and hold-ups to extract more undue payments (Transparency International 2011). In fact, Transparency International's Bribe Payer's Index 2011 revealed that the mining, oil and gas sectors are among the sectors in which foreign companies are most likely to pay bribes (Transparency International 2011).

Corruption risks in the extractives sector can occur in every step of the extractives industries value chain, in particular in the following areas:

Diagram 2 EITI and the extractive industries value chain



Source: Alba 2009b.

(i) Award of contracts and licenses.

(ii) Regulation and monitoring of operations.

(iii) Collection of taxes and royalties.

(iv) Revenue distribution and management.

The last link in the value chain shown above (the implementation of sustainable development policies and projects) concerns the use of revenues from the extractives for long-term development and economic growth. However, as this topic is very broad and goes beyond the scope of this query, this Helpdesk answer will only focus on good practices in steps (i) to (iv) in the extractives value chain.

In light of the various corruption risks, good governance of the extractives sector is therefore essential for the successful development of countries with large natural resources endowments.

There are many examples of good practice from developed and emerging economies that have helped mitigate the risks of corruption along the extractives value chain. This demonstrates that the so-called "resource curse" is not inevitable. Importantly, research also shows that many innovative practices also arise directly in developing countries, although challenges in implementation exist.

The practices listed below are categorised by the individual links in the value chain. Nevertheless,

many are relevant for other links and can impact the value chain as a whole.

2 Award of contracts and licenses

The government decides on a framework for awarding exploration, development and production rights. This is usually done by means of concessions, leases, licenses or contracts (Alba 2009). However, the level of control and ownership in these arrangements can vary considerably. Some countries negotiate poor terms with extractives companies, at the expense of potential long-term benefits (Revenue Watch 2013). Moreover, contractual arrangements are typically very complex in nature and difficult for the general public to understand and monitor, which limits accountability (World Bank 2007).

The awarding of contracts and licenses is an area that is assessed to be particularly vulnerable to corruption. Award criteria, access to information, and the selection process can be manipulated for corrupt processes (Le Billon 2011). The awarding of contracts can create incentives for corruption, such as firms attempting to influence government decision-making through bribery (Kolstad et al. 2008) or firms with political contacts being given preferential treatment (Alix Partners 2012).

The license agreements themselves can also be exposed to corruption in terms of determining the area of exploitation, the cost recovery basis, the licensees' share of the profits, the length of operation, rate of production, environment concerns, end-phase commitments, as well as reporting and control commitments (Kolstad et al. 2008).

Transparency and accountability measures

Criminalising foreign bribery

Bribery and facilitation payments are a major threat in the awarding of contracts and licenses. This is particularly the case for companies operating in countries with high levels of corruption, weak governance and weak or non-existent anti-bribery laws. As such, many developed countries have implemented extra-territorial bribery laws to criminalise the bribery of their companies abroad.

In the **US**, anti-bribery provisions in the Foreign Corrupt Practices Act (FCPA) make it illegal to "corruptly" give, promise to give, or authorise the giving of, whether directly or through another, "anything of value" to a foreign official (Pepper Hamilton LLP 2013). The laws apply to the conduct anywhere of a) any business entity that issues securities in the United States, b) a non-issuing US business entity or individual or c) the conduct within the US by a non-issuing, non-US business entity or non-US individual (Pepper Hamilton LLP 2013).

In the **UK**, the UK Bribery Act criminalises both active and passive bribery and is often considered to be one of the strongest anti-corruption legislations passed to date (Pepper Hamilton LLP 2013). The UK Bribery Act goes much further in its jurisdictional application, covering the overall conduct of a broader range of foreign companies that do business in the UK (Swan 2012). In addition, while facilitation payments are still exempt under the FCPA the UK Bribery Act also criminalises facilitation payments (PwC 2012a).

The UK Bribery Act makes businesses responsible not only for the actions of its employees but also for those of all "associated persons" (Ethic Intelligence 2012). As companies can therefore be held liable for the actions of third parties operating on behalf of the company, experts advise companies to engage in extensive due diligence practices and ongoing monitoring of third parties to avoid any risks (KordaMentha Forensic 2014, Transparency International 2013).

Moreover, under the UK Bribery Act, a company "will have a full defence if it can show that despite a particular case of bribery it nevertheless had adequate procedures in place to prevent persons associated with it from bribing" (UK Ministry of Justice 2012). There is therefore an incentive for companies to create adequate control procedures. Accordingly, many experts advise companies to take appropriate steps to ensure anti-corruption compliance and become familiar with the specific corruption issues in the countries a company is operating in (King and Spalding 2014). A recently published report by Transparency International USA also provides an overview of the corporate anti-corruption landscape and existing anti-corruption compliance guides and verification methods.

Clear and transparent awarding

A variety of standards and principles can guide the awarding of licenses and contracts. According to the World Bank, efficient and effective award

policies require transparent, competitive and non-discretional awarding procedures (Alba 2009). This includes, for example, necessitating pre-qualification rounds that ensures quality tender participants (Kolstad et al. 2008). Moreover, clear and transparent award criteria are important to reduce the risk of corruption (Kolstad et al. 2008).

Botswana is argued to be a leading developing country in terms of good practice in its mineral regulations. Its mining policies have the highest score of any African country in the Fraser Institute's 2013 survey of mining companies under the policy perception category (Fraser Institute 2014).

Botswana's 1999 Mines and Minerals Act reformed the process of licensing, making it predictable and clear (Leon 2013). What is specifically acknowledged is that the Act provides the Minister of Minerals, Energy and Water Resources, who grants licenses, with little or no administrative discretion; instead, the conditions are stated clearly in the Act (Leon 2013). The government's website also clearly details the application process as well as the costs of obtaining the licensing service.

As a response to corruption, malpractices and revolving doors, in 2012, Uttar Pradesh state in **India** implemented an e-tendering system for awarding all new mining leases (Jain 2012). In the past, contracts were awarded on a "first come, first serve" basis, where transparency was mostly lacking (Jain 2012). With this new system, the entire bidding process from registration to awarding will be done online and is publicly accessible.

Indonesia's new Mining Law incorporates a transparent tendering procedure for granting licenses. Under this, new licenses can only be issued through a competitive tender process rather than direct appointment, creating greater transparency and fairness (PWC 2012b). Under the new procedure, if there is no more than one bidder, there must be a re-tender; if upon re-tender there remains one bidder, the license can only be awarded to that sole bidder where the base price has been met (PWC 2012b). Selection criteria are determined on price bid and technical considerations, including evidence of previous mining experience by the company and submission of an annual work plan for the first four years of exploration (PWC 2012b). However, PWC notes that the precise details of how this is to be assessed in detail remains to be determined by further regulation.

Contract transparency

Contract transparency can help citizens assess whether they are getting a fair deal and monitor obligations by governments and companies. Stakeholders can know whom to hold to account for what and know what payments should be made (Open Contracting no date). Contract transparency is encouraged under the revised Extractive Industries Transparency Initiative (EITI) standard and recommended good practice by the IMF, World Bank and required by the International Finance Corporation in its extractives projects (Open Contracting no date). Open Contracting, a multi-stakeholder movement that seeks greater disclosure in public contracting, also specifically focuses on open contracts in the extractives sector.

According to Open Contracting, there is a great trend towards contract disclosure in the extractives sector (Open Contracting no date). Accordingly, many countries now publish some or all of their oil, gas and mining contracts and licenses.

The lists of countries that publish contracts compiled by the Resource Centre and Publish What You Pay show that it is primarily developing countries rather than emerging or developed countries that publish contracts. For example, **Liberia**'s Transparency Act of 2009 included a provision promoting the transparency of contracts, which are available on the Liberia EITI website, categorised by sector and county. Another example is **Guinea,** which, in 2011, revised its mining code to make public all mining conventions, amendments and other related legal documents (Contrats Miniers Guinée 2013). In 2013, it launched a new website that provides easy access to all documents, categorised by document type, resource, and year. **Mexico** is one of the few emerging economies that publishes its contracts, namely those from the state-owned Pemex oil company.

3 Monitoring of operations

The extractives sector is exposed to a number of corruption risks during the operation process. This includes undue influence by special interests on the enforcement of sector policies, administrative corruption in the form of officials extracting corrupt benefits in exchange for administrative approvals,

and grand corruption where public funds are diverted into private pockets (World Bank 2007).

As such, a necessary process in the extractives value chain is the monitoring of operations. In particular, this means establishing regulatory capacity to monitor operations, ideally complemented by some element of participatory monitoring.

Transparency and accountability measures

This section will focus on monitoring practices rather than regulation and establishing a regulatory capacity as a whole as this goes beyond the scope of this Helpdesk answer.

Monitoring by governments

Auditing and parliamentary oversight

Regular audits and parliamentary oversight are seen as essential in the monitoring process. This is in the form of a national audit office or similar body that reports regularly to parliament on the revenue flows.

The World Bank published a report on Parliamentary Oversight of the Extractive Industries Sector, which outlines the role parliaments can play in the extractives industries sector along the different stages of the sector's value chain. It provides a list of tools legislatures have developed to assist them in practicing oversight, including: question sessions that give parliament the opportunity to regularly question ministers; committee hearings; requests for documentation, submitting formal questions to the government; creating an ombudsman person; setting parliamentary debates; and establishing audit and oversight agencies that conduct reviews of government spending and reports these to parliament (World Bank 2010).

In terms of examples of good practice, the **UK** and the **US** Gulf of Mexico petroleum extraction are two of the top performers in the safeguards and quality controls section of the Resource Governance Index.

The **US** received a score of 89 out of 100 achievable points. The Government Accountability Office, the Office of the Inspector General and other external organizations routinely oversee and monitor U.S. mineral management activities (NRGI 2013a). In addition, both houses of Congress have natural resources committees that regularly scrutinise petroleum management and revenue collection issues (NRGI 2013a).

The **UK** was assessed as having comprehensive audit requirements and parliamentary oversight for its petroleum sector, earning it a score of 83 out of 100 achievable points (NRGI 2013b). The National Audit Office reviews the accounts of the HM Revenue and Customs, including petroleum receipts (NRGI 2013b). The Energy and Climate Change Committee of the House of Commons oversees the management and accounts of the Department of Energy and Climate Change, the body that regulates the extractives industry (NRGI 2013b).

Monitoring of state-owned enterprises[1]

State-owned enterprises are vital entities of national economies in most countries (Revenue Watch 2013). They control some of the most significant revenue flows generated by natural resources. Given their unique institutional status and high levels of authority, state-owned enterprises at times escape necessary oversight and accountability (Revenue Watch 2013). Mismanaged state-owned enterprises can exacerbate waste and corruption (NRGI 2014).

Assessments by Revenue Watch (now known as the Natural Resource Governance Institute (NRGI)) in 2013 reveal that transparency is yet to be fully embraced by many state-owned enterprises. Those that do perform well on transparency have legal requirements to publish reports, regularly disclose audits and data on production and revenues, are transparent on their extra-budgetary spending, comply with international accounting standards and include their information in national budgets (Revenue Watch 2013).

The top performer on the Resource Governance Index that assesses the governance of state-owned enterprises is **Norway**'s Statoil. In fact, Statoil was one of the first major oil companies to start disclosing all revenues and payments in the countries in which it operates (OGP 2013a).

Mexico's Pemex oil company is also a solid performer. Overall, experts note that **Mexico** has undertaken major changes in recent years to

[1] For more on corruption risks and transparency of state-owned companies, see this Helpdesk answer.

advance transparency and accountability in its extractives sector (Moreno 2012). As such, it is ranked 6th out of 58 countries assessed in the 2013 Resource Governance Index (Revenue Watch 2013). It is argued that this is largely due to the fact that state-owned oil company Pemex is obliged to comply with the advanced Mexican Federal Transparency and Access to Public Information Law (Moreno 2012).

Mexico's 2008 Energy Reform also introduced several initiatives to advance transparency and accountability at Pemex. This included the creation of (a) two internal oversight committees that monitor Pemex's board of directors, (b) a special commissioner position charged with reporting on the accuracy and sufficiency of the information provided by the governing body of the company and (c) a regulatory body to act as a counterweight mechanism to decisions taken inside the company (Moreno 2012). While experts have expressed concern about remaining transparency challenges at Pemex, the level of information regarding decision-making, oil projects and other areas of the company's operations has been argued to have increased substantially (Moreno 2012).

Monitoring by civil society and media

There are a number of international organisations and multi-stakeholder initiatives that focus on giving civil society and media the space to monitor extractives projects. This includes organisations such as Publish What You Pay, Natural Resource Governance Institute, Global Witness, and Transparency International. The EITI standard also requires the active participation of civil society in the design, monitoring and evaluation of audits (Le Billon 2011). Through the EITI process, civil society organisations are also involved in efforts to raise public awareness about resource transparency as well as support legislation that strengthens and advances resource revenue transparency (EITI 2011).

Investigative journalists have also played an important role in uncovering corruption in the extractives sector. They can help put pressure on governments to be more accountable (Schiffrin and Rodrigues 2014). As there has been a move towards greater transparency in recent years, there is a lot of data and information for journalists to draw on (Schiffrin and Rodrigues 2014). A paper by Schiffrin and Rodrigues at the 2013 Global Investigative Journalism Conference provides a detailed list of tools and sources of information for journalists covering the extractives sector.

In **South Africa**, in the context of limited civil society activity on transparency and accountability in the extractives sector, it is the organised labour associations and media that play a particularly active role (Hughes 2012). The Congress of South African Trade Unions (COSATU), for example, is identified as an especially strong critic of opacity and non-accountability in the extractives sector (Hughes 2012). The media has also covered stories and issues relating to corruption in the extractives sector, in particular focusing on tendering and licensing agreements (Hughes 2012).

One way in which civil society can monitor extractive operations are integrity pacts[2]. Integrity pacts require governments and participant bidders in a specific contract to commit to high levels of transparency, integrity and accountability and to abstain from corrupt conduct (Transparency International 2014a). With the help of civil society organisations, an independent monitor oversees the whole process, making sure promises are kept (Transparency International 2014a).

Breaches of integrity pacts can result in serious sanctions, including contract termination and blacklisting. In **India**, for example, the Indian Ministry of Defence cancelled a huge contract for helicopters worth over US$750 million because they breached a pre-contract integrity pact (Transparency International 2014b). The integrity pact had obligated the company to abstain from all forms of bribery, which they were found to be in breach of following allegations the company had paid bribes to Indian officials to influence the deal (Transparency International 2014b).

Several Transparency International chapters have utilised integrity pacts for major projects in their country. In **Mexico**, for example, the Mexican federal electricity commission approached the Transparency International chapter to implement an integrity pact in the contracting process for the El Cajón hydroelectric project in north-western Mexico. With the pact in place, construction took

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[2] Transparency International has published a hands-on practical resource that explains how integrity pacts work, how they can be used, and cases of good practice. Download pdf.

place as scheduled and free from corruption scandals (Transparency International 2014a).

Corporate transparency and monitoring of associates

By being open and transparent, companies can also facilitate monitoring by others. They can comply with standards on accounting and auditing and publicise accounts.

There have been some international efforts aimed at the corporate sector to improve corporate transparency. One of these is the UN Global Compact, the world's largest corporate sustainability initiative, which adopted an anti-corruption principle through which businesses commit to work against corruption in all its forms. It published a guidance document that included a set of 22 reporting elements which can be reported against. These include reporting on internal accounting and auditing procedures related to anti-corruption.

Within the extractives sector, there is, for example, the International Council on Mining and Metals (ICMM). It was founded in 2001 to improve sustainable development performance in the mining and metals industry. It currently consists of 22 companies and 32 mining associations. Through membership in the ICMM, member companies are EITI supporting companies. Through membership in the ICMM, companies commit themselves to endorse the EITI, provide government regulators with information on all material payments, and support the public disclosure of relevant data in line with the implementation approach adopted in-country (ICMM 2009).

However, the level of corporate reporting overall remains somewhat limited and challenges remain. As the results of Transparency International's Transparency in Corporate Reporting (TRAC) report – which assesses the transparency of corporate reporting among the 105 largest publicly listed companies – revealed, most companies disclose little or no financial data on a country-by-country basis.

Nevertheless, there are some examples of good practice among extractives companies.

For example, in 2009 Rio Tinto, a global mining company, joined a small group of oil and mining companies – including **Canada**'s Talisman Energy, **US**-based Newmont Mining Corporation and **UK**-based Anglo American – that disclose information about revenue payments that they make to governments on a per-country basis (PWYP 2009). Rio Tinto voluntarily disclosed the total tax and royalty payments to 13 of the countries where it operates (PWYP 2009).

South African companies also provide some good examples of companies working towards transparency. In 2011, South African companies in the extractives sector scored high in a 2011 survey of sustainability and transparency of South Africa's largest 25 companies (Hughes 2012). It is argued that this is because the industry is under greater scrutiny than others (Hughes 2012). Gold Fields Ltd, for example, has received international recognition for its transparency and reporting (Ernst and Young 2012). It is a member of the ICMM and thus supports the EITI (Gold Fields 2013). It also subscribes to the principles of the UN Global Compact and publishes integrated annual reports according to the advanced UN Global Compact standard (Gold Fields 2013). According to its 2013 Integrated Annual Review, Gold Fields Ltd also implemented the World Gold Council's new reporting metrics that gives investors, governments and local communities better understanding of the "true cost" of producing and selling an ounce of gold (Gold Fields 2013).

Lastly, companies can also play a role by monitoring the activity of their associates. After all, as mentioned above, companies can be held liable for the activities of third parties operating on behalf of the company. As such, experts advise companies to engage in extensive due diligence practices and ongoing monitoring of third parties to avoid risks (KordaMentha Forensic 2014, Transparency International 2013). Due diligence practices can include demanding a variety of documentation (financial statements, independent checks, references, etc.), requiring the party to sign an anti-corruption certification, and conducting detailed interviews to assess the integrity of the company (Manuel 2011). The UN Global Compact also recommends incorporating anti-corruption clauses into joint venture contracts. These clauses allow for the ending of the contractual relationship in cases where the company or its senior management is found guilty of corruption (UN Global Compact 2010).

4 Collection of revenues

Extractive operations are subject to a wide range of rent collection, many that are also specific to the industry. These include, in addition to taxes, royalties, duties, surface fees, signature bonuses, production sharing, dividends, etc. There are, therefore, great volumes of revenue at stake, making them attractive for corrupt practices both by government officials and companies. This is particularly the case when there is no transparency and accountability in the manner in which these payments are collected and reported on.

Transparency and accountability measures

Fiscal regime

Sound fiscal regimes can help countries benefit from resource wealth. Careful macroeconomic management and prudent fiscal policy can help foster the efficient use of public funds, reduce the risk of unstable macroeconomic policies, and improve confidence in the budget process (IMF 2007).

In order to provide resource-rich countries with guidance on how to ensure good, transparent fiscal practice, the IMF released its Guide on Resource Revenue Transparency in 2007. It covers the four pillars of fiscal transparency, namely: clarity of roles and responsibilities, open budget processes, public availability of information and assurances of integrity. It advises governments to make their policy framework and legal basis for taxation or producing sharing agreements with resource companies available to the public clearly and comprehensively.

Tax avoidance and evasion are also major issues in the extractives sector. The OECD Global Forum on Transparency and Exchange of Information for Tax Purposes serves as an intergovernmental initiative on taxation. The purpose of the forum is to ensure that all countries adhere to the same standard of international cooperation in tax matters. To achieve this, it conducts peer reviews of its members' laws and practices in the areas of availability of tax information, access to tax information and exchange of information. Of the 121 assessed countries, **Australia**, **Canada, China, India**, **Mexico**, and **South Africa** have been assessed as compliant (OECD 2014).

The **UK** has introduced regulations to enhance transparency and raise the importance of tax risk management in corporations. It requires the senior accounting officer of certain large companies to certify annually that he or she has established and monitored accounting arrangements capable of supporting accurate tax returns across all major taxes (Misutka and MacEachern 2013). This includes having mechanisms in place for identifying, managing and monitoring the risks that might result in the tax returns not being accurate (Misutka and MacEachern 2013). If the company is found not to have appropriate arrangements in place, penalties can be imposed both on the individual senior accounting official as well as on the company as a whole (Misutka and MacEachern 2013).

Tax avoidance and evasion can also happen through transfer mispricing, through which trade between related companies is meant to deceive tax authorities (Tax Justice Network 2013). It is estimated that several hundred billion dollars annually are lost due to transfer mispricing (Tax Justice Network 2013). One of the approaches to dealing with transfer mispricing is the unitary taxation approach, which is advocated by many academics, development practitioners and civil society organizations, and is used in many federal states in the **US** (Tax Justice Network 2013). The aim of unitary taxation is to tax portions of a multinational company's income without reference to how that enterprise is organised internally (Tax Justice Network 2013).

Reporting transparency

Clear and transparent rules on what types of revenue governments and companies should report on are also crucial in the collection of revenues.

One important initiative in creating greater transparency of corporate reporting in the extractives industry is Section 1504, also known as the Cardin-Lugar provision, of the **US** Dodd Frank Act. This specifically mandates oil, gas and mining companies (including company branches, consolidated entities, and entities under control) to disclose all payments made to the United States and foreign governments (Oxfam 2012b).

Following the Cardin-Lugar provision, many others have followed suit. In 2013, The **EU** passed a directive that would make it a legal requirement for EU-listed and large privately-owned oil, gas, mining and logging companies to

publish country-by-country and project-by-project payments (Publish What You Pay 2013a).

This is an area that emerging and developing economies are advised to follow suit on. However, as of yet, there has not been indication of a high-level systematic response to the Cardin-Lugar provision from extractive countries in Africa (Ushie 2013).

Nevertheless, a number of developing countries are members of the EITI. Through the EITI, member countries commit themselves to implement the international EITI standard on good governance in the oil, gas and mining sectors. The EITI requires production of comprehensive EITI reports that include full government disclosure of extractives industry revenues and disclosure of all material payments to government by oil, gas and mining companies. The reporting standards cover a wide range of revenue streams including the host government's production entitlement, revenues received by state-owned enterprises, taxes, royalties, dividends, bonuses, fees, and all other significant payments and material benefits to the government.

Some of the leading emerging economies (such as the BRICS countries (**Brazil**, **Russia**, **India**, **China**, **South Africa**)) are not members of the EITI. Of the list of countries in this Helpdesk answer, only **Indonesia** and the **US** are EITI candidate countries.

Nevertheless, the **Canadian** government in 2013 announced that it will implement mandatory requirements for Canadian extractives companies operating both in Canada and abroad (Publish What You Pay 2013b). A working group consisting of the Mining Association of Canada, Publish What You Pay Canada, National Resource Governance Institute and the Prospectors and Developers Association of Canada submitted a framework for mandatory disclosure rules, similar to the ones adopted by the EU and the US (Publish What You Pay 2014).

Transparency of state-owned enterprises

Reporting transparency of state-owned enterprises in the extractives sector is another area that governments have focused their attention on. In addition to being covered in the EITI, reporting of state-owned enterprises is also highlighted by the Natural Resource Charter. According to this, relevant information for publication includes: revenues collected by the state-owned enterprise, a detailed accounting of the fiscal relationship between the company and the state, assets held by the company in subsidiaries and joint ventures, expenditures by the company on quasi-fiscal activities, company debts, description of major activities in exploration and production, the company budget, detailed reporting on sales, and the corporate structure (NRGI 2014).

According to NRGI (2014) state-owned enterprises in **Mexico**, **Brazil**, **Malaysia** and **Cameroon** have adopted transparency reporting practices. For example, **Mexico**'s 2002 Federal Law of Transparency and Access to Information requires Pemex, the state-owned oil company, and its subsidiary bodies to publish information on its finances and revenues (Moreno 2012). Requests for information can also be submitted independently (Moreno 2012).

Additional best practices are: external, independent audits; publishing audit reports; hiring auditors through open tenders; and changing auditors periodically (NRGI 2014). The latter is, for example, a statutory requirement for Pemex every four to five years (NRGI 2014).

Brazil is also considered to have good levels of revenue and expenditure transparency in its state-owned enterprises. This is driven both by its legislation for disclosure of public data on government web pages but also by the National Oil Company's participation in the stock exchange (OGP 2013b). The National Petroleum Agency (ANP) regularly publishes information on reserves, production volumes, prices, exports, investment, the names of companies operating in the country, production data by company, and disaggregated revenue streams such as production values, royalties, special taxes, bonuses, and acreage fees (OGP 2013b).

Turkey is also regarded as having improved the reporting transparency of its state-owned enterprises (OECD 2011). The role of the Treasury Under-secretariat was strengthened to allow for collecting information from all state-owned enterprises and preparing a yearly aggregate report (OECD 2011).

5 Revenue spending

As the revenues begin to flow the government must decide how to make effective use of them. This requires deciding how much to save, how much to spend, and what to spend on. As with any government budget, this can be susceptible to corruption when carried out with limited oversight, transparency, accountability as well as community participation. Without disclosure, citizens are unable to assess whether revenues are spent efficiently and equitably (Le Billon 2011).

Weak institutions and mechanisms to manage and spend resources can lead to significant losses and waste (Dyne and Sothath 2013).

Decisions on extractives revenue spending are crucial because they are directly linked to development and economic growth (Dyne and Sothath 2013). As such, when managing resource revenue, governments need to address the following issues (Dyne and Sothath 2013): (i) needs for social and infrastructure development; (ii) choosing between current and future benefits; (iii) policy design to deal with volatility of resources prices and their eventual depletion; and (iv) enhancement of domestic capacity to absorb the spending from the resource revenue.

Transparency and accountability measures

Natural resource revenue spending should adhere to the same principles of prudent, transparent and accountable government practices. It therefore goes beyond the scope of this Helpdesk answer. This section will only focus on some areas that are specific to the extractives sector.

For more on budget transparency, see this Helpdesk answer.

Sovereign wealth funds

One common practice by resource-rich countries to manage government revenue from the extractives sector is to use sovereign wealth funds (also known as natural resource funds). These essentially manage revenue volatility, balance expenditures and savings, and utilise revenues to generate sustainable economic growth and development. The collective assets of 23 funds covered in the Resource Governance Index were estimated to total more than $2 trillion in 2012 (Revenue Watch 2013).

However, studies show that the implementation of a natural resource fund alone will not necessarily lead to less corruption (Bradley and LeVine 2012). In fact, many argue that corruption risks are particularly high as revenues that go into natural resource funds can bypass regular budget processes and can become vehicles for patronage and discretionary allocations (Revenue Watch 2013). This is for example the case in **Russia**, where the spending from the funds bypasses legislative approval (Revenue Watch 2013).

Fund design and governance are determining factors in ensuring that sovereign wealth funds help curb corruption (Bradley and LeVine 2012). It requires a robust legal framework to promote sound institutional and governance arrangements for effective management (Al-Hassan et al. 2013). Experts also suggest that the funds should be independently managed to minimise political interference (Al-Hassan et al. 2013). Moreover, the funds that receive the best assessments have several things in common: transparency of operations, accessibility of reports that are published in the public domain, audit results are made regularly available, there are vertical and horizontal checks and balances, and fund managers, board members and others involved in fund management and oversight are selected on merit (World Bank Cambodia 2009).[3]

The natural resource fund that stands out as the best governed is **Norway**'s Government Pension fund, which received a perfect score on the 2013 Resource Governance Index. According to the IMF, it has a well-formulated and transparent asset management strategy for its fund (IMF 2007). The Ministry of Finance bears overall responsibility for the fund's asset management but delegates the operational asset management to the central bank based on a management agreement (IMF 2007). Nevertheless, the Ministry of Finance defines the strategy for investment and also controls exposure to risk (IMF 2007). Moreover, Norway has also established ethical guidelines for the fund that promote good corporate governance as well as screening of companies from fund investment

[3] For more guidance on how to set up sovereign wealth funds, see here. Bloomberg Law Reports have also published a checklist for effective compliance programmes for sovereign wealth funds

options (IMF 2007). Lastly, the fund also publishes annual and quarterly reports in a timely fashion on the central bank's website.

Canada's Alberta Heritage Savings Trust Fund ranks 7th out of the 23 assessed natural resource funds on the 2013 Resource Governance Index. The government of Alberta has conducted a number of surveys to ask its residents how they would like to see the petroleum revenues used (World Bank Cambodia 2009). Its original focus on economic diversification and improving social infrastructure receive limited public support and residents gave their overwhelming approval instead for channelling revenues to a savings fund for future generations (World Bank Cambodia 2009).

The **US** state of Alaska's Permanent Fund has a novel approach in that it combines a natural resource fund with a cash transfer[4] scheme. In 1982, the US government established the Permanent Fund Dividend programme, a regular cash transfer of the fund's interest earnings to state residents (Moss 2011). The programme was created to give Alaskans a stake in protecting oil revenues and the integrity of the fund and limit wasteful spending (Moss 2011). Alaskan households have been receiving 3-6% of their average income in recent years from the Permanent Fund (Moss 2011). Other countries are adapting part of the Alaska model to their own natural resource management. For example, **Bolivia**'s earnings from its exported natural gas go into the pension system (Moss 2011).

Strategic planning processes

Strategic planning processes can help ensure that extractives resources are properly spent.

The EITI, for example, requires that each country's multi-stakeholder group – a group made up of government, company and civil society representatives that oversee the EITI implementation in a country – maintains a workplan that forms the foundation of all EITI activities. Among other aspects, this workplan must identify national priorities for the extractives sector (EITI 2014). These priorities should be identified through consulting stakeholders regarding their views on the priorities for the management of the extractives sector (EITI 2014). For example, in the **Kyrgyz Republic**, consulted participants highlighted the need for reducing conflict among local communities and thus asked for fairer and more accountable distribution of revenues to local levels (EITI 2014). In the **Ukraine**, participants wanted the EITI process to contribute to a more attractive investment climate by reducing corruption and red tape (EITI 2014).

National development plans can also be used to determine how to channel funds and resources. A national development plan establishes expenditure priorities for the short and medium term on the basis of long-term macroeconomic and social objectives (Alba 2009).

The IMF provides the case study of **Botswana**'s national development as a good practice. Overall, the IMF notes that Botswana has pursued broadly prudent economic policies and dealt effectively with its diamond revenues (IMF 2007). In particular, it highlights the country's medium-term National Development Plans as having been an important fiscal policy instrument for channelling diamond revenues into capital investments (IMF 2007). Plans have been formulated with a view to maintaining a sustainable fiscal position (IMF 2007).

Similarly, in **Ghana**, the national development plan serves as the basis to guide the expenditure arising from natural resources (Dyna and Sothath 2013). This framework requires the Minister of Finance to identify not more than four priority areas for spending the petroleum revenue each year (Dyna and Sothath 2013).

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[4] For more on using cash transfers in natural resource management, see Moss, T. 2011. *Oil to Cash: Fighting the Resource Curse through Cash Transfers.*

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