Sub-National Benefit Sharing of Natural-Resource Revenues

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Issues

- Arguments around (fiscal) EI Benefit Sharing
- Institutional Design of Benefit Sharing
- Post-commodity boom sub-national adjustment
Decentralized Benefit Sharing and Natural Resources

• Prevailing Issues in Range of Developing Countries
  – Nigeria, Russia, Indonesia, Iraq, Bolivia, Sudan, DRC, Malaysia, PNG, Peru, etc.

• Challenges in applying developed country models for our clients
  – Natural resources fail to translate into demonstrable and sustainable development in places of extraction
  – Weak Institutions, capacity and poor governance contribute to “resource curse” at various levels of government
  – Recent price increases and new discoveries in range of countries with pressures for decentralization
  – Claims to mining and oil revenues highly contested with diverse states…
  – Commodity slump may aggravate situation
Natural Resource Dependence Varies Significantly

Oil & Gas Revenues (Share of Total)
Most Recent Available Year

Source:
EI Fiscal Dependence + Decentralization

Extractive Industries (EI) Revenues
(as % of Total Government Revenues)
Welcome to Southern Sudan
The Extractive Industries Value Chain Across Levels of Government

Non-renewable Resources → Sustainable Development

- National Government
- State/Provincial Level Government
- Local Government
- Communities/Indigenous Groups

Stages:
- Award of contracts and licenses
- Regulation and monitoring of operations
- Collection of taxes and royalties
- Revenue distribution and management
- Sound Sustainable Projects
Arguments Around Natural Revenues Sharing

• Arguments for Greater Degree of Centralization
  – Stability: *Natural Revenues Subject to high Degree of Volatility*
  – Disparities: *Known and potential endowments highly unequal*
  – National Treasure: *Belongs to all the people!*
  – Local Capacity: *National governments better placed to manage*
  – Coherence in Natural-Resource Policy: *Avoid distortion across regions*
  – Revenue Transparency: *Easier if revenues accrue to one “account”*

• Arguments for Decentralization/Derivation Based
  – Cost-Reimbursement: *Including Environmental Costs*
  – Heritage Argument: *Non-renewable resource*
  – Political/Conflict Resolution Arguments:
    • *Often very important where legitimacy between central and sub-national governments have been contested*
“Performance” of Natural Resource Revenue Sharing in an Intergovernmental Context

- Glue or Solvent for National Cohesion?
  - Averting grievances, Promoting Sustainable Local Development
- Revenue Flows Translate Into Development Outcomes
  - Finance Follows Function
  - Accountabilities Promote Service Delivery
- Revenue Assignments/Collection Consistent with Coherent Revenue Policy
  - Effective in attracting investment to best placed locations
- Consistent with Good Public Financial Management (PFM) at all Levels
- Intergovernmental Arrangements Consistent with Fiscal/Macro-Economic Stability
  - “Overgrazing” undermines stabilization/heritage arrangements
- Natural-Resource Rents Don’t Subvert Country’s Institutional Development/Integrity
  - Corruption Further Corrodes Representative/Legitimate Institutions
Natural Resource Revenues Must Be Seen Within the Context of Good Intergovernmental Design

Decentralization spans
✓ Political/Legal
  ✓ Including Constitutional Assignments (e.g., DRC 2005)
✓ Fiscal
  ✓ Shaped by country’s economic/revenue structure
✓ Administrative

Natural-resources can add to the complexity…
Five Fundamental Questions Facing Any Decentralizing System

• Expenditure Assignments/Responsibilities
  – *Finance Follows Function Principle*

• Revenues
  – Own Source Revenues (autonomy of bases/rate setting)
    • Role of Sub-Nationals in Negotiating Exploitation/Revenue Streams
  – User Fees

• Intergovernmental transfers
  – Derivation Based Revenue Sharing
  – Transfers
    • Fiscal Equalization
    • Specific Purpose/Conditional Grants

• Subnational borrowing/debt

• Capacity Development: Organizational, Institutional and Human
Mining Benefit Sharing and Sustainable Development

- Clarifying Roles and Responsibilities
  - Government
    - National
    - State
    - Local
  - Communities
    - Indigenous/Traditional Authorities
  - Mining Companies

- Mining’s Development Footprint
  - Administrative Jurisdictions: National, Intermediate, Local
  - Communities/Indigenous Groups

- Promoting Mutual Accountability
  - Development Outcomes, Sustainability, Efficiency
Intergovernmental Revenue Management

- Addressing Natural Resource Revenue Volatility
  - Transfers Based on Realizations or Actuals
    - Sub-National Revenue Predictability
      - Ex Ante Rules
    - Stabilization Accounts
- Addressing Natural-Resource Revenue Non-Renewability
  - Heritage Funds
    - Who benefits and when?
- Transfer Transparency
  - Commissions for Dispute Clarification/Resolution
  - Reporting to Higher Levels
  - Revenue Transparency and Accountability
Expenditure Assignment Considerations

- Macroeconomic stability
  - Takes on special importance with natural resource revenue dependence
- Public Service Delivery
  - Effectiveness/Efficiency
  - Public Management Innovation
- Poverty Reduction
  - Responsiveness
  - Equalization

Expenditure assignments often span multiple tiers of government
Rationales for Intergovernmental Transfers

- Vertical imbalances
- Horizontal imbalances
- Inter-jurisdictional spillovers (externalities)
- Enhancing national objectives at the subnational level
- Paying for national programs implemented by subnational governments
(Sub-National) Natural-resource revenue assignments tend to make inter-regional disparities prominent

- Assignment of Natural Resource Revenues to Sub-Nationals
  - Shared versus Own Source (i.e., incorporates effort)
  - How much is assigned to sub-nationals on derivation basis?
- Assignment of Other Revenues
  - Property Tax?
  - Income Tax? Other?
- Expenditure Needs
  - Ideally funds follow function
- Transfer Design
  - Vertical Shares/Pools?
  - Horizontal Allocation Criteria
A “Good” Transfer System

- Transfers should be transparent and predictable
  - Preference for formula-based
  - Natural-resource revenue rich settings need to place special emphasis on transparency
- Equalization transfers should include
  - A realistic measure of “need”
    - Population, Area, Cost, “Backwardness”
  - A realistic measure of “fiscal capacity”
  - Adequate sub-national revenue autonomy
  - Stable but flexible financing
- No Single Transfer May Meet All Objectives
  - But, avoid proliferation of different grants
Managing Transfers Across Levels

• Hierarchical Models
  – 2nds tier has full autonomy over LG allocations
    • Indonesian districts receive direct allocations
    • Pakistan (with some modification)
    • Nigeria: transfer allocations earmarked to locals, but concerns about state interception

• National Models
  – Direct allocations to second & third tiers
    • E.g., Indonesia’s provinces & districts
    • Guidelines for 3rd tier allocations

• Mixed/Asymmetric Models
  – Special autonomy in Indonesia (Aceh/Papua)
  – North/South Sudan
  – Iraq’s Regions/KRG
The Challenge of Sub-National Accountability

- Natural-Resources Revenues May be Especially Prone to Weak Accountability
  - Weak Bottom-Up Accountabilities
    - No Representation Through Local Taxation
  - Beneficiary Regions Subject to Windfalls
  - Weak Top-Down Accountability
    - Sub-National Allocation of Natural-Resources May Be Subject of Political Bargains

- Natural Resource Revenues May Be Inherently “Centralized”
  - Allocation to Sub-National Governments May (Also) Fail to Trickle Down
  - Differences between Mining and Petroleum?

- Revenue-led Fiscal Decentralization Associated with Weak Accountability for Outcomes
  - Explore Linkages to Sectoral/Frontline Outcomes?
  - Role of Communities?
Post-Boom Adjustment

- Quality of National & Intergovernmental Revenue Management?
  - Nigeria: Federation Account with Central Bank (Excess Crude Accounts receives “windfalls”)
  - Clarity, Transparency and Predictability of Transfer Arrangements
    - De Jure versus De Facto

- Most exposed sub-nationals?
  - SN EI Fiscal Dependence & Projected Volatility
  - Fiscal, economic, social
    - DRC’s Katanga Province
Q&A

Selected References
