Natural Resource Governance Institute

Precept 1: Strategy, Legal Framework and Institutions

Resource management should secure the greatest benefit for citizens through an inclusive and comprehensive national strategy, clear legal framework and competent institutions.

–Precept 1, Natural Resource Charter

Natural resources present both opportunities and risks for the countries that choose to extract them. Managed well, they can support greater prosperity for current and future generations; but managed poorly, they can cause economic instability, social conflict, and lasting environmental damage. For decision-makers, making the right choices is difficult. They must navigate a wide range of issues, and work with a diverse array of actors with many competing needs and interests. To do this, they must build a resource strategy that is both comprehensive and inclusive. This strategy is likely to be more successful if it is rooted in a realistic understanding of the country's resource wealth, developed in dialogue with a wide range of stakeholders, and is authoritative enough to guide the development of the legal and institutional framework.

Precept 1 considers two main issues: understanding the country's resource endowment (Q1.1) and the quality of the government's strategy (Q1.2).

PRIMARY QUESTIONS

1.1 | Fundamentals of the resource endowment

Has the government clearly identified the country's resource endowment, who owns it, and the positive and negative impacts of extraction?

1.2 | Resource strategy

Does the government have an inclusive and comprehensive national strategy for the management of resources?

1.1 | Fundamentals of resource wealth

Has the government clearly identified the country's resource endowment, who owns it, and the positive and negative impacts of extraction?

Before embarking on a strategy, government officials should acquire a full and clear understanding of fundamental aspects of the country's resource endowment. This is not as straightforward as it might sound. In addressing these issues, the government must wrestle with the inherit uncertainty of geological information and commodity prices, and determine the relative importance of a wide range of potential impacts. While there is no standard checklist for success in this area, at the very least government must gain clarity on the issues examined below.

Secondary question	Guidance
1.1.1 **Ownership** Has the government clearly established who owns extractive resources?	Clarity on who owns extractive resources is critical because it determines who ultimately has the right to carry out exploration and exploitation activities, with whom private companies must make agreements if they want to carry out these activities, and who receives certain types of payments, particularly royalties. In most countries, subsoil assets are owned by the citizens and it is the responsibility of governments to manage resources as representatives of citizens. There are exceptions to this norm, notably in the United States, where subsoil wealth can be owned by private individuals as well as the state. The government should establish ownership of natural resources long before exploration and production activities start, and should support this with active and ongoing communications. Failure to do so carries the risk that resource finds will fuel discord and conflict as rival parties make claims for ownership. Resources that lie under international borders also present challenges. If there are disputed territories, the government should act to establish certainty around international borders before carrying out exploration activities to ensure that resource finds do not complicate ongoing disputes. *Researchers should consider:* • Has the government clearly detailed property rights for oil, gas and mineral assets in law or in the constitution? • Do citizens understand and accept the national policy on ownership of natural resources? Has the question of ownership of natural resources ever resulted in conflict in the past? Is there any chance that misunderstanding of the modalities of resource ownership could fuel conflict in the near future? • Does the government disseminate the national policy on ownership of natural resources through active and ongoing communications? For further reflection on government communications, see Q2.3.1. • Has the government agreed international borders, in particular maritime borders, with neighboring countries?

1.1.2 **Resource endowments** Does the government have a well-informed understanding of the country's resource endowment?	A well-informed understanding of resource endowments is essential for developing a strong strategy for resource management. Arriving at this understanding is challenging because the scale and value of resources are inherently uncertain. For example, the value of the resources depends on volatile prices, and the quantity of extractable reserves may depend on new technologies. Governments vary in how well they manage this uncertainty. To inform its policymaking, the government should collect and consider the following information for each major commodity: • **Volumes.** An understanding of volumes allows the country to determine the actual and potential scales of production. Government should collect information on production volumes, total reserves under production, as well as total proven reserves. • **Prices.** An understanding of prices allows government to determine which assets are commercially viable at any point in time given cost information. Of all the variables in this list, this is the most uncertain. When making price projections, it is good practice to use and communicate a range of scenarios for low, medium and high prices. • **Values.** The government should collect data on the value of resources produced. It should also project the value of total reserves under production, as well as value of total proven reserves, both under low, medium and high price scenarios. • **Costs.** Each asset has a cost associated with development. Understanding where this cost sits on global cost curves for the commodity in question allows government to understand how competitive national assets are on global markets, and how profitable these assets might be. • **Time horizons.** The projected time horizon for the development of each resource project allows the government to determine the length of time the country has to reap the benefits of a particular asset. • **Global and regional significance.** An understanding of global and regional significance of resource endowments allows the government to determine its relative global importance in the production of a particular commodity. For example, is the country a leading global or regional producer for a particular resource? Does the country have significant reserves regionally or globally for a particular resource? How do costs of reserves compare with global cost curves for that reserve? This impacts a country's relative bargaining power. It can also have important considerations for infrastructure and/or private sector development. *Researchers should consider:* • Does the government have figures on the current values for the information types listed above, and how do they compare to other resource producers? If it is not possible to obtain this information, the researcher should calculate these figures. This information will help inform the overall assessment. • Does the government have a sophisticated understanding of the geological and market factors underlying these figures? Is its information realistic and well-informed? • Does the government produce and publish information on each of the above on a timely and regular basis? • What are the additional discoveries expected in the country? Is the country a new or mature producer? What has been the recent level of exploration in the country? Has the government accounted for these prospective changes?

1.1.3 **Resource dependency** Does the government have a realistic and sound understanding of how dependent the country is on natural resources?	High levels of dependency on the production of natural resources brings about a set of economic and governance risks. The government should therefore maintain and share a well-informed and realistic understanding of the country's level of dependency on natural resources. This understanding should inform the country's strategy for resource management. • **Government revenues.** The government should publish the ratio of resource revenue to total revenues. This is important in understanding the susceptibility of the government budget to commodity price volatility (see Q7.3), the extent to which the government should work to diversify the economy (see precept 10) and the political power the resource industry may acquire. • **Exports.** The government should publish the ratio of resource exports to total exports. Dominance of resource sector exports can potentially lead to foreign exchange appreciation and the decline of other export-oriented sectors under a phenomenon termed "Dutch disease." (See Q10.1 and Q7.2.) • **Per capita resource wealth.** The government should publish per capita resource wealth by production and by proven reserves. This indicates the development potential of natural resource endowments. While aggregate figures for resource wealth may sound large, they are often quite small when expressed in per capita terms. Of course, low ratios do not necessarily indicate limited opportunities; as exploration of precepts 9 and 10 show, resource revenues can be invested by the government to earn a return for the country that is much larger than the initial value of production. *Researchers should consider:* • What are the current levels of dependency according to the three measures above, and how does this compare to other countries that produce natural resources? This information will help inform the overall assessment. • Does government produce information on each of the above figures on timely and regular basis? • Are the figures realistic and well-informed?

1.1.4
Impacts of extraction
 	
Has the government seriously considered the positive and negative impacts of exploitation in making the decision whether or not to extract?
	The distribution of benefits and costs from resource extraction is inherently unbalanced. Often, tax benefits accrue to central authorities and are spent nationwide, while non-monetary costs of extraction (e.g. environmental and social issues) are borne by those living near extraction sites. Opening up to exploration and extraction may not always be the best course of action—negative impacts may outweigh the overall positive impact on the production region or the country more broadly. Governments can use tools such as strategic impact assessments to help account for environmental impacts within the wider strategy-making process before irreversible decisions are enacted at project sites. If the costs are too high, it may not be feasible to replace the environmental value that is lost, or adequately compensate those adversely affected. In such cases a country may opt not to extract.
	
	Researchers should consider:
	
	• Does the government use strategic impact assessments (SIAs) or some other method to help consider the decision to open up new areas to extraction? Are these of high quality? For considerations on SIA processes see Q5.2.1 and Q3.1.2.
	
	• Does the government's consideration of the positive and negative impacts of extraction examine:
	
	  ◦ Fiscal benefits and their distribution (see Q9.2)
	
	  ◦ Social and environmental costs of extraction (see Q5.2)
	
	  ◦ Macro-fiscal risks (see precepts 7 and 8)
	
	  ◦ Infrastructure, employment, business linkages (see precept 10)
	
	  ◦ The impacts of extraction on vulnerable groups including women and indigenous peoples (see Q5.1.1 and 5.1.5)

1.2 | Resource management strategy

Does the government have an inclusive and comprehensive national strategy for the management of resources?

An effective and sustainable strategy for resource management requires the government to make a series of key decisions that will affect different groups, and set choices extending far into the future. To avoid doing this in a piecemeal fashion and to build a shared sense of direction, governments should, in dialogue with stakeholders across government and beyond, including affected communities, parliamentarians, civil society and the private sector, develop a national strategy to guide extractive resource management decisions. The resource management strategy should be integrated into national planning documents, and supplemented with more detailed planning by government institutions that work directly on the issues. Developing a strategy is difficult and while varying circumstances facing each resource-rich country mean that every national strategy must be different, good resource strategies share a number of common characteristics that are considered by the secondary questions in this section.

It is common for a resource strategy to be spread across a number of documents. Researchers should start by analysing the dedicated resource strategy, if there is one. But they shouldn't stop there. For each of the questions in this section, it is important that researchers also consider national strategy documents, including national development planning documents and/or poverty reduction strategies, and strategy documents for the main institutions managing natural resources and the revenues they generate, including the resource ministry and ministries responsible for finance, energy, environment, infrastructure, industrial policy and others if necessary.

Secondary question	Guidance
1.2.1 **Cognizant of reality** Does the resource strategy reflect an understanding of the fundamentals of resource wealth?	A resource strategy should reflect a well-informed understanding of fundamentals of resource wealth explored in Q1.1. *Researchers should consider:* • Is the resource strategy based on a reliable understanding of national resource endowments? Does it communicate a range of scenarios for low, medium and high prices? See Q1.1.2 for background. • Does the resource strategy take realistic approach to the risk of resource dependency? See Q1.1.3 for background. • Does the resource strategy seriously consider the benefits and costs of extraction relating to the decision to extract? See Q1.1.4 for background.

1.2.2 **Considering the long term** Does the resource strategy take a long-term approach?	Resource extraction is a long-term process with long-term consequences. Due to the non-renewable nature of extractive resources, exploitation by one generation carries the opportunity cost that the resource may not be available for future generations. While the extraction process can last decades, the environmental, social, health and economic impacts of extraction can be felt for multiple generations if not longer. Approaches for managing resource endowments are complex and can take a long time to build. Developing a national workforce with the necessary skills and a legal and institutional framework to manage resources can take decades. Government must therefore design strategies for resource management and development with a long-term view. *Researchers should consider:* • Do national strategy documents for the extractive industry provide a long-term vision that considers the impact of resource extraction on future generations? • Does the strategy present a pathway to achieve this vision? Is there evidence that this is followed by government and other actors? Areas of particular importance include the pace of licensing (see Q3.1.5); fiscal terms (see Q4.1); local impacts, particularly project closure (see Q5.3.5); questions around the applicability of state-owned enterprises (SOEs, see precept 6); revenue management (see precepts 7 and 8); and the private sector enabling environment (see Q10.1). • Do government communications set reasonable expectations about the long-term nature of the gains and costs of extraction? (See Q2.3.1.)
1.2.3 **Comprehensiveness** Does the resource strategy reflect consideration of the full range of issues in the management of resource wealth?	Harnessing extractive resources for development requires the government to develop a chain of good policy decisions over a range of issues that are not traditionally linked. Beyond the management of the extractive sector, this chain includes the governance of planning, environmental management, taxation, SOEs, finance, monetary issues, industrial policy, energy, infrastructure, labor and education. Given that this chain is only as strong as its weakest link, the government should ensure that each link in the chain is strong. *Researchers should consider:* • Does the resource strategy consider all of the links involved in harnessing extractive resources for development? Are there any notable gaps? • Does the resource strategy identify priority areas in the chain for strengthening? • Are policy areas along the chain sufficiently aligned or do they conflict with one another? Does policymaking happen in a joined up way or does decision-making in different parts of the chain take place in isolation? See question Q1.2.4 on inclusiveness, and Q1.2.6 on the institutional framework including issues of coordination.

1.2.4 **Inclusiveness** Does the government engage all relevant actors in the development, implementation and oversight of the resource strategy?	A national strategy is more likely to be successful if development, implementation and oversight processes are inclusive. The government should aim for wide and meaningful participation in the development and implementation of the strategy using actors across government and those beyond, including affected communities, parliamentarians, civil society, extractive companies and the private sector more broadly. Not only does this build buy-in, but it also ensures that the strategy benefits from the expertise, understanding and experiences of those engaged with, or about to engage with, resource management. It is particularly important that the government recognize and enable strong oversight of the strategy within and beyond the executive branch of government. Because the extraction process can last many generations, decisions made in the present must be able to withstand the changes in government. Actors outside the executive, including legislators, journalists, and civil society groups are guardians of the strategy, playing a scrutinizing role by holding decision-makers to account. A successful strategy therefore not only requires an understanding of the policy issues, but also an appreciation for accountability, the structure and capability of government institutions, and the relationship with civil society. (Accountability is explored in detail in precept 2.) *Researchers should consider:* • Does government ensure participation in the resource strategy development, implementation and oversight by all government bodies with a role to play? See Q1.2.3 for an overview of the policy areas involved. • Does government ensure participation in the resource strategy development, implementation and oversight by actors outside the executive branch including member of parliament, affected communities, civil society organizations and the private sector? • Is participation informed and free from coercion and manipulation? Do stakeholders have adequate time to contribute? Affected communities and indigenous peoples have specific needs which the government and the private sector should consider. These are explored in more detail in Q5.1.1 and Q5.1.5 respectively. • Does the final strategy demonstrably take into account the inputs of these diverse actors? • Does the government recognize and enable strong oversight of the strategy? Does the strategy include oversight roles for actors within the executive and beyond?

1.2.5 **Legal framework** Does the resource strategy guide the relevant legal framework?	To be effective, a resource strategy must guide the rules that ultimately govern the resource sector. Although the structure of resource-related legal frameworks vary from country to country, most countries spread relevant laws across four levels of legal documents. These include: • The constitution, which establishes the authority of the government to make and enforce laws. It may also include information about the fundamental rights and values of the country, potentially including natural resource ownership. (See Q1.1.1.) • Laws and policies, which govern specific parts issues. These might include a mining or petroleum law, environmental laws, health and safety laws, tax laws and labor laws. • Regulations, which are more specific requirements that are usually created to provide details to aid the implementation of a law. • Contracts and other agreements between the government and companies. These may set out rights and obligations agreed between the government and a company for a specific resource projects. Translating a resource strategy into a clear and coherent framework of rules generally requires elements among each of these levels of legal documents. Setting terms in law increases transparency and limits opportunities for discretionary action, but may restrict the ability to change rules in response to changing circumstances as the sector develops. Use of contracts, in contrast, gives the government the flexibility to develop new legal provisions on a project-by-project basis, but this may result in a complicated legal framework that is difficult to monitor, particularly if the contracts are not made public (as is often the case). An alternative to both legislation and contracts is to empower government agencies to regulate the extractive sector. Regulators properly capacitated and monitored can provide rules that respond to changing circumstances, filling in necessary details that legislation may lack. *Researchers should consider:* • Does the resource strategy identify areas for the development of the legal framework? Are these in cognizant of reality? (See Q1.2.1.) • Is there evidence that the government is using the resource strategy in the development of the legal framework? If the strategy is new, are there new legislative and policy processes in place to develop the legal framework in line with the strategy? • Are there gaps and/or conflicts in the legal framework that need to be addressed? To determine this, it may be helpful to map the legal framework against the precepts of the Natural Resource Charter.

1.2.6
Institutional framework
 	
Does the resource strategy guide the relevant institutional framework?
	An effective resource strategy must also guide the development of institutions tasked to implement the strategy. Given the multitude of actors involved, this requires assignment of clear roles and responsibilities, strong coordination mechanisms and a respected authorizing body to choose between competing actors. In many countries, such an authority may take the form of an overarching government committee chaired by the executive office (e.g., the presidency or prime minister's office).
	
	Building institutions that are able to carry out effective resource management takes time. For the governments of many new hydrocarbon or mineral producers, it will be necessary to address two challenges in parallel: resource management and institutional strengthening across the whole decision chain. (See below.) This is made all the more challenging by the fact that resource wealth tends to deteriorate the very incentives, such as relying on citizens for raising taxes, that favor institutional strengthening.
	
	Researchers should consider:
	
	• Does the resource strategy identify priorities for the development of the institutional framework? Are these in keeping with priorities on the ground?
	
	• Is there evidence that the government is using the resource strategy in the development of the institutional framework? If the strategy is new, are there new legislative and policy processes in place to develop the legal framework in line with the strategy?
	
	• Which institutions have responsibility for each of the following governance areas? For each of these tasks, is it clear which body is responsible for policy development and which is responsible for regulation and enforcement?
	
	   ◦ collecting geological information
	
	   ◦ managing and awarding licenses
	
	   ◦ agreeing fiscal and other contractual terms with resource companies
	
	   ◦ regulating extractive operations
	
	   ◦ managing social, environmental and health impacts
	
	   ◦ developing a government fiscal framework and monitoring fiscal rules
	
	   ◦ administering and collecting taxes
	
	   ◦ budget formulation
	
	   ◦ industrial policy
	
	   (Note: It may be helpful to map these institutions across the precepts of the Natural Resource Charter.)
	
	• Are the people assigned to make decisions the genuine decision-makers, or does the power lie elsewhere?
	
	• Are there any necessary tasks that are not clearly assigned to an institution?
	
	• Are there any overlaps in which two or more institutions have responsibility over a certain task?
	
	• Does any institution have a conflict of interest in meeting its objectives?

ANNEX 1. PRECEPT 1: STRATEGY, LEGAL FRAMEWORK AND INSTITUTIONS

This transparency table summarizes the specific disclosures that governments should make to help build an effective resource strategy, legal framework and institutions as outlined in precept 1. (General transparency requirements that support this precept are covered in the transparency table for precept 2.) Unless otherwise stated, disclosures should be made by government in line with the standards of open data outlined in Q2.1.4. Existing country-specific research on some disclosure items may be available in the Resource Governance Index (RGI) country questionnaires using the indicated question numbers.

For each disclosure, researchers should consider the following questions:

- Is the *all* latest information available? If not, what are the exceptions?

- Is *all* historical information available? If not, what are the exceptions?

- Is information provided in sufficient time to enable effective monitoring and scrutiny of activity?

- Is information available in a machine-readable format? Are there any other barriers to access to information? (See Q2.1.4 for background.)

Disclosure item	Guidance
Resource volumes	Table or set of tables detailing total production volumes, total reserves under production, as well as total proven reserves. This should be produced by the government on at least an annual basis. It should be disaggregated by each commodity and resource project in the country. It should indicate global and regional significance in each case. See question 1.1.2 for background. **If not available:** Researchers should calculate using available information. The following sources may be useful in this effort: government statistics, BP Statistical Review (fossil fuels only), JODI database (petroleum) and the US Geological Survey. **Related standards:** EITI 2016, 3.2 **Resource Governance Index:** 2013: question 2.2A.020.a − b, 2.2B.020.a − b, 2.2C.020.a − b
Resource prices	Table or set of tables detailing global and regional prices and production values for each commodity and resource project in the country. This should be produced by the government on at least an annual basis. See question 1.1.2 for background. **If not available:** Researchers should calculate using available information. The IMF Commodity Prices database may be useful in this effort. **Related standards:** EITI 2016, 5.3.c **Resource Governance Index:** 2013: question 2.2A.020.c − d, 2.2B.020.c − d, 2.2C.020.c − d
Resource values	Table or set of tables detailing the value of resources produced. It should also project the value of total reserves under production, as well as the value of total proven reserves under low-, medium- and high-price scenarios. This should be produced by the government on at least an annual basis. It should be disaggregated by each commodity and resource project in the country. It should indicate global and regional significance in each case. See question 1.1.2 for background. **If not available:** Researchers should calculate using volume and price data. **Related standards:** EITI 2016, 3.2 **Resource Governance Index:** 2013: question 2.2A.020.a − b, 2.2B.020.a − b, 2.2C.020.a − b

Cost information	Table or set of tables detailing project cost information for each commodity and resource project in the country. This should be produced by the government on at least an annual basis. It should indicate where these costs lie in relation to global and regional cost curves. See question 1.1.2 for background. **If not available:** Researchers should calculate using volume and price data. Costs curves are typically not freely available. The government may have access to some, or companies may state where they expect each project to be in the cost curve in development plans or feasibility studies.
Time horizons	Table or set of tables detailing the project time horizons for each commodity and resource project in the country. This should be produced by the government on at least an annual basis. It should indicate how these time horizons relate to global averages around the world for the commodity. See question 1.1.2 for background. **If not available:** Researchers should calculate using information on resource volumes and production historic production rates.
Ratio of resource revenue to total revenues	A figure or table showing the ratio of government revenues from the resource sector against total government resources. Should be disaggregated by commodity and by project. This should be produced by the government on at least an annual basis. See question 1.1.3 for background. **If not available:** Researchers should calculate using available data.
Ratio of resource exports to total exports	A figure or table showing the ratio of resource sector exports against total exports. Should be disaggregated by commodity and by project. This should be produced by the government on at least an annual basis. See question 1.1.3 for background. **If not available:** Researchers should calculate using available data.
Per capita resource wealth	A figure or table showing per capita resource wealth. Should be disaggregated by commodity and by project. This should be produced by the government on at least an annual basis. See question 1.1.3 for background. **If not available:** Researchers should calculate using available data.
Rationale for the decision to extract	Documents/text. See Q1.1.4 for background.
Resource strategy	Documents/text

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The Natural Resource Governance Institute, an independent, non-profit organization, helps people to realize the benefits of their countries' oil, gas and mineral wealth through applied research, and innovative approaches to capacity development, technical advice and advocacy.
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