



NATURAL
RESOURCE
CHARTER

PREAMBLE

Countries with non-renewable natural resource wealth face special opportunities and special challenges. Used well, these resources can create greater prosperity for current and future generations; used poorly, they can cause economic instability, social conflict, and lasting environmental damage.

The purpose of the Natural Resource Charter is to assist the governments and societies of countries rich in non-renewable resources in managing those resources in a way that generates economic growth, promotes the welfare of the population, and is environmentally sustainable.

Exploitation of natural resources should be pursued in order to help a country meet its broader social and economic goals, not as an end in itself. This means having a vision of how the resource sector fits in a country's economic future. For some countries the best use of resource endowments may be to leave them in the ground for future use; for others, it may be to extract rapidly in order to generate revenues to sustain the investment necessary for growth and to meet urgent human needs. Whatever a country's ultimate development goals, there are certain practical guidelines that can help maximize the opportunities provided by resource wealth for social and economic development.

The Charter is directed primarily at policy makers and citizens in resource-rich countries. These are not the only important actors: international companies, industry associations, international organizations, civil society groups, and the governments of resource-importing states all have roles which affect the ability of societies to harness their endowments. Still, the most important decisions rest with the governments of resource-rich countries, since they have both the sovereign right and the moral responsibility to harness natural wealth for the benefit of their peoples. Nonetheless, resource companies, their home governments, and financial centers do play a critical role in supporting or weakening effective policy.

The Charter has been written by an independent group of economists, lawyers, and political scientists under an Oversight Board composed of distinguished international figures. We do not represent any institution or special interest. We share the belief that natural resource wealth can be a powerful tool for social and economic advancement, but only if countries are able to meet some special challenges. We try to offer advice that is useful and clearly expressed.

The Charter contains twelve Precepts. Ten of these offer guidance on core decisions that governments face, beginning with the decision to extract the resources and ending with decisions about using the revenues generated. The remaining two Precepts are addressed to other important actors and their responsibilities. To make the Charter easy to use, there are three levels of detail. Level 1 sets out the Precepts. Level 2 contains an elaboration of what they mean. If readers wish to pursue the discussion of issues in greater depth and technical detail, they are referred to Level 3.

THE PRECEPTS (LEVEL 1)



PRECEPT 1

The development of a country's natural resources should be designed to secure the *greatest social and economic benefit* for its people. This requires a *comprehensive approach* in which every stage of the decision chain is understood and addressed.



PRECEPT 2

Successful natural resource management requires *government accountability* to an *informed public*.



PRECEPT 3

Fiscal policies and contractual terms should ensure that the country gets full benefit from the resource, subject to attracting the investment necessary to realize that benefit. The long-term nature of resource extraction requires policies and contracts that are robust to changing and uncertain circumstances.



PRECEPT 4

Competition in the award of contracts and development rights can be an effective mechanism to secure value and integrity.



PRECEPT 5

Resource projects can have significant positive or negative local *economic, environmental and social effects* which should be identified, explored, accounted, mitigated or compensated for at all stages of the project cycle. The decision to extract should be considered carefully.



PRECEPT 6

Nationally owned resource companies should operate transparently with the objective of being commercially viable in a competitive environment.



PRECEPT 7

Resource revenues should be used primarily to promote *sustained, inclusive economic development* through enabling and maintaining *high levels of investment* in the country.



PRECEPT 8

Effective utilization of resource revenues requires that *domestic expenditure and investment be built up gradually* and be *smoothed* to take account of revenue volatility.



PRECEPT 9

Government should use resource wealth as an opportunity to increase *the efficiency and equity of public spending* and enable the private sector to respond to structural changes in the economy.



PRECEPT 10

Government should *facilitate private sector investments* at the national and local levels for the purposes of diversification, as well as for exploiting the opportunities for domestic value added.



PRECEPT 11

The *home governments* of extractive companies and *international capital centers* should require and enforce best practice.



PRECEPT 12

All extraction companies should follow best practice in contracting, operations and payments.

THE PRECEPTS (LEVEL 2)

Guiding Principles



PRECEPT 1

The development of a country's natural resources should be designed to secure the *greatest social and economic benefit* for its people. This requires *a comprehensive approach* in which every stage of the decision chain is understood and addressed.

Governments owning natural resources have the responsibility to manage those resources for the benefit of current and future citizens. Where the revenues from resource extraction are properly managed they can help to alleviate poverty, generate economic growth, and develop the economy, thus sustaining a more prosperous future. Realizing this vision, however, requires governments in resource-rich countries to formulate, implement, and monitor detailed programs and policies in multiple areas, including leasing and fiscal regimes, social and environmental regulation, and national development plans. Resource governance and policy formulation should be guided by the principle of securing the **greatest social and economic** benefit for current and future citizens, including an equitable distribution of resource wealth. Decisions also need to be taken on how to obtain — whether from public or private companies — the capabilities and capital required for efficient development of the resource.

The sequence of choices for governments related to resource extraction can be thought of as a decision chain. The first link in the chain is the evaluation of a country's geological potential and choices about when — and if — to develop. Next, if development is contemplated, governments must formulate the fiscal, contractual, and regulatory terms. Further, governments must ensure oversight regimes and a revenue management policy are in place before projects are implemented. Decisions must be taken about the use of public revenues for poverty alleviation and economic development, including investment in infrastructure, health and education,

and choices made between consumption and investment. Such decisions should also take into account the tradeoffs associated with investment in the resource sector (such as upstream services or value-added processing) and diversification of the economy into other sectors.

In addition to the complexities of resource governance and the potential for mismanagement, **the extractives decision chain suffers from a 'weakest link' problem.** A weak or broken link in the chain undermines the ability of governments to capture revenues and use them effectively. For example, if exploration of resource deposits does not take place or is limited in scale, due to problems in the allocation of exploration rights, a country may never know the extent of its resource wealth. Poorly structured concessions may yield little revenue. Similarly, if the decisions on public expenditure are compromised, governments may raise large amounts of revenue but then squander it on poorly selected projects or by subsidizing uncompetitive industries. Governments, therefore, should carefully consider all stages of the decision chain.



PRECEPT 2

Successful natural resource management requires *government accountability to an informed public.*

Successful resource governance requires government to possess the political will, capability, and capacity to take difficult and complex decisions and effectively implement them. Resource governance will be strengthened where those decisions are subject to well-informed public scrutiny and when decision makers are held to account. Extractive resources are public assets,¹ and decisions concerning their exploitation and use should be a matter of public debate. **Transparency along the entire decision chain is essential.**

Effective resource governance requires that citizens are able to hold their government representatives account-

able for decisions and policy choices. Accountability to an informed public can mitigate the mismanagement of resource revenues. A well-informed public with the capacity to act can engage in constructive discussion about policy formulation and government oversight of resource wealth. Through public scrutiny, officials can be held to account for abuses of power for private gain.

Citizens are best able to hold governments and companies to account where **they, their parliamentary representatives and civil society organizations² are well informed and have the capacity and freedom to act** on the information they obtain. It is increasingly accepted that citizens have a basic right to information about government activities and the use of public assets. This principle is enshrined in international instruments, including the Universal Declaration of Human Rights, the Rio Declaration, the Aarhus Convention, and the OECD Guidelines for Multinational Enterprises (2008). The wide international support and country participation in the Extractive Industries Transparency Initiative (EITI) have advanced the principle that the public is entitled to information on the payments and revenues derived from extraction. An increasing number of countries have so-called freedom of information laws stipulating, in one form or another, that all government information is public unless specifically proscribed by law. The IMF's Code of Good Practices on Fiscal Transparency sets out strong rules for all member governments for informing the public about the use of public assets, specifically including natural resources.

Alongside disclosure of information, governments should adopt **transparent processes** for establishing and implementing resource policies, for awarding contracts, for taxing, collecting and managing revenues, and for taking spending decisions. Resource decisions involve long-term commitments. These will be more credible if their rationale is understood by citizens. Legislative oversight is a critical part of establishing government accountability. Any concessions which depart from standard legislated terms should be submitted to and approved by the legislature. **Citizens can only be confident about the integrity of the resource extraction process if they know about it.**

An informed citizenry requires an informed government, at both the national and regional levels. **Governments should have the capabilities and capacity to take effective decisions around resource extraction.** In some cases, particularly where new

resource discoveries take place, governments may lack the internal expertise for effective policy formulation and governance at various stages of the decision chain, including the collection and disbursement of data. Such transitional deficits may be overcome by a combination of capacity building and/or acquiring expertise from a trusted source or institution.

Transparency and availability of information yield other direct benefits for policy making. **Transparency can improve the efficiency and effectiveness of government policies.** Public disclosure requirements can improve the quality of data the government gathers and maintains. This makes it easier for relevant bodies such as the financial, energy and mining ministries, as well as environmental and regulatory agencies, to do their jobs. Reliable and frequent data can make it easier for governments to plan and manage their budgets and long-term development plans. Where an extractive regime enjoys public legitimacy there may be a reduced likelihood that successor governments will make arbitrary and ill-considered changes to a country's extraction regime. Transparency also lowers the cost of capital.³

Availability of information should be supplemented by an active civil society with the capacity and freedom to hold governments and companies to account. Capacity building in civil society requires balance and a long-term perspective. Governments and extraction companies may have a role in providing resources and capabilities to help civil society organizations establish themselves and develop their skills. But the ultimate objective is to create self-standing and independent civil societies. Governments must allow civil society, especially the press and electronic media, **to operate freely** and without harassment or intimidation. It has been known for governments to take a role in appointing civil society representatives for multi-stakeholder discussions. In order to improve credibility, civil society should be free to appoint these individuals independently. Civil society must remain independent of government.

Finally, citizens will be empowered to oversee the governance of natural resources where there are enforceable penalties in place for the abuse of power. These penalties should be legislated for at both the national and international levels. They will require strong political will and capacity to administer. The theft of natural resource wealth is a criminal offense, and those found guilty should be held to account.

THE CHAIN OF DECISIONS FOR RESOURCE OWNERS

Governments must make decisions at all stages of resource development, from setting the terms for discovery and extraction through to investing revenues and promoting economic development and diversification. The following eight Precepts address the key decision points along this chain. Each link in the chain must be addressed; to avoid a weakest link problem, and to realize the potential for natural assets to be transformed into prosperity for all.



PRECEPT 3

Fiscal policies and contractual terms should ensure that the country gets *full benefit* from the resource, subject to attracting the investment necessary to realize that benefit. The long-term nature of resource extraction requires policies and contracts that are *robust to changing and uncertain circumstances*.

The characteristics of major natural resource projects — their longevity, scale and capital requirements, the social and environmental impacts, specialized and demanding technology, and exposure to commodity market risks — mean that development may be most efficiently achieved in cooperation with partners possessing significant financial capacity and which have the necessary technical and managerial skills. To attract such partners while still securing full value for the country's resources requires carefully designed **fiscal and licensing policies or contractual terms**.

Well-designed fiscal regimes should allow the government to share in profitability and to have some minimum revenue stream in all production periods. This implies that the regime contain both a royalty levied on a value or physical basis linked to production and a charge linked with profitability. The latter may be achieved through a corporate or entity income tax, perhaps at a special resource sector rate and possibly supplemented with additional taxes linked to particularly high returns. Enforceability and administration will be

enhanced if these fiscal elements are linked, when possible, to variables that are observable and verifiable, such as world prices.

An alternative to the royalty/income tax system is the use of production sharing arrangements, especially common in the petroleum industry, in which output is 'shared' between the investor and the government. Production sharing arrangements can be designed to provide a minimum revenue stream in all production periods by limiting the rate of cost recovery. They can also provide a form of progressive income tax through the use of "R" factors and other devices altering the sharing of output between the investor and the government.

Fiscal Stability and Changing Circumstances.

Given the long-term, capital-intensive nature of major natural resource projects, governments need to provide investors with a stable environment that provides a reasonable opportunity for realizing expected returns. In addition, investors need to be protected from confiscatory government action. Contractual stability can be enhanced by provisions which respond to **changing circumstances** — both anticipated and unanticipated — so as to preserve an equitable balance between the parties, reducing the incentives to seek renegotiation or for the government to make abrupt changes in the fiscal rules applicable to existing investors. If the government does provide some form of contractual assurances regarding taxation or royalties, it needs to ensure that such provisions are limited so that the state remains free to regulate other areas of concern, such as labor, health and safety, environment, security, and human rights, through generally applicable law. This is especially important given the long-term nature of many resource contracts.

Social and Environmental Impacts. Projects have social and environmental impacts. There may also be legacy impacts from prior exploitation of natural resources or other activities in the same region. Well-designed regulations or contractual terms must specifically identify the nature of these impacts, how to avoid or mitigate them, and how to compensate those injured by the remaining risks. Responsibility for legacy impacts needs to be carefully assigned. Typical tools include baseline studies to determine current status, development impact studies, and remediation and closure provisions at the end of project life.

Management and Technology. Efficient natural resource extraction requires the deployment of technology and management capabilities that governments may seek from their partners. Granting of licenses should require demonstration of such capabilities, and, where bidding is employed, eligibility should be limited to entities which have demonstrated their possession of, or access to, such capabilities.

Allocation of Risk. Natural resource projects are subject to many risks: future commodity prices; uncertainties about the quality and quantity of the resource base; developing technology; input prices; and external or domestic political developments. These risks must be assessed and assigned. Typically, investors are the best party to bear operational or market risk since they can better manage or control it; governments should bear the political risks. Even where the investor is the best bearer of the risk, governments and investors must take account of political perceptions if, in the future, the allocation of risk can lead to situations in which the investor appears to be making disproportionate gains.

Knowing the Investor. Governments and investors are engaged in a long-term relationship and it is important that a government knows with whom it is dealing and that the investor has the management, technical, and financial capabilities to carry out its obligations. Investors should be required to disclose those persons and entities directly or indirectly exercising management rights or holding beneficial interests. These requirements should extend throughout the life of the investment.

Clear Rules and Transparency. Governments and investors are generally better served if there are clear rules applicable to all investors in similar circumstances.

Transparency and uniform rules help ensure that operators know that treatment is non-discriminatory, reduce opportunities for corruption, and may reduce the demand by individual investors for special treatment. Uniformity does not mean that new projects must be subject to the same rules or contractual provisions as older projects. Policies, rules, and contracts for new projects should reflect current government priorities and lessons learned from older projects, as well as the prevailing economic environment.

Administration. Licensing, fiscal, and contractual regimes need to account for the evolution of the government's administrative capacity. Audit is critical in all periods, including initial stages in which losses are being incurred which will be offset by future income. Employment of outside auditors should be considered when domestic administrative capacity is still being built. Requiring certifications from the investor's senior company officials with respect to output, financial data and related party transactions may enhance compliance. Administration may also be facilitated if key parameters are measured relative to observable and verifiable variables such as world prices.

Enforceability. Because of the long-term nature of the investment and the relationship between the government and the investor, contracts and regimes need to have flexible mechanisms for resolving disputes and adjusting for changed circumstances. Where disputes cannot be resolved at the business level, governments and investors need to have clear legal remedies. If domestic legal institutions are thought inadequate, access to international arbitration should be provided for the in-country investor and its identified shareholders.



PRECEPT 4

Competition in the award of contracts and development rights can be an effective mechanism to secure value and integrity.

Governments may contract with third parties, including private and state-owned companies, at different points during resource extraction. Such contracts need

to secure full value for the host government and its citizens while at the same time providing the incentives to attract investment and ensuring that exploration and production will be undertaken efficiently. Natural resource extraction is particularly contractually complex. There are numerous uncertainties regarding geology, costs, technology, resource prices, and the capabilities of firms and local human capital.

Governments face a range of problems, from securing sufficient exploration and extraction activity on reasonable terms to ensuring credibility and stability of contractual commitments while retaining some flexibility in the face of changing circumstances. Governments require a robust mechanism by which value and sufficient extraction can be achieved; competitive bidding and auctions are often the most desirable instruments for allocation of rights. However, they also face limitations, notably where the number of viable competitors is low; here, resource owners may wish to pursue alternative strategies.⁴

There are several key principles that apply across the range of mechanism design, including competitive bidding, license-based regimes and negotiation-based systems of allocation:

- ii. **Terms should be set in law or regulations** to the greatest extent possible. Setting policy in law increases public input and support, enhances stability for the investor, ensures uniform treatment, and reduces opportunities for gaming and side-dealing. It may also enhance the return to government by reducing uncertainty.
- ii. As much information as possible should be made public prior to the awarding of contracts, and contracts themselves should be made public. This includes the fiscal regime under which firms will be operating. It also includes geological knowledge; publicly available findings of advanced survey work are likely to be beneficial in drawing firms into the bidding process. Social and environmental terms should be made public too. Robust and well-thought-through model contracts that have been subject to detailed legal review provide a sound basis for bids. Broadcast and open media access to the bid or auction event aids transparency and helps establish the legitimacy of the outcome, particularly where the development is of national importance. Social and environmental terms should also be made public.

Competitive allocation mechanisms are preferred for a number of reasons:

- i. **Government may be at an informational disadvantage**, knowing relatively little about technical details and perhaps having little or no experience in the complex negotiations that are characteristic of the resource sectors. Through auctions and competitive bidding mechanisms, governments need not know the true value of the rights to secure full value for them. Competition between firms that are technically and financially competent has the potential to deliver maximum value to a government which may possess less expert information than the bidders.
- ii. The use of well-designed auctions can reduce opportunities for discretion by government officials that create opportunities for favoritism and abuse.
- iii. Sequential auctions can secure greater value for governments. Initial bidding rounds can reveal privately held information about the true value of neighboring plots.

Competitive bidding can be achieved through the design of instruments to allocate rights or contracts. Auctions are one such instrument, but they can range from certain kinds of single buyer-seller negotiations through to competitive markets with many buyers and sellers. The prospects for delivering the benefits of competitive bidding are enhanced if a number of pre-conditions are met, including the provision of regional geological information, the presence of qualified bidders, and physical security in the license area.

The process for government allocation of contracts amongst competing firms needs to be carefully designed. Technical competence, capacity and financial capability may be important criteria for careful and robust pre-qualification. The true beneficial owners of the firm and their sources of funds should be known. There should be strong rules to prevent public officials steering business to firms in which they or their relatives and proxies may have a financial interest.

Where practical, **auctions are generally the preferred mode, both on grounds of transparency and of securing maximum value.** The design of the auction or allocation mechanism may differ across resource types and geological conditions.

During a strategic analysis of contracting options or the pre-bid process it may become clear that an auction is unlikely to be successful, perhaps because the structure of the industry means that there are likely to be few bidders or because of particular local factors. In these cases a strategic partnership may be a legitimate option. However, without the discipline of an open competitive process, special efforts to ensure and demonstrate transparency and the alignment of the interests of the contracting parties may be required.

The auction itself needs careful design, both in terms of selecting the bidding variables (e.g., royalty rate, production share, work program or profits tax) and the design of the auction process. Post-bid negotiations should be minimized; this is facilitated by clear and transparent bid terms, including well-prepared model contracts.

- i. **Competitive bidding should take place on observable or verifiable bid variables.** This ensures that bids can be compared and assessed. Further, subsequent delivery on bid variables can be monitored and enforced. If bidding takes place over a domain of variables which are hard to measure and verify, there will be increased opportunities for gaming and abuse.
- ii. **Competition need not simply be on price, but competition on too many variables erodes transparency, increases administrative costs, and can lead to unintended consequences.** For example, if bidding takes place on a factor such as the production rate, it is decoupled from government influence on the subsequent rate of extraction and the associated economic impacts. In all cases competition should be on the basis of clear and transparent rules, thus minimizing the possibility of back-room deals and abuse of discretion.
- iii. **Competition in bidding can be enhanced by good prior geological information.** Governments need not allocate extraction rights prior to obtaining exploration information. Such activities can be directly contracted or undertaken as a public good. Donors can support countries in acquiring geological survey data prior to the allocation of extraction rights. Incumbency rights of those who have carried out prospecting or supplied geological information should be clear from the start of the process.

Competition and competitive bidding mechanisms have implications for different modes of allocation and for different actors involved:

- i. **Barter deals or tied sales should be allocated competitively and transparently to secure maximum value.** For example, it is common, especially in low-income countries, to include as part of the investor's obligations requirements to provide social benefits, such as housing, education, health, training, or related infrastructure. As long as such requirements are made clear in regulation or the bidding process they should not prevent the government from realizing the benefits of competition. More difficult situations arise in the case of government-to-government deals for infrastructure which require that the host government give preferential access to the other country's companies. Such transactions usually lack transparency and are difficult to value. Governments choosing this route need to carefully analyze both the benefits of the infrastructure and the value received for their resource to ensure that they are, on balance, ahead. A common pitfall is that the access to the resource is a firm commercial contract while the government-to-government element relies on high-level undertakings that are not enforceable.
- ii. There may be advantages in **unbundling the contract into separate parts.** Certain activities, e.g., limited seismic acquisition and interpretation, could be subject to separate contracting from the allocation of exploration rights. It should be clear from the start what the benefits of incumbency in any stage of a separated process are, so that they can be properly reflected in the competition between firms. In some mining jurisdictions competition between investors has historically taken place during the exploration or prospecting phase, with subsequent development governed by existing fiscal and other regulations. While this may be an acceptable competitive model where an adequate body of fiscal and other regulations exists, post-exploration one-on-one negotiation of terms with investors will not result in adequate transparency or competition.
- iii. **Competition in downstream activities and procurement of upstream services is also important for achieving value and efficiency in the extraction process.** This may include avoiding the allocation of resource outputs to the domestic market

at a value lower than the international price. Governments should take steps to ensure transparency, open access, and fair competition in procurement processes, which should also include the knowledge of the true beneficial ownership and the source of funds behind the companies that bid. Competitive rules should apply equally to private and state-owned companies.

 **PRECEPT 5**

Resource projects can have significant positive or negative local *economic, environmental and social effects* which should be identified, explored, accounted for, mitigated or compensated for at all stages of the project cycle. The decision to extract should be considered carefully.

Because of their location, nature, and often their scale, resource projects can have significant local economic, environmental, and social effects. Governments must account for these in any plan to initiate exploration or to develop the resource. The decisions to explore or develop should be informed by an **understanding of the possible local economic, environmental and social consequences**, usually through a strategic or project impact assessment. These consequences need to be weighed in the decision of whether or not to extract. Public participation should be integral to the process. In some cases it may be appropriate to defer investment until technology improves, or until the impacts can be better assessed on the basis of new data. Impact assessments should be public documents. If the decision is made to invest, then **environmental and social monitoring** should be maintained throughout the project's life consistent with a plan to minimize or mitigate possible adverse consequences.

The social, economic and environmental spillovers will be felt most by communities located in the region being explored or developed. The decision to explore or develop may present these communities with direct economic and social opportunities linked to the estab-

lishment of industries and services based on natural resources. These may be associated with employment opportunities or the increased availability of goods and services. New transport infrastructure, as well as improvements in training and education, health services, etc., may also enhance the development of local communities or regions. This in turn calls for a proactive spatial and land use planning approach by local, regional and national governments, in order to direct developments according to approved structural plans and policies.

The social, economic and environmental costs of extraction are often borne disproportionately by those in the vicinity of the extraction process. Where these costs are incurred, citizens have a claim to be compensated through services, infrastructure, or dividends. Indeed, without a clear commitment to provide reasonable compensation for these costs as well as equitable participation in the national benefits, local communities are liable to sabotage the extraction process.

Local communities and the wider public should be consulted prior to development. The UN Declaration on the Rights of Indigenous Peoples calls for the free, prior and informed consent of indigenous peoples. The World Bank requires "free, prior and informed consent" for lending to extraction projects. The voluntary Equator Principles call for free, prior and informed "consultation." The ICMM also stresses consultation, but notes growing pressure to make consent the standard. A prerequisite for prior informed consent will be sufficient capacity of citizens and civil society to participate in meaningful dialogue and debate. The ownership rights of local communities need to be clearly defined in law. Overall, affected communities should be left better off as a result of extraction.

The government is responsible for setting and enforcing environmental standards and determining the claims of local communities for compensation. These may be established by reference to international standards such as the Equator Principles,⁵ now accepted by commercial capital providers to extraction projects, and by IFIs. While governments must set standards and monitor their enforcement, the costs of mitigation, avoidance, and compensation are part of the economic cost of the project and must be accounted for. The impact on women should be separately and explicitly identified and factored into the decision making process.

The security arrangements of projects can give rise for negative human rights impacts when private or state security forces use excessive force. Legal operating of projects has to include strong safeguards and mechanisms for recourse in case of human rights abuse.

The investor is in the best position to control or mitigate environmental damage during operations and is likely to be the most efficient party in conducting reclamation at the time of project closure. A requirement to conduct ongoing reclamation during operations is likely to be efficient and avoid larger liabilities at project closure. Where private companies take on the responsibility for mitigation of environmental damage and project closure, it is important to ensure that national and local government and civil society have the capacity to monitor and enforce company obligations and conduct. Escrow accounts can be an effective tool to ensure that reclamation costs are covered.

When deciding on if, and when, to proceed with project development, government should take into account economic benefits, both locally and nationally, in addition to social or environmental impacts. In some cases, and in some locations, it may be appropriate to restrict or prohibit project development. Candidates for such restrictions include areas of significant national or international environmental or cultural importance, or areas of particular value for agriculture, fisheries, water or for indigenous peoples.

The presence of artisanal mining can create challenges for government and investors, but if carefully managed they can foster local development benefits. Governments should seek to formalize and regulate such activities with the objective of encouraging positive development impacts while mitigating negative effects.

 **PRECEPT 6**

Nationally owned resource companies should operate transparently with the objective of being commercially viable in a competitive environment.

Some resource-producing countries use public sector enterprises to develop their resource base, either in whole or in part.

State-owned companies might be used to develop domestic capacity and support development of domestic linkages between the resource and other sectors. These objectives might be beneficial at some point during an economy's development, but the state enterprise should adapt to changes in the economic environment. Successful companies have been characterized by their limited scope, professional management and a founding goal of becoming commercially viable.

National Resource Companies (NRCs) can provide a viable vehicle for a country to build its own expertise and professionalism in the resource sector. In addition, the government might be able to exert direct control over the pace of resource development, secure supply, or achieve other national objectives, including the development of ancillary and downstream industry. Historically, a key prerequisite of success for NRCs has been a commitment to maintain the capability and professionalism of the national champion at international levels, either by continuous renewal of skills or by competition on the global stage. However, many national companies have performed poorly. Furthermore, investments in NRCs can limit diversification and increase a country's reliance on the resource sector, making total government revenues⁶ more dependent on the resource sector and thus subject to changes in resource prices.

NRCs can be successful, efficient revenue-generating operations. Efficiency is best attained through provisions protecting against the entrenchment of the bad practice that leads to poor outcomes. Ways to reduce the probability of such entrenchment include, but are not limited to:

- i. Structuring companies so that decisions are transparent and subject to market tests. Any protection of national companies should be clearly defined and limited in time so that the risk of abuses from the privileged position is reduced.
- ii. Managing ownership through a commercial relationship such as shareholdings. NRCs should be established under the relevant commercial code to distinguish them from other state agencies established to pursue non-financial objectives.

Transparency can be facilitated by having the national company organized as a separate legal entity with clearly established authorities and objectives, and by having governing and management boards separate from the government. Public oversight and control can be enhanced by:

- i. having public accounts maintained in accordance with international standards and subject to independent audit,
- ii. clearly identifying any private ownership interests and transactions with such interest holders,
- iii. having the national company make the same disclosures required of publicly held companies, and
- iv. conducting regular and systematic oversight through parliament or other entities.

The goal of establishing a company should be to achieve the best returns from being in open and genuine competition with other companies. Competition can act as a disciplining mechanism on the efficiency of the national company, and the government more generally, and provides a useful yardstick in measuring its performance. Open and effective competition may also be the best policing device for procurement. Competition is enhanced if the state enterprise is subject to the same fiscal regime, including royalties, as a private investor in this and other sectors.

The state enterprise should compete for inputs as well as outputs. New investments and additional operating costs come either at the expense of other government programs or via increases to total public debt (SOE debt plus public debt). All investments should be judged relative to the cost of public funds.

NRCs should not be charged with conducting regulatory functions. Conflicts of interest between commer-

cial and public interests can result when the same party is charged with delivering commercial viability and regulating.

When institutional capacity allows, government should separate the national resource company from the licensing, technical and regulatory supervision of the resource sector, placing those functions instead in independent governmental entities. Where such functions are retained within the national company, conflicts of interest can be reduced and better monitored if non-commercial functions are segregated and subject to separate supervision and reporting.

NRCs should avoid engaging in governmental activities, including social functions such as distributing subsidized output. In the event that such programs are entrusted to the national resource company, government and legislative control and oversight can be improved by having the national company report separately and in detail the costs of the social programs that the company undertakes, including the equivalent budgetary cost of such items. These costs should also be explicitly recognized in the budget and national accounts.



PRECEPT 7

Resource revenues should be used primarily to promote *sustained, inclusive economic development* through enabling and maintaining *high levels of investment* in the country.

The revenues from resource extraction are **intrinsically time-limited**; natural assets will be depleted. Hence even where citizen needs are acute, if the resource revenues are consumed but not invested, the resulting increase in **living standards may not be sustained**. If the revenues are to be harnessed for a sustained increase in living standards a substantial part must be invested outside the resource sector in physical, human, and environmental infrastructure including education, health care, roads, railways, and ports. Low-income countries, particularly those faced with urgent unmet needs, are also likely to possess a wide range of **opportunities to increase growth** across the economy via

domestic investment. Broad-based growth increases jobs and household incomes and is a necessary condition of sustainable poverty reduction. Growth also gradually generates the non-resource tax revenues that can sustain enhanced social spending.

To be effective and enduring, such growth requires **sustained high levels of investment** over an extended period. The amount of investment which a country can absorb productively (its “absorptive capacity”) may at any time be limited by its human capital and administrative capacity as well as by its physical infrastructure. Many resource-rich countries have low levels of infrastructure, skills, and labor productivity. These in turn produce an unpromising climate for private investment. For example, private investment in electricity generation may be unprofitable because transport infrastructure is too poor to support the firms that would be reliable purchasers of power. Investment in agriculture may be low because of a lack of rural roads, irrigation, or knowledge of appropriate technologies. A significant increase in public revenues creates the **opportunity to break the trap of low private investment**. By simultaneously increasing public investment to meet a wide range of needs the return on private investment can be raised, thereby stimulating activity.

However, precisely because the unmet needs are wide ranging, **appropriate public investment takes many forms**, not all considered to be physical capital investment. In addition to physical infrastructure, spending on human capital — e.g., education and healthcare — and other complementary investments such as those made in better public administration, may be worthwhile in of themselves, delivering high social returns. However, they also serve the important function of improving the climate for investment and complementing private investments by raising the returns to capital.

For low-income countries, domestic investments are preferable to overseas investments. High-income countries — such as Norway — may find it appropriate to build up SWFs to support future generations, but this strategy is inappropriate for low-income countries. Low-income countries are **capital scarce**, lacking vital **infrastructure, public services and public goods**, including health and education services. It is appropriate to remedy these deficiencies. The sequencing of investment should address these limitations early in order to permit more rapid levels of future investment and growth.

Countries which come into a commodity boom with high foreign debt levels can usefully apply some of the windfall to paying off outstanding debts. Debt reduction raises no domestic absorption issues, enhances the country’s credit standing and appeal to investors, and — most importantly— will reduce the cost of capital for the domestic private sector via its effect on interest rates.

While the key objective is *sustained growth*, the citizens of many resource-rich countries have urgent needs. They are currently much poorer than they and their children are likely to be in the future. Thus it is appropriate to use some resource revenues to fund an immediate increase in living standards.

One mechanism for delivering the benefits associated with resource revenues to citizens may be direct conditional or unconditional cash transfers or “dividend” payments. Direct transfers can help get around spending bottlenecks and capacity constraints and can also help overcome individual credit market constraints. Such a dividend also recognizes that citizens are the ultimate owners of the resource. Furthermore, transfers to citizens can increase accountability and also generate public interest in the way revenues are spent. Direct transfers need not account for the full stream of resource revenues for these advantages to be realized. However, it should be noted that many resource-rich countries lack the public administration to cost-effectively distribute revenues to individuals. Doing so may incur high costs. Furthermore, individuals may be less able to make optimal investment decisions than governments on their behalf, perhaps due to market failure and volatility.

The mechanisms by which citizen transfers are made are critical, particularly where public administration and social security infrastructure may be underdeveloped. Recent research suggests that conditional cash transfers may be an effective channel to distribute money to households. Alternative distribution mechanisms, such as subsidizing the domestic price of the extracted commodity, or its associated products such as petroleum, is the least desirable way to increase household expenditure. Such mechanisms are widespread, however. The use of commodity subsidies spurs wasteful consumption and may encourage smuggling and the development of parallel markets. In times of high world prices the loss of export earnings and the macroeconomic burden of domestic subsidies can be unsustainable. Furthermore, the distributional targeting of such subsidies is typically

absent or infeasible, leading to perverse distributional consequences, often at odds with wider government objectives such as poverty alleviation or redistribution. Some form of direct or targeted transfers may be preferable and less costly.

Expenditure programs need to be formulated with prudence, and due attention paid to the volatility of resource revenues and the fact that expenditures are typically hard to reverse. Any such programs should also be developed within the context of a Medium Term Expenditure Framework that properly assesses their internal consistency and economic impact. Expenditure and savings plans and their execution should be fully transparent, reviewed and approved by legislatures, and understood and supported by the public.

 **PRECEPT 8**

Effective utilization of resource revenues requires that *domestic expenditure and investment be built up gradually and be smoothed to take account of revenue volatility.*

Resource revenues can fluctuate dramatically, varying with the development of new discoveries, price changes and fiscal provisions. Effective utilization of revenues requires that **expenditure be smoothed** and that investment and outlays be built up over time. A gradual buildup is likely to be necessary to ensure the quality of public spending and to avoid adverse macroeconomic repercussions.

In budgeting, it is critical to take account of the volatility of commodity prices and revenue flows, something that has been particularly apparent during the financial crisis which began in 2007. Such a domestic expenditure pattern can be achieved by saving a portion of revenues during high revenue periods, holding the surplus in a ‘stabilization fund’, and then drawing down the saved revenues during low revenue periods. Smoothing can also be enhanced by limited foreign borrowing or adjustment of the rate of resource depletion. Assets held for the purposes of stabilization have a different function than longer term, “future generations” assets, and

their management may be designed accordingly. However, both such assets can be held in a combined fund with a portfolio of different holdings.

The amounts paid into the fund should be held in international financial assets. If the government relies upon domestic savings it will cushion its own expenditure during fluctuating events, such as a period of low prices, only at the expense of passing all the contraction in resource revenue on to domestic households and firms, as it liquidates its domestic savings. A better strategy is for the government to smooth public expenditure by means of foreign financial assets, avoiding adverse effects on domestic households and firms when the fund is drawn down. Such policies can be made more effective by ensuring transparency and by taking the response of private sector actors into account.

Stabilization or ‘future generations’ funds, should not be designed to deal with large financial downturns — the size necessary to cushion an economy against such events would be inefficient for the country to bear across the remainder of the business cycle.

Smoothing public expenditures around fluctuations in revenue has implications for both the **scale of foreign asset accumulation and its composition**. Although the objective is not to build an exclusively long-run fund, less liquid assets may need to constitute a substantial part of the accumulation during boom periods (at least until a significant cushion of holdings is established). The investments will need to be sold during periods of low global commodity prices and may coincide with global recessions and low asset prices. Therefore a stabilization fund should hold a portion of its investments in a reasonably liquid form and some portion in a form that is less exposed to fluctuations in value. Effectiveness will be enhanced if there are transparent rules or guidelines for triggering asset accumulation and withdrawals, with any deviations subject to public debate and formal procedures.

Smoothing of expenditures may also require **borrowing** in international capital markets. Such borrowing may be particularly valuable in the interval between resource discovery and significant revenue flow, during which time an initial ramping up of expenditure is appropriate. Governments can use such borrowing to facilitate the anticipated increase in private investment. However, it is important to signal prudence,

both internationally and domestically. Caution must be exercised to avoid driving up the cost of capital to the private sector. An **international facility** (such as IBRD lending) is preferable to private borrowing as a means to ensure this. An international facility can help reinforce the government's direction of sustainable spending.

Over the longer term, resource wealth should be used to reduce government debt, not increase it.

The postponement — and hence smoothing — of spending can alternatively be achieved by **limiting the rate of resource depletion**. If the resources are left in the ground, economic principles suggest that their expected return will be competitive with the returns of foreign financial assets. **Leaving resources in the ground can also reduce the risk of their misappropriation**; for example, by government revenues being allocated for to fund consumption for political ends rather than being invested in domestic assets. The costs of any deferred development strategy include current unpopularity and delay in the **diversification of the total asset portfolio** of the economy. Such diversification could be achieved by extraction and conversion of resource wealth into a broad portfolio of other assets.



PRECEPT 9

Government should use resource wealth as an opportunity to increase *the efficiency and equity of public spending* and enable the private sector to respond to structural changes in the economy.

The opportunities for sustained growth that are created by a large increase in public expenditure, such as that made feasible by new resource revenues, require effective allocation and control of spending. Government should pay careful attention to the macro-economic impacts on other sectors of the economy.

Governments facing increased public revenues from resource extraction must pay special attention to the problem of the **quality of public spending**.⁷ If public spending has been properly prioritized, extra spending

will be less valuable — in efficiency and equity terms — than existing spending. Deterioration in the quality of spending may also occur as a result of political economy pressures: once lobby groups know that public spending will increase, they will increase their efforts to capture it for their own advantage; 'rent-seeking'. If the quality of extra public spending is low, then the resource revenues cannot be transformed into substantially higher living standards.

The **solution to the problem of low-quality public spending** is to recognize that a substantial increase in public spending is also an opportunity for innovation in spending systems. In countries with low institutional capacity it may be politically easier to introduce improved, tougher management for new spending than to reform existing spending.

Innovation in public spending systems is needed to ensure two distinct objectives are met: (i) integrity — avoiding misallocation and minimizing the opportunities for corruption; (ii) quality — the efficiency and equity of spending.

As when pursuing integrity and quality in contractual regimes, competition can be an effective instrument. The institutional equivalent of an auction for the sale of extraction rights is to require competitive tendering for all public procurement.

In addition to competitive tendering there are some systems which are primarily designed to ensure integrity. The decisions to approve expenditures should be made transparent through published budgets. Once expenditures have been incurred they should be subject to the scrutiny of independent audit. Other systems are primarily for efficiency purposes. Prior to approval, the costs of major expenditures should be compared to their likely benefits (cost-benefit analysis). After completion, such expenditures should be evaluated, the results being used both for accountability and for learning.

Large increases in spending financed from resource export earnings have **macroeconomic repercussions** which can damage sectors indirectly in competition with resource export. Firms that produce other types of exports can be hurt by changes in exchange rates that make them less competitive. Firms which produce tradable goods for the domestic market, such as manufactures, can be hurt because labor and other costs may be

bid up by demands from the resource sector. Together, these effects are known as ‘Dutch disease’.

The **solution to Dutch disease** is, in part, to offset the damage done to producers of other exports and import substitutes by lowering their costs. The way to do this on a sustainable basis is not through subsidies but through choosing public investments that are ‘general purpose’, such as health, education, and infrastructure, which will benefit essentially all sectors of the economy and all regions of the country.

Dutch disease can also be reduced by smoothing peaks and troughs of commodity price fluctuations. However, even with such smoothing the economy will need to adjust to periodic external shocks. This has implications for the design of economic policies that might appear superficially unrelated to resource extraction. A key economic characteristic that appears to improve the ability of resource-rich economies to weather shocks is labor market flexibility. Since resource-rich economies are exposed to particular types of shocks they should prioritize such flexibility accordingly. This implies that policies for social protection might need to be distinctive in such economies, with greater focus on direct help to households and assisted job mobility rather than on the protection of existing jobs.



PRECEPT 10

Government should *facilitate private sector investments* at the national and local levels for the purposes of diversification, as well as for exploiting the opportunities for domestic value added.

Revenue from resource extraction can be harnessed to support the creation of employment and income in various sectors. Opportunities arise from the direct stimulus created by the resource sector as well as from the availability of funds generated by resource revenues. This employment and income will be created largely by the private sector, but government has a role in facilitating it. Investment may take place in resource-related

activities, in line with the view that the **resource sector should yield direct benefits and local economic activity** over and above tax and royalty payments. But countries will also want to ensure that non-resource sectors are enabled to grow.

A useful role of government is to create the investment climate and public goods that are complementary to private investment. This involves the removal of impediments to private investment. Because a resource boom brings about structural change in the economy it is particularly important that the business and regulatory environment is supportive of new investments and flexible enough to allow redeployment of capital and labor across sectors of the economy. Potential bottlenecks — for example in the construction sector — can be identified and addressed. Openness to international trade, for example, can help to mitigate them.

Government may wish to use incentives targeted at particular sectors of the economy or specific economic activities. The case for such intervention is strengthened in the presence of market failures which prevent or impede firms from being able to undertake potentially high-return investments. However, such policies carry risks; witness the numerous ‘white elephants’ in many resource-rich economies. If such policies are to be implemented, then several design principles should be followed. First, **investments should be credibly expected to attain long-run commercial viability.** Investments that fail this test are likely to destroy rather than add value, and will be a continuing drain on public funds. Second, **government support should be linked to success, not failure.** Open-ended support packages should be avoided. Support should involve credible criteria for termination in the case of continuing poor performance. Lobbying by interested parties is frequently an obstacle to this, so decisions should be taken at a high level and in consultation with a wide section of society — consumers and taxpayers as well as producer interests.

In selecting sectors for promotion there is a tension between building resource-related sectors and diversifying the economy away from dependence on a narrow resource base. The choices that have to be made here are country-specific, but there are several guiding principles.

- i. Where an extracted resource incurs significant transportation costs in its unprocessed form there may exist opportunities to invest in downstream processing and value-added. This may not be the best option due to high capital intensity, dependence on imported skills and equipment, and the possibility that it may create relatively few jobs.
- ii. There may exist opportunities for supplying inputs to resource extraction (upstream investment) such as providing goods and services, as well as expertise, to extraction partners.
- iii. If the resource is easily traded internationally (e.g., oil and high-value minerals), then the best option is likely to be to export the resource and use the funds to invest in diversification into other sectors.

Decisions for investment in downstream processing should be based on assessment of countries' capabilities and long-term comparative advantage, including the likelihood of achieving world-level efficiency or commercial viability. Where the resource is less readily traded (e.g., gas, low-value minerals), or likely to have significant local demand, the case for developing downstream sectors is strong. Gas is particularly worthy of note because of its linkages to power generation, a pre-requisite for economic development. It has a lower capital intensity compared with alternatives such as oil, coal, and nuclear, as well as hydro power and other renewables.

Economic activities supplying the resource sector (upstream activities) may offer viable opportunities for investment. A full spectrum of goods and services will be required, ranging from catering and accommodation to specialized equipment and geological analysis. While local firms are unlikely to be competitive in highly specialized areas, or are likely to lack the capabilities to meet

demand for particular services, there may be opportunities to build capabilities in cooperation with external partners. The role of government can include requiring investors to use local sourcing or other levers to build the competitiveness of local firms. Large investors often have access to technology, skills and standards which would make local firms more competitive. Governments can require investors to develop a package of local sourcing and knowledge transfer as a part of their bid for concessions, or in post-award negotiation.

It should be noted that laws which simply require a portion of investor expenditures to be made inside the country may lead to adverse and unintended effects. These can include rent seeking, importing products without adding jobs or value locally, and the build-up of local industry which is non-competitive once the investor departs. As a general rule, laws that incentivize long-term competitiveness are superior to laws that incentivize short-term purchasing alone.

Diversification of the economy presents a viable development path for many countries with resource wealth. In many cases the structural changes associated with resource wealth, combined with the increased availability of domestic capital, create opportunities for diversification of the economy away from resource dependence and for building for future prosperity beyond the lifetime of the resource. Successful diversification of the economy is most likely to result from private investment supported by government policy and public investments rather than from an attempt to 'pick winners' or foster specific industries outside the resource sectors. In cases where comparative advantage in downstream processing industries is unlikely, diversification of the economy is the preferred use of increased capital availability.

RESPONSIBILITIES OF OTHER ACTORS



PRECEPT 11

The *home governments* of extractive companies and *international capital centers* should require and enforce best practice.

All actors within the international community have an important role in enabling resource-rich countries to realize the potential of extractive revenues. This includes advocating, supporting, monitoring and enforcing international best practice.

Enhancing transparency in payments to governments is an important starting point. However, companies and their home countries have a valuable role to play in requiring and enforcing best practice across as much of the value stream as possible.

Auctions and competitive processes should not be undermined by government-to-government deals that are outside of competitive processes. Governments under the jurisdiction of which the parent companies of resource extraction entities reside have often acted in ways that undermined the good governance of resource extraction. For example, some governments have used their influence to lobby for special deals for their own companies, undermining the integrity of the fiscal system and the process by which extraction rights are awarded. Such use of diplomatic influence is far in excess of that wielded in normal tax treaty negotiations and trade discussions. Where the governments of resource-rich countries have decided to use **transparent procedures**, such as auctions, to award extraction rights, companies and the governments of countries in which the parent companies of extraction entities reside should not use their influence to circumvent or otherwise compromise these procedures.

Similarly, **transparency of extraction revenue streams** is vital to effective public oversight. Home governments should require that parent companies and all related entities over which they have jurisdiction

report their payments to governments in a form that enables public oversight. In addition, they should support the Extractive Industries Transparency Initiative (EITI), and meet EITI reporting standards themselves. Considerable progress has already been made in this area, notably with the Cardin-Lugar Amendment's reporting requirements for US-registered companies. But in order to universalize disclosure and to level the playing field for extraction companies, home governments should support an **international accounting standard** for reporting such payments and for reporting production and revenues on a country-by-country basis. The latter would also make it easier for producing countries to administer resource taxes more effectively.

International Financial Institutions (IFIs) and national government export credit and political risk insurance agencies provide major financial support to extractive projects. Such agencies should use their leverage (and technical assistance) to support resource-producing authorities in meeting the highest standards of public accountability, transparency, and social and environmental protection. IFIs and export credit agencies should work together to develop common standards to avoid a race to the bottom. The G-20 can play an important convening role here.

In recent years international competition for access to natural resources has intensified, bringing with it the potential for a standards 'race to the bottom', particularly in countries which are not well integrated into the international system. Competition for access to natural resources is often motivated by an economic rationale; however, the economic benefits of such a strategy are likely overstated. The commodities typically sought will often have close substitutes that are internationally traded. Thus importing countries can generally pay market rates without the need to secure preferential access to extraction or long term contracting. Cross-border oil and gas pipelines are a potential exception as their fixed physical nature restricts supply and off-take points, though products may be shipped to world markets. Where host governments of extraction companies recognize that competition for access to fungible commodities is *not a zero-sum game*, there is potential for them to agree a minimum set of international standards

applicable to all international extractive industry investments. The international community should seek to **improve the standards set by international bodies** while **enforcing existing standards** in countries which are not well integrated into the international system.

The **major financial centers** should help to limit the **leakage of public resources** through illicit channels, which is prevalent in some resource-rich countries. The international supervisory authorities in major financial centers should ensure that the banks they regulate do not engage in transactions that involve looted assets. Due diligence requirements for transactions which could reasonably be suspected of constituting the diversion of resource revenues from their proper uses should be as strict as those that apply to the laundering of drug money or financing of terrorist organizations. Effective limits on the flow of looted assets through the international banking system require the cooperation of the major financial centers, which already coordinate on drug and terrorist financing through the Financial Action Task Force and the Basel Committee on Banking Supervision.

A concerted policy shift towards the tightening of regulation of illicit financial flows, coordinated through the G-20, would have the greatest impact. The first steps beyond voluntarism have already been taken. These successes must be secured and built upon. Extractive companies claim the greatest constraint on disclosure comes from the governments in producing states. **Comprehensive home country regulation** or an international accounting standard would protect companies from retaliation or discrimination and level the international playing field in the industry.

International NGOs should be the advocates of international best practice, lobbying for policy change through direct contact with policymakers and by raising public awareness. They can monitor the implementation of international policy, making governments, firms and capital markets accountable for their actions.

Capacity building in resource-rich countries, whether by host governments, local NGOs or national extraction companies, is an area in which the international community can make a substantial contribution. Resources can be provided, training conducted and staff seconded in both directions in order to build skills and institutional capacity.



PRECEPT 12

All extraction companies should follow best practice in contracting, operations and payments.

Companies should recognize the importance of their “social license to operate” by taking steps that go beyond minimum legal requirements to **implement international best practice**. This should not be limited to passive observation of norms. It should include engagement with governments and communities to ensure the delivery of benefits to the host society and support for the development of capacity and best practice in partners.

Companies, in their dealings with governments and society, should operate with **integrity, inclusivity and transparency**. When complying with international best practice in their contracting, operations and payments companies should:

- i. observe external rules and best practice and set consistent internal standards,
- ii. ensure staff and sub-contractor compliance,
- iii. adhere to industry standards and ethical business practices, and,
- iv. respect citizen rights.

Companies should recognize that the capacity of governments and host societies to deliver the expected benefits from resource extraction may be limited, at least initially, as will be the ability to monitor social and environmental protection. Exploitation of these weaknesses is unlikely to lead to a successful long-term partnership and could result in re-negotiation, nationalization, or expulsion. Companies should instead **support local capacity building and institutions**, and the development of industry standards with self-policing and voluntary reporting. Governments should consider what international best practice and capacity building requirements are appropriate to include as contractual obligations for companies

Major oil and mining companies have embraced the Extractive Industries Transparency Initiative (EITI) and work to promote it. A number of companies unilater-

ally disclose details of physical and financial operations country-by-country and provide social services to the communities in which they operate. Some companies voluntarily seek to procure products and services locally. This form of corporate social responsibility should be the norm — not the exception — for all companies within the extractive sector.

There are a number of voluntary efforts already in place within the extractive sectors. Perhaps the broadest of these is that of the International Council on Mining & Metals (ICMM).⁸ ICMM has undertaken studies to identify policies and practices that can increase the economic benefits that accrue from mining at the local and national levels, recognizing that extractive companies are not passive actors but have the ability to influence governance and economic outcomes beyond the extractive process.⁹ ICMM has created a Sustainable Development Framework defining best practices across the full range of mining activities, from the decision to extract, to local content provisions, to revenue transparency, right up to mine closure and cleanup. Its members have agreed a far-reaching set of binding principles together with reporting and assurance processes.

Petroleum industry organizations OGP (International Association of Oil & Gas Producers) and IPIECA (International Petroleum Industry Environmental Conservation Association) are also to be commended on their efforts to standardize good practice among their members. However, they are yet to produce an initiative comparable to ICMM's. Such an initiative would be welcome for all extractive company associations and could use the Charter as a framework.

There is an evolving body of international law and practice that suggests that corporate responsibility goes beyond a legal license to operate and short-term profit maximization. Many OECD countries encourage corporate responsibility, variously defined. Danish law

requires large companies to report on their Corporate Social Responsibility policies. The UK Companies Act requires boards of directors to “have regard” for “the impact of the company’s operations on the community and the environment.” Investors with a long-term perspective are also requiring action, with some large funds like the Norwegian Pension Fund barring investment in companies that do not observe international codes and standards or follow industry best practice.

Extractive activities fall under UN and international conventions, including those for the protection of the environment, human rights and labor. The United Nations has long been developing a set of principles for business and human rights in collaboration with the business community. The organization’s definition of human rights includes economic rights and the “right to development.” The conceptual framework presented by the Special Representative of the Secretary-General for business and human rights, John Ruggie, has been endorsed unanimously by the Human Rights Council and by leading business organizations including the International Chamber of Commerce and the ICMM. Ruggie describes the responsibility to respect human rights as a near-universal norm that exists independently of State duties and variations in national law. There are signs of growing acceptance of this in some areas¹⁰

Through the interaction of many formal and informal stakeholder processes, a body of international norms and industry best practice for the extractive industry is being built up. This includes EITI, the transparency and environmental standards adopted by international financial institutions for their engagement in commercial extraction projects (the Equator Principles), the principles of free and informed consent, the Voluntary Principles on Security and Human Rights, and guidelines for investors and companies like the project risk assessment and the social license to operate developed by Critical Resource.¹¹

WHAT IS THE NATURAL RESOURCE CHARTER?

The Natural Resource Charter is a global initiative designed to help governments and societies effectively harness the opportunities created by natural resources. Some of the poorest countries in the world have vast amounts of natural resources — much of which remain to be discovered. This natural wealth can provide a pathway out of poverty primarily through the vast untapped wealth of developing countries themselves, which dwarfs the volumes of official assistance.

In the past, natural resource opportunities have been missed. Many resource-abundant countries have remained poor while some have fallen into cycles of conflict and instability. The lessons and experience of those which have escaped the resource curse have proved difficult to spread. Natural resources have the potential to be transformative if they are properly harnessed for development. Doing so is difficult. The decision chain from discovery to expenditure of revenues is long and complex. This is why the process has so often been unsuccessful. The Natural Resource Charter provides twelve Precepts to inform decision-making and improve natural resource management. It will help to ensure that the opportunities provided by new discoveries and commodity booms will never again be missed, not least as there may never again be such a development opportunity — and necessity — as that faced by the current generation.

What makes the Natural Resource Charter unique?

It is a common framework for addressing the challenges of natural resource management. It is also a tool for citizens. It has the potential to be an international convention, but one that will be built by a participatory process guided by academic research.

The Charter's guidance emphasises the importance of transparency, but the ultimate aim is to help build a critical mass of informed opinion within resource-rich countries that will provide the animating force to make use of such information. It has lists of specific recommendations, and more general advice, as well as the aim of using existing indices to aid self-assessment of adherence with its Precepts. However, the over-arching goal is not merely measurement, but the change of behaviour. The purpose of the Charter is to inform and empower those that will actually do the holding to account as well as those who take the decisions. It is only in such informed societies that a consensus of sufficient depth, breadth and longevity can be generated in which to embed a vision of the role of natural resources in development. The Charter operates on the basis that such a vision is essential in building a pathway out of poverty for and in securing a sustainable, diverse and broadly beneficial economy for the day when resources are depleted.

THE PEOPLE INVOLVED

The Charter has no political heritage or sponsorship. The drafters of the Charter are an independent group of the world's foremost experts in economically sustainable resource extraction, assembled by Paul Collier, Director of the Centre for the Study of African Economies at Oxford University. The drafters make up the Charter's Technical Group, chaired by Nobel Laureate Michael Spence. The Group, which is currently being expanded, will continue to incorporate views, feedback, and input into the Charter on an annual basis.

THE OVERSIGHT BOARD

The Charter is governed by an Oversight Board chaired by Ernesto Zedillo, former President of Mexico and Director of the Yale Center for the Study of Globalization. The other members of the Oversight Board comprise Luisa Diogo, former Prime Minister of Mozambique, Abdlatif Y. Al-Hamad, Director General and Chairman of the Board of Directors of the Arab Fund for Economic and Social Development, Mo Ibrahim, a global expert in mobile communications, a philanthropist and influential thinker on development and governance, and Shengman Zhang, Chairman of Citigroup Asia-Pacific and former China director of the World Bank.



Ernesto Zedillo

Luisa Diogo

Abdlatif Al-Hamad

Mo Ibrahim

Shengman Zhang

ENDNOTES

- 1 In most countries, natural resources, particularly sub-soil minerals, are deemed the property of the state, and are hence public assets.
- 2 Reference to Civil Society and civil society organizations throughout is intended in the broadest sense; the totality of voluntary civic and social organizations and institutions that form the basis of a functioning society.
- 3 An IMF study of fiscal transparency found that “Fiscal transparency is associated with higher credit ratings even after controlling for various economic fundamentals.” “Fiscal Transparency and Economic Outcomes,” Farhan Hameed. IMF Working Paper December 2005.
- 4 For example, countries may seek to build a strategic long-term partnership with a single company or consortium. Here open competition between multiple parties may not be feasible.
- 5 The Equator Principles (EPs) are a voluntary set of standards for determining, assessing and managing social and environmental risk in project financing.
- 6 Fiscal revenues plus returns from the state enterprise.
- 7 Here we use quality to refer to the efficiency, equity and overall effectiveness of public expenditures, both recurrent spending and government investment.
- 8 ICMM is an organization of 19 of the leading mining and metal companies, national and regional mining associations and global commodity associations — www.icmm.com
- 9 See, for example, “Sustainable Development in the Mining and Minerals Sector: The Case for Partnership at Local, National and Global Levels”, Kathryn McPhail, International Council of Mines and Minerals May 2008, and “Resource Endowment Toolkit. The Challenge of Mineral Wealth: Using resource endowments to foster sustainable development.” International Council on Mining & Metals with UNCTAD and the World Bank. September 2008.
- 10 UN Human Rights Council Report A/HRC/11/13, para. 48.
- 11 Critical Resource Strategy & Analysis Ltd. www.c-resource.com



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