

Managing and Spending Natural Resource Revenues

NATURAL RESOURCE REVENUES ARE SPECIAL

Oil, gas and mineral resources are distinctly different from other sources of government income:

They are finite. Unless they are invested to grow the national economy rather than consumed, the country ends up worse off once they are depleted than it was when it started extracting.

They are volatile. Revenues can vary wildly. When revenues are increasing there is a tendency to overspend on “legacy projects” such as monuments, cultural centers or new government buildings. When revenues decline unexpectedly, the government is either forced to cut spending or go further into debt.

They can damage other industries. If revenues are large enough, revenue inflow into the country causes a real exchange rate appreciation that makes it cheaper for the country to buy goods and services from abroad and more difficult for national industries to export. This phenomenon is called “Dutch disease”. Natural resource booms also draw an overwhelming share of national talent and resources to oil, gas and mineral extraction, harming national competitiveness. As a result of these effects, the country might deindustrialize.

They can foment conflict. As has been seen in Sierra Leone (with diamonds), Angola and Sudan (oil), and Myanmar and the Democratic Republic of Congo (coltan, copper, gold, tin and other metals), resource-rich developing countries face higher risks of conflict.

Therefore, depending on their size and management, revenues can either transform millions of lives for the better (e.g., Botswana, Chile) or they can leave a country worse off than before production started (e.g., Angola, Nigeria).

REVENUE MANAGEMENT STRATEGIES

Good macroeconomic policy and public financial management of resource revenues are key elements of any strategy to take full advantage of natural resources. Countries should consider three fundamental sets of tools:

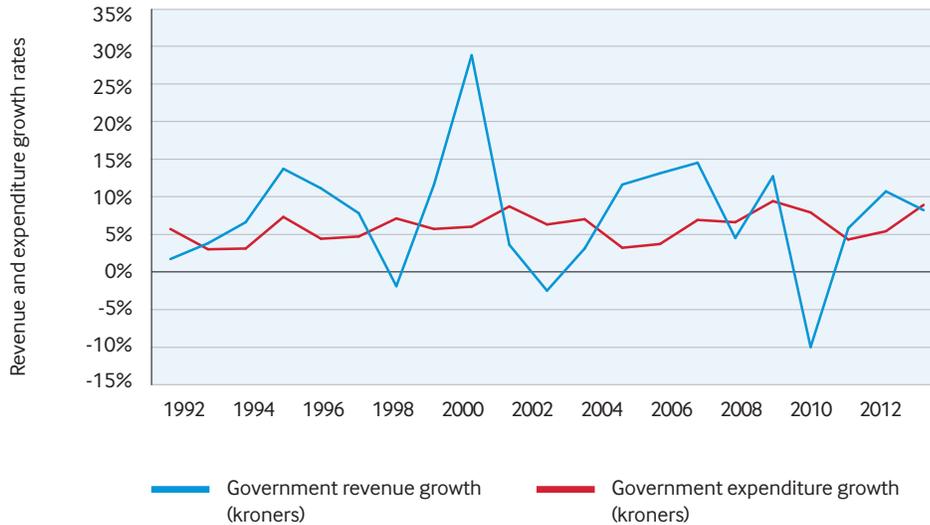
- **A strong macroeconomic framework that includes fiscal rules.** To support long-term fiscal sustainability, governments can adopt fiscal rules that constrain government spending or debt. Chile, Ghana, Peru and Norway, for example, have implemented rules that smooth volatile expenditures, in order to improve the quality of public investments and save oil or mineral revenues in cases of economic or environmental crisis. Chile, Norway and Timor-Leste have also enacted rules that save resource revenue for the benefit of future generations.

Key messages

- Oil, gas and mineral revenues are volatile and finite; if large enough, they can prompt wasteful spending, inflation and deindustrialization. In order to address these challenges, governments may wish to develop a medium- to long-term fiscal framework including legislation of fiscal rules, establishment of a natural resource fund, and commitment to a medium-term development plan.
- Fiscal rules—constraints on government spending or public debt—can be enacted to stabilize the budget, save for future generations, and improve long-term development planning.
- Development planning and strong public financial management systems are also key elements in turning resource revenues into tangible benefits like roads, electricity and education systems.
- Parliament has two important roles in this regard: enact rules to manage resource revenues and oversee the government’s management of these revenues.

These fiscal rules limit the amount of petroleum or mineral revenue that a government can spend in a given year. Fiscal surpluses are either deposited in one or more special funds designed to help achieve fiscal goals, or are used to pay down public debt. When revenues decline because of negative price shocks or declines in production, the government can draw on the fund or borrow in line with the fiscal rule.

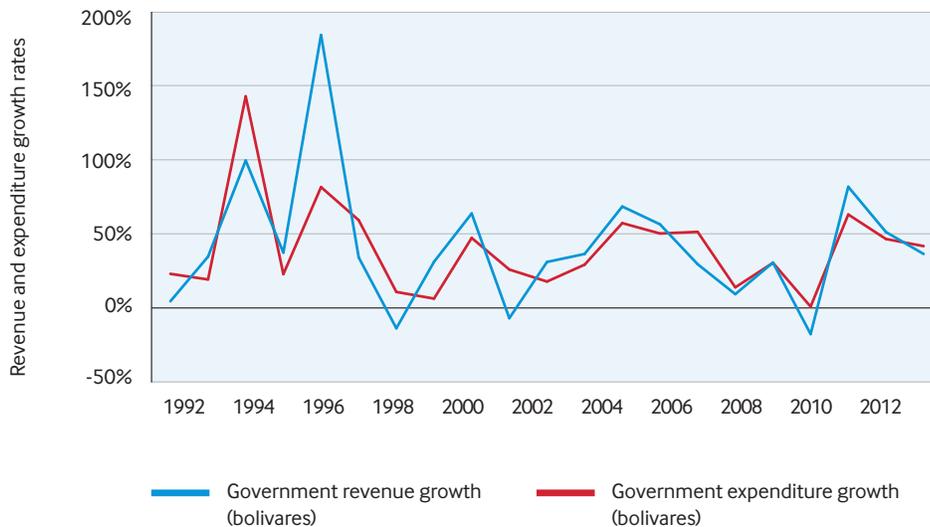
Norway



Figures 1 and 2. Effects of fiscal rules, or lack thereof, on revenue and expenditure volatility in Norway and Venezuela respectively

Source: World Economic Outlook data (IMF)

Venezuela



Today, more than \$4 trillion in assets purchased using resource revenues are held in increasingly common **natural resource funds (NRFs)**, which are a subset of **sovereign wealth funds (SWFs)**. Natural resource funds can have different objectives, including stabilizing budget spending, saving revenues for future generations, and channeling oil, gas or mineral revenues to key development sectors. However, without integration into the budget framework and parliamentary oversight, these funds could divert scarce resources away from countries' priorities.

Resource revenues should be invested to achieve optimal and equitable outcomes for both current and future generations.

Precept 7, Natural Resource Charter

Development plans. Where resource revenues are large, in the short-run development is more likely to be driven by governments than the private sector for one simple reason: governments have the most money. As a result, it is imperative that the government creates a realistic pro-growth development plan. In order to be effective, a development plan should be based on a thorough analysis of bottlenecks in the economy and include a detailed year-by-year list of priority public investments (e.g., a port; primary road from location x to y). A development plan should also be drafted for at least 5 years.

Implementing the plan is often a major challenge. In many cases much effort is put into creating a strong document, but over the course of the budget process, political priorities can take precedence over established development objectives. Parliaments have an important role in monitoring development plan implementation and should use all their powers to pressure the government to abide by the plan.

Public financial management. Even if a country has a strong macroeconomic framework and well-designed development plan, a poor public financial management (PFM) system could undermine the transformation of resource revenues into tangible benefits. PFM is the system of budget execution which includes public procurement of infrastructure, as well as reporting, monitoring and evaluation of infrastructure projects. Good PFM of public investment projects involves:

- accurate appraisal of all costs and benefits
- independent technical review
- open, competitive procurement
- comprehensive monitoring of execution
- training of workers to operate and maintain infrastructure, and budget for this operation and maintenance

WHAT ROLE DO PARLIAMENTS PLAY IN OVERSEEING THE MANAGEMENT OF NATURAL RESOURCE REVENUES?

Parliaments have two important roles in improving the management of natural resource revenues:

One is **enacting rules to govern revenues**. Parliaments play a key role in the budget process that governs the allocation of resource revenues. They can also pass legislation creating tools such as resource funds and fiscal rules as described above. Many countries, like Ghana, Chile and Timor-Leste, have passed comprehensive revenue management legislation that not only clarifies the fiscal rules, but also explains how saved revenues are managed using natural resource funds that hold their assets. Legislation can include rules for what kinds of assets the fund can invest in, on who is in charge of managing the funds (usually the minister of finance or central bank), and about reporting requirements.

Parliaments can also inform national development plans, for example by debating them or approving them. They may also pass laws improving the public financial management system.

The second role is overseeing revenue management systems to improve compliance with the rules and government performance. With the help of external auditors, budget offices, or multi-stakeholder oversight groups, parliaments can better take on an oversight role. Parliamentarians should ask tough, well-informed questions around the flow of resource revenues, natural resource fund investment performance and management of risk and decision-making processes. They should participate actively in shaping changes to revenue management provisions, if these are necessary to improve investment effectiveness.

What not to do: Nauru

Nauru, an island state, used to be mineral-rich, but the government did not plan well and the country quickly consumed all of its resource revenues. At independence, in 1968, Nauru was one of the world's poorest countries; by 1973, thanks to a phosphate boom, GDP per capita exceeded \$25,000 per person, the world's second highest. Bad revenue management meant that by 2007, it had once again become one of the world's poorest countries with GDP per capita of less than \$1,900.

The government should smooth domestic spending of revenues to account for revenue volatility.

Precept 8,
Natural Resource Charter

PARLIAMENTARY STRATEGIES FOR EFFECTIVE POLICY AND OVERSIGHT

Parliament can attempt to persuade the government to use resource revenues efficiently and for the public good, or force the government to do so by legislating rules. Specifically, parliamentarians can:

- Insist that annual budget decisions be linked to a medium- and long-term national development plan and, if such plan is in place, oversee compliance with set objectives.
- Monitor annual budgets closely to ensure that implementation is in line with a long-term revenue management strategy or with revenue management legislation.
- Introduce legislation creating or modifying a natural resource fund and revenue-sharing regime, as long as sound fiscal management and forecasting, and institutional capacity are already in place.
- Exercise powers to monitor the cost, quality and speed of delivery of large infrastructure projects. When projects are poorly constructed or managed, contractors should be sanctioned or replaced.
- Produce a committee report that assesses the strengths and weaknesses of the revenue management system, large infrastructure project cycle and/or economic diversification strategy.
- Sanction officials who act unethically or disregard the public interest.
- Ask parliamentary staff or civic groups to prepare briefings that identify options, challenges and available tools for managing and spending revenues well.
- Encourage critical debate on government policies by holding media briefings and informational hearings.
- Build political consensus around the need for review and reforms of revenue and expenditure policies.
- Reach out to parliamentarians from other countries that share similar challenges to learn how they addressed the issues.

QUESTIONS PARLIAMENTARIANS CAN ASK

- Given my country's aspirations for future revenues from natural resources, should the country introduce comprehensive fiscal rules to guard against volatility or save for future generations? If so, which rules would be most appropriate?
- Does my country have a coherent medium-term national development plan? If not, why? If so, does it address my country's challenges, and is it used in annual budget planning?
- Are there any indications that funds are misused or not used effectively for the betterment of the country? What actions can be taken to address these problems?
- Is the government actively pursuing a policy of economic diversification?

Further reading and engagement

NRGI revenue management and natural resource fund website pages, www.resourcegovernance.org/issues/revenue-management or <http://www.resourcegovernance.org/natural-resource-funds>