



# **Can Transparency Transform Mineral Wealth into Wellbeing?**

Good Governance of Mineral Resources in the Maghreb:  
The Challenges and Opportunities of Regionalization

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## Introduction

North Africa and the Middle East account for more than 35 percent of global crude oil production, nearly 60 percent of the world's proven oil reserves and 45 percent of known reserves of natural gas. In many states in the region—including Algeria, Iran, Iraq, Kuwait, Libya, Saudi Arabia and Yemen—oil and gas account for over half of government income.

In the Maghreb, Algeria produced about two millions of oil barrels per day in 2011 and is the sixth-largest gas exporter in the world. Hydrocarbons have long been the backbone of Algeria's economy, accounting for roughly 60 percent of state revenues, 30 percent of GDP, and over 95 percent of export earnings in 2011. Morocco holds three quarters of the world's phosphates reserves and is the top phosphate exporting country. The phosphate sector is a key driver of the country's economy representing approximately one quarter of Morocco's total exports and about four percent of GDP. Tunisia is also a significant phosphate producer. Although minerals play a significant role across the Maghreb, the size of the hydrocarbon rents is significantly smaller than the role of the phosphate sector in Morocco and Tunisia, which are typically classified as resource-poor countries.

Yet natural resources have been a mixed blessing for the Maghreb and the Middle East, bringing wealth but also autocracy and often closed societies. Minerals have played a critical role in the uprisings in the Arab world, in ways not always apparent to the region's long-time rulers or to new governments seeking political stability. Kaufmann (2011) notes that "although the absence of democratic governance in the Middle East was no secret, relatively little attention was paid to the deterioration of democratic governance in almost all the region's countries during the past decade." The lessons from previous transitions in Central Europe, Iran and Indonesia show that change in political leadership or more radical regime transformation does not guarantee success.<sup>1</sup>

The governance of oil, gas and mining loom large in the future of the region. Maintaining and restoring stability requires a significant change in the extractive industries' role and management. Reforms in the governance of minerals also offer significant opportunities to transform economies in the Maghreb. Oil, gas and mining resources represent a fundamental source of financing for economic diversification, job creation and development for the Maghreb and the broader Middle East. Reforms in the management of the minerals sector offer a sound platform for broader economic and political reforms to build more open and inclusive societies in the Maghreb. However they cannot substitute for complementary initiatives to stimulate private sector investment to create jobs and other structural reforms to sustain long-term economic growth.

This paper provides a critical assessment of the linkages between minerals governance and economic

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<sup>1</sup> Ahmed Heikal, Egypt's largest private investor, said to the Economist: "If we get things right, we could be Turkey in 10 years. If we get them wrong, we could be Pakistan in 18 months." Quoted in Kaufmann (2011)

development in the Maghreb and Middle East. We attempt to disentangle four critical dimensions of resource governance in the region:

- The nexus between resource governance and economic development in the Maghreb
- The linkages between weak minerals governance and the Arab Spring
- The role of State Owned Enterprises in the minerals sector in engineering more systemic reforms.
- The challenges of strengthening natural resource funds governance to facilitate regionalization in the Maghreb

The paper relies on the Revenue Watch Index 2012<sup>2</sup> – a systematic initiative to compare the strengths and shortcomings of natural resource management in 58 countries- to assess minerals governance in the Maghreb and formulate policy options for reform.

## Minerals Governance and Economic Development

Oil has not always been a “curse” to the Arab countries. According to UNDP, for example, life expectancy in North Africa increased to 71 years from 51 years, between 1970 and 2001. The percentage of children in school grew to 70 percent from 37 percent—better performance than any other region during the same period. Economic growth has been mixed, averaging 3.7 percent a year between 1960s and 1980s but a modest 1.7 percent a year in the 1990s. More significant is that these decades included great volatility in oil prices which hinders economic and social progress, and creates unstable foundations for nations’ economies: When oil prices rapidly climb or fall, oil-dependent economies encounter large swings in revenues and budgets, making long-term planning more difficult.

In addition, these resource rich countries have experience mixed economic growth, deindustrialisation and high unemployment rates. Arezki and Nabli (2012) argue that “resource rich countries in MENA have experienced relatively low and non-inclusive economic growth as well as high levels of macroeconomic volatility. Important improvements in health and education have taken place but the quality of the provision of public goods and services remains an important source of concerns. (...) The success of economic reforms in MENA rests on the ability of those countries to invest boldly in building inclusive institutions as well as high levels of human capacity in public administrations.”

Many states in the region were less industrialized in 2010 than in 1970. According to UNCTAD, the size of the manufacturing sector relative to total GDP declined to five percent from nine percent in Algeria between 1974 and 2006, to 15 percent from 18 percent in Egypt, to 15 percent from 20 percent in Syria, and stagnated at two percent in Libya. Even in countries where the manufacturing sector grew, such as Tunisia and Jordan, products remain relatively unsophisticated compared to other

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<sup>2</sup> The results of the Revenue watch Index 2010 are available at: [www.revenuewatch.org/rwindex2010](http://www.revenuewatch.org/rwindex2010)

regions. In 2008, non-oil exports accounted for only 16 percent of the region's GDP, compared to 44 percent in East Asia.

Oil has also played a role in the loss of competitiveness of other sectors of the economy (a phenomenon often called "Dutch disease"): the accumulation of foreign reserves drives up the exchange rate of the currency, making the country's other exports more expensive and leading to an increase in imports. A weak, declining manufacturing sector also means that Arab countries are oil rich but job poor. The International Labor Organization estimates that the unemployment rate for 15- to 24- year olds in the Middle East is 25 percent. A survey of 1,500 youth by the World Bank found that the self-declared or perceived jobless rate was even higher—35 to 40 percent.

Reforms--and even rapid economic growth as seen periodically in Tunisia and Egypt—can only be sustained if they create jobs for the rapidly growing labor force and are accompanied by social policies for the most vulnerable. According to the UNDP, MENA will need 51 million new jobs by 2020, requiring GDP to grow 7.6 percent a year—about double the current rate. Resource wealth and generous state subsidies will never, in themselves, guarantee political and social stability, which will depend on more transparent management of natural resource revenues. Citizens must be able, not only to give voice to their political aspirations, but very specifically to hold their government accountable for the way they manage the countries' natural resources and spend the proceeds.

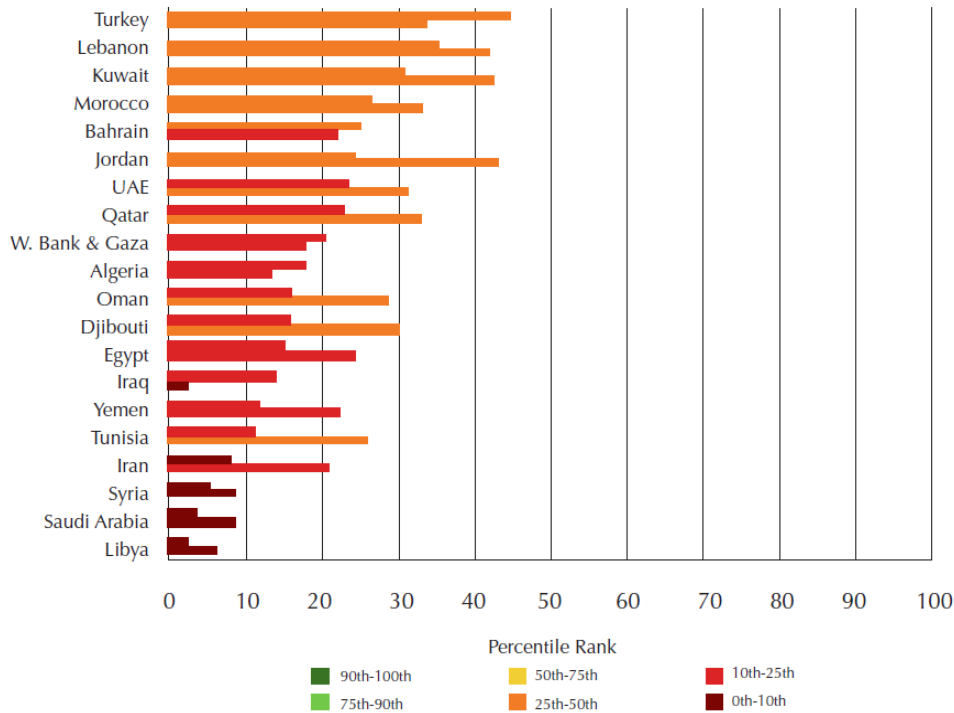
## The Governance Gap in the Maghreb and the Middle East

The dependency on minerals revenues has also encouraged patronage, fuelled corruption and undermined state institutions. A society's elite benefits from the low taxes made possible by high government revenues from minerals and it may also benefit from corruption in the spending of those revenues (Brautigam et al., 2008).

In 2008, the region saw, thanks to Tunisia, a preview of how a government's poor management of natural resources could fuel political turmoil. That year, phosphate miners and other workers in Tunisia's Gafsa region went on strike to protest the high cost-of-living, corruption in hiring practices at the mines, as well the lack of job opportunities due to mechanization. The corrupt management of resource revenues played a critical role in fuelling public discontent. Economic conditions, however, remained unchanged—as did dissatisfaction among the workers. In January 2011, Tunisian protestors demonstrating against many of the same issues—corruption and high prices, as well as a lack of political freedom—toppled Tunisia's government.

According to the Worldwide Governance Indicators, voice and accountability has deteriorated over the last decade in the Maghreb and most Arab countries. MENA countries fare particularly poorly in freedom of expression, the ability of citizens to elect their officials and government and perceptions on the ability of officials to take advantage of their positions for personal gain (see figure 1 below). The Revenue Watch Index 2010 shows that the majority of countries surveyed in the Middle East and North Africa provide limited public information on their natural resource sector.

Figure 1: Voice and Accountability in the Middle Eastern and North African Countries, 2000 (bottom bar) and 2009 (top bar)



Source: Kaufmann et al (2009)

The spread of the Arab Spring suggests a complex relationship with minerals wealth and political change. Large wealth amassed by various regimes also enabled some governments to use wealth from natural resources to buy stability. In Algeria, Public spending increased by more than 50 percent in the last two years. The government allocated more money for food subsidies and awarded pay increases to civil servants. It also offered young entrepreneurs interest-free loans to establish their businesses, granted tax exemptions, and reserved a quota of local public contracts for them. Kuwait promised a cash bonus for every citizen, as well as free food for 14 months. Saudi Arabia, unveiling a \$36 billion public spending program, announced a 15 percent increase in salaries for all government workers. In an attempt to stop a revolt already underway, Libya’s government promised cash grants to each household to offset rising food costs, and pledged to raise salaries of government workers by 150 percent. Efforts to “buy” stability, however, cannot succeed over the long-term, since they fail to resolve the underlying problems that triggered the unrest.

However the “governance gap” *alone* does not provide a compelling rationale for understanding the political and economic changes that affected the Maghreb and the Middle East. Other factors – including socioeconomic, demographic and technological- also played a role in the build-up to the Arab Spring. The potentially destabilizing effects of such processes had also been studied, including in the works of Lipset and Przeworsk most notably, who argued, for instance, that autocratic regimes

were relatively stable at low and high-income levels but most vulnerable at intermediate levels of economic development. Nonetheless, none of these countries was ever seriously considered on the verge of a revolutionary movement. Before the Arab Spring, the OECD did not consider any MENA country as a “fragile state.” According to Foreign Policy’s failed state index<sup>3</sup> 2010, Tunisia had the same score as Brazil. By and large, a ‘thin’ conceptualization of (good) governance and state fragility primarily concerned with capacities and processes failed to capture what a ‘thick’ conceptualization may have, i.e. the decay of the social contract between these countries’s leaders and growing shares of their citizens, especially the educated, connected and unemployed youth (OECD, 2012). The limits of broad governance measures to predict and understand the political and economics require more in-depth analysis of the main drivers of change in the region. The following section provides insights into minerals governance to understand the prospects and priorities for reform in the region.

## Measuring Minerals Governance: The Revenue Watch Index

The Revenue Watch Index assesses oil, gas and mineral governance. The Index documents how much information governments make available on these industries through channels easily accessible to citizens, and compares the findings across a wide range of resource-rich countries –including Algeria and Morocco.<sup>4</sup>

Box: The Revenue Watch Index 2012 methodology

The RWI Index is based on a detailed questionnaire that identifies publicly available information from official sources on the government’s management of the extractive sector and its revenues. The questionnaire reflects transparency standards promoted by actors such as the Extractive Industries Transparency Initiative<sup>5</sup> (EITI), the Publish What You Pay<sup>6</sup> (PWYP) campaign and the International Monetary Fund (IMF).<sup>7</sup> The Index is not a survey of opinions but instead bases its scores on verifiable primary evidence gathered in each country by researchers.

In 2010 the RWI Index assessed 41 resource-rich countries and found that a majority published limited information on their mineral resource sector, undermining the ability of citizens to hold their governments accountable for their performance in managing public resources. The 2012 RWI Index methodology has an expanded scope, considers 58 resource rich countries (including Algeria and Morocco- not Tunisia) and provides detailed information about each country and its scores<sup>8</sup>.

The Index defines transparency as the disclosure of information about natural resource governance available through official sources of information, including websites. However, the legal framework and practices surrounding disclosure also affect transparency. This includes rules that facilitate disclosure, limit arbitrary decisions, curb conflicts of interest and clarify roles and authority. Both elements are crucial to evaluate how governments manage their oil, gas and mineral resources.

Building on this work, the RWI Index organizes its indicators and questions into three components that describe processes and rules regarding access to information, revenues and mechanisms of oversight and control. The three components of the index are: Institutional & Legal Setting; Reporting Practices, and Safeguards & Quality Controls.

<sup>3</sup> See: [http://www.foreignpolicy.com/articles/2010/06/21/2010\\_failed\\_states\\_index\\_interactive\\_map\\_and\\_rankings](http://www.foreignpolicy.com/articles/2010/06/21/2010_failed_states_index_interactive_map_and_rankings)

<sup>4</sup> The Revenue Watch Index 2012 does not include Tunisia. A supplemental country specific assessment will be carried out in 2013.

<sup>5</sup> See: <http://eiti.org/eiti/principles>

<sup>6</sup> See: <http://www.publishwhatyoupay.org/>

<sup>7</sup> See the IMF’s Guide on Resource Revenue Transparency, available for download at: <http://www.imf.org/external/np/pp/2007/eng/051507g.pdf>

<sup>8</sup> Given the methodological changes between 2010 and 2012 Indexes, results are not comparable.

Institutional & Legal Setting refers to the laws, regulations and institutional practices that define the governance environment. These indicators<sup>9</sup> capture the context in which disclosures take place, and assess whether the governance system facilitates openness and accountability. They assess laws and practices that enable comprehensive disclosure, freedom of information, and open and fair competition.

Reporting practices refer to the actual publication of information by governments as well as how comprehensive it is. This component is crucial for the index. Disclosure is at the core of transparency, answering the question: do citizens have enough information to understand, evaluate and debate public policies?

Safeguards & quality controls refer to the checks against conflicts of interest, undue discretionary powers, and the rules in place to control for timeliness, accuracy and integrity of information. These indicators assess whether governments provide regular, understandable and audited information.

A fourth component, composed of external indicators, measures the Enabling environment for transparency. This data reflects the extent to which transparency leads to accountability or the gap between the two. For instance, the external measures capture whether citizens or media are able to openly discuss matters of public interest, or whether extractive activities occur among high/low corruption. These indicators are external to the Index. They include measures provided by the World Bank Governance Indicators (Voice & Accountability; Government Effectiveness; Rule of Law and Control of Corruption), the Economist Intelligence Unit Democracy Index, the Open Budget Index and Transparency International Corruption Perception Index.

*The Revenue Watch Index 2012 will be released in early 2013. However data collection is complete and scores have been finalized. Scores are strictly confidential until public release. The following section provides a detailed qualitative assessment of minerals governance which will be updated when the results become public.*

The evidence emerging from the Revenue Watch Index 2012 underscores four distinct features of minerals governance in the Maghreb which we discuss further:

- Oil, gas and mining management in the Maghreb and the Middle East is weak in comparison to other regions which is consistent with broader governance measures.
- There is a negative correlation between the degree of resource dependency and minerals governance –with Morocco performing significantly better than Algeria on aggregate.
- Sonatrach and the Office Chérifien des Phosphates- the minerals State Owned Enterprises of Algeria and Morocco, respectively- perform relatively better than other key agencies and ministries (regulator, ministry of finance, ministry of energy...)
- Weak revenue management appears as a major challenge for channeling resource revenues to productive investment for economic diversification. The lack of transparency and accountability in the management of natural resource funds hinders effective economic collaboration between capital rich (Algeria) and capital scarce countries (Morocco and Tunisia) in the Maghreb and undermines possibilities for regionalization.

## *Morocco*

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<sup>9</sup> These indicators are drawn mainly from standards identified by the IMF Guide on Revenue Transparency and the Natural Resource Charter. The Fiscal Affairs Department at the IMF applied the principles of the Code of Good Practices on Fiscal Transparency (2007) and the Manual on Fiscal Transparency (2007b) to the problems faced by resource-rich countries. The organizing principles of these practices are four: (1) clarity of roles and responsibilities, (2) Open Budget Process, (3) Public Availability of Information; and (4) Assurances of Integrity. The IMF approach is to comment on the transparency of institutional arrangements and not to identify the optimal ones. For the Natural Resource Charter see: <http://www.naturalresourcecharter.org/>

The Revenue Watch Index shows that mineral governance in the Maghreb is weak compared to other regions despite significant differences between countries. In Morocco, the phosphate exploitation is a state monopoly represented by the Office Chérifien des Phosphates Group (OCP) and regulated by the Ministry of Energy and Mines. The government does not grant any licenses and OCP, the largest Moroccan enterprise, covers the entire phosphate value chain. The government publishes mining legislation and the 2011 Constitution confirms the right of access to information but there is no Freedom of Information Act. We also find that environmental impact assessments are required prior to a project implementation but are generally not published.

The Ministry of Finance collects taxes and dividends from OCP. However, OCP's financial balance is not consolidated with the public sector balance and revenues allocated for social projects are not placed in the national treasury. The Ministry of Finance publishes annual reports with information on production volumes, prices, value of resource exports, estimates of investment in exploration and development, production costs, production data by block and production streams value. Dividends are not disaggregated by sector. The Ministry of Energy and Mines publishes the same type information apart from prices and dividends while the Central Bank publishes some aggregated figures on the mining sector.

### *Algeria*

In Algeria, all natural resources belong to the state. The Ministry of Energy and Mines (MEM) regulates the hydrocarbon sector while the national agency for the development of hydrocarbon resources, which falls under the MEM, grants licenses and rights following direct negotiations. Since 2009, Sonatrach, the Algerian state-owned energy company, is involved with a majority share in ventures with all other energy companies.

The licensing process before negotiations is specified by legislation, which is a major change compared to 2010. However, details of the negotiations, contracts and environmental impact assessments are not public. There is no specific rule on disclosure of information and, in practice, foreign companies are often subject to an arbitrary process with discretion exercised by the executive office.

The Ministry of Energy and Mines collects payments from resource companies. Apart from the limited information published by the Ministry of Finance on oil prices and value of resource exports, the Ministry of Energy and Mines is the main source of information on the hydrocarbons sector. It publishes data from 2005 on reserves, production volumes, exports, names of companies operating in country and production data by company/block. It does not publish any information on disaggregated revenue streams. Its annual reports are audited by a national audit office but are only available on demand. Government officials with an oversight role of the hydrocarbons sector are not required to disclose information about their financial interest in any extractive activity.

### *Can State-Owned Enterprises (SOEs) help strengthen minerals governance in the Maghreb?*



State Owned Enterprises are critical drivers of minerals governance. They have a large and direct impact of public revenues, and on governance and accountability. Their relative performance compared to other agencies and their overall country –particularly in Morocco- underscores their importance in driving the reform process to strengthen resource governance in the Maghreb. Sonatrach and OCP are fully owned by their respective governments. Algeria’s SOE is less transparent than its Moroccan counterpart. However Sonatrach and OCP perform relatively better than their aggregate country scores and ranking. Sonatrach publishes information in annual reports on reserves, production volumes, exports, names of companies operating in country, production data by company/block, production streams value and the government’s share in production sharing agreements. License fees, acreage fees and Sonatrach’s audited financial statements are available on request only.

OCP publishes comprehensive reports on its operations and subsidiaries including on production volumes, phosphates prices, value of phosphate exports, estimates of investment in exploration and development, production costs and quasi-fiscal activities. However, information on taxes is not disaggregated and it is not possible to reconcile figures between the Ministry of Finance and OCP. Although a National Audit Office is legally competent to examine OCP’s management, it does not appear to enforce its oversight role. It publishes audits of the ministries’ financial statements, but not on OCP. Similarly, we find that no specific Parliamentary Committee scrutinizes reports on resource related revenues. However, the new Constitution followed by the Code for Good Governance Practices of State Enterprises establish that state-owned companies might, from now on, be audited by an independent external auditor.

We also find that SOEs that are listed and have partial private ownership –which is not the case in Algeria and Morocco- tend to be more transparent and accountable. Although significant changes to the ownership structure of Sonatrach and OCP are unlikely (and may not be commercially desirable in the short-term), full government ownership creates vulnerabilities to political interference and can hinder SOEs reform agenda. Public listing of SOEs can provide strong incentives to increase corporate governance while keeping government’s control over the company.

### *Strengthening Natural Resource Funds Governance*

The management of minerals revenues to preserve macroeconomic stability and foster economic diversification to create jobs represents a major challenge. The Revenue Watch Index finds that MENA countries have weak revenue management systems.

Unlike Morocco and Tunisia, Algeria has created a mechanism to manage the revenues from oil and gas. The Ministry of Finance and the Central Bank are responsible for the revenue regulation fund set up in 2000 to reduce the impact of price volatility, its income coming from taxation of natural gas and oil exports. There is no clear procedure for deposits or withdrawals from the fund, and detailed reports on its assets, transactions and investments are not published. It appears that money is allocated discretionarily by the Algerian government without explicit rules or guidelines.

Poor governance of natural resource funds -a subset of the so-called sovereign wealth funds (SWF)- undermines resource rich countries' ability develop more significant fiscal buffers against commodity prices volatility.<sup>10</sup> The financial clout of these funds, the lack of transparency in many of them, and the fear that some governments may invest them with political or geostrategic rather than purely financial objectives, have attracted the attention of market participants and politicians alike.

In October 2008 a group of 26 SWFs committed themselves to transparency, good governance, and accountability standards by signing a voluntary code of principles, the "Generally Accepted Principles and Practices" for SWFs (GAAP), also known as the "Santiago Principles." The key transparency elements require SWFs to disclose their legal framework, define and disclose their policy purpose and publish their funding and withdrawal arrangements. However the implementation of the Principles is left to the discretion of individual SWFs –which explains the varying degrees of compliance.

The framework provides another example of external accountability towards the market rather than to citizens of resource rich countries (Heuty, 2011). Since natural resources are public assets, their proceeds and management should also be subject to public scrutiny. The rationale for secrecy in the management of natural resource funds appears unfounded. A recent report by the International Forum of Sovereign Wealth Funds (2011) notes that "some Members still face constraints regarding the information they can disclose" and implicitly recognizes that only half of the 26 members of the group "confirmed that transfers and withdrawals are determined as part of the annual budget process" (page 14-15).

Minerals governance deficits – particularly in NRFs management- undermine the potential for the creation of an efficient regional capital market and the prospects for regionalization in the Maghreb. SWFs from resource rich countries such as Algeria have a key opportunity to invest in capital scarce countries such as Morocco and Tunisia. SWFs also have long term investment horizons which are consistent with developing countries' development needs (Griffith-Jones and Ocampo, 2008). The global financial crisis also means that the impulse for large cross-border investments toward developing countries could come not from the US or Europe but from surplus saving countries from the region. The creation of a *governance compact* to increase regional investments across the Maghreb and MENA could boost economic growth and employment.

## Conclusion: A Minerals Governance Compact for the Maghreb

Reform in the governance of minerals is a necessary, important springboard for successful political transitions in the Maghreb and the Middle East. But reform of natural resource management will spur employment and sustainable development only if governments also make critical reforms to macroeconomic policies management, and modernize the financial sector.

A compact for minerals governance would involve an agreement by the governments of Algeria, Morocco and Tunisia on a package of reforms to transform their oil, gas and mining sectors. A joint initiative in the Maghreb would have –at least- three distinct advantages: it would send a strong

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<sup>10</sup> For further discussion, see Heuty (2012)

signal to domestic and foreign investors to stimulate investment and create jobs; it would strengthen intra-regional capital and labor flows and it would enable the group of Maghreb countries to increase their bargaining power to develop strategic partnerships with the Middle East, Africa and Europe. The compact requires a set of domestic reforms to increase openness and transparency about revenues from minerals and about how those monies are spent. Greater openness will inhibit corruption and build trust in government institutions. And governments can begin to become more transparent by taking relatively simple steps:

- Publish what they earn from the mineral sector and follow international best practice. All resource-rich countries in the region should work to implement the Extractive Industries Transparency Initiative, following the example of Iraq.
- Make public all minerals contracts.
- Disclose on a regular, timely basis detailed information about reserves accumulated in sovereign wealth funds.
- Make public the revenues, spending and assets of state owned companies.
- Ensure free and full participation by civil society in the oversight of the oil and gas sector.

State Owned Enterprises play a dominant role in the sector and can be major agents of change for the region. They are the most important employer in Algeria, Morocco and Tunisia and play a critical role in stimulating small and medium businesses. Overall they also appear more open and accountable in their management of the sector than other government ministries and agencies. The Maghreb can build on some of the good practices adopted by the SOEs to strengthen the management of minerals for development.

In the longer term, countries need to alter the role of minerals in their economies, an undertaking that will require greater regional cooperation. To reduce oil's dominance, these states must make large, long-term investments in other sectors of their economies, a necessary step toward creating jobs.

They also must address the governance gap in the management of natural resources revenues. Weak revenue management is one of the barriers to transforming resource wealth into well-being, for it facilitates corruption and undermines public expenditure management. Implementation of the "Santiago Principles" (see page 10) would improve the investment climate and increase capital flows to and within the region.

The governments could also create a regional platform for public-private partnerships, to attract and channel savings from minerals into the non-resource sector, the better to accelerate job creation and diversification of their economies. In partnership with the private sector, a clearing mechanism could provide an efficient market to mobilize minerals rents to finance investment projects with high social and economic returns for the region. A regional approach would have the necessary scale to mobilize resources for large projects with significant economic benefits across countries. A regional approach would also alleviate the risks of opposition and backtracking at the national level and increase governments' incentives to implement broad reforms in the mineral sector.

Powerful forces and vested interests will stand in the way of governance reforms in the minerals sector. The youth and unemployed across the Maghreb and the Middle East expect change that delivers jobs and tangible social reform. Maintaining and restoring stability requires a complete transformation in the extractive industries role and management. Without that change, democracy will be associated with economic failure and may prove short-lived.

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