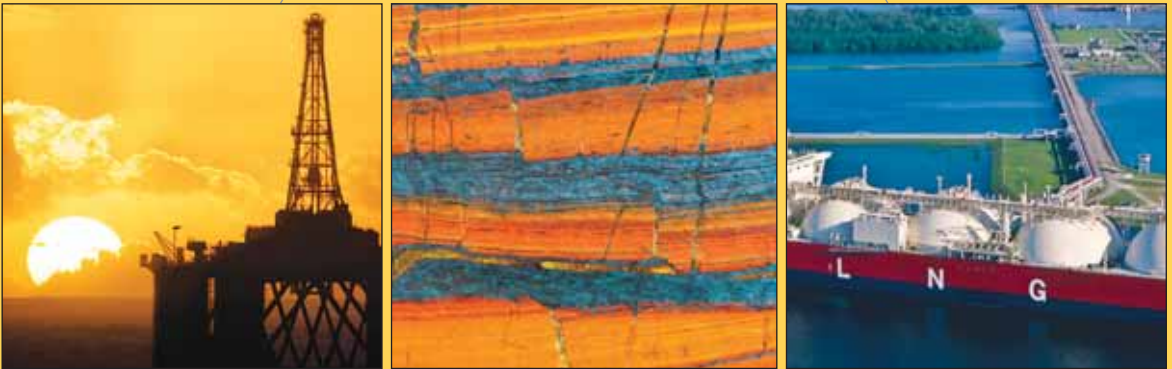


Implementing EITI at the Subnational Level



Emerging Experience and
Operational Framework

Javier Aguilar
Georg Caspary
Verena Seiler



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The Oil, Gas, and Mining Unit series publishes reviews and analyses of sector experience from around the world as well as new findings from analytical work. It places particular emphasis on how the experience and knowledge gained relates to developing country policy makers, communities affected by extractive industries, extractive industry enterprises, and civil society organizations. We hope to see this series inform a wide range of interested parties on the opportunities as well as the risks presented by the sector.

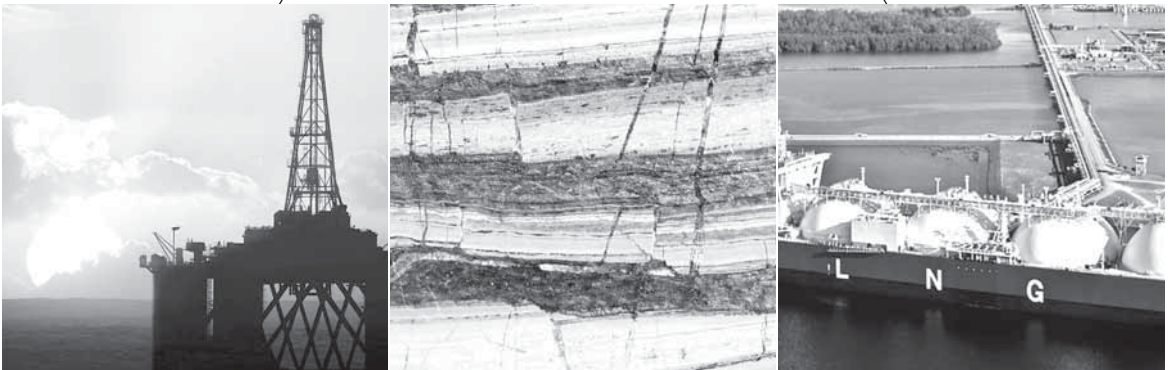
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Executive Summary

Rationale for Subnational Implementation

The fundamental rationale behind EITI is that increased transparency and knowledge of revenues from the extractive industries will empower citizens and institutions to hold governments accountable. By implementing EITI at the subnational level, countries could reduce opportunities for mismanagement or diversion of funds from sustainable development purposes, especially for prominent oil, gas, or mining regions. It is also an effective way of strengthening EITI local ownership among stakeholders. This report presents a preliminary analysis of emerging experiences in EITI countries implementing subnational EITI. Six countries have been selected as case studies: Ghana, Indonesia, Mongolia, Nigeria, the Democratic Republic of the Congo (DRC), and Peru. Based on these experiences, the report proposes a common operational framework for implementing EITI at the subnational level, laying the ground for further practical guidelines on deepening or strengthening the subnational plans or activities of implementing countries.

Subnational Governments' (SNGs) Access to Resource-Revenues

SNGs access nonrenewable natural resource-revenues (resource-revenues hereafter) through two main fiscal arrangements: (i) *local payments*, in which legislation assigns specific collection responsibilities to SNGs, which we will consider from an EITI perspective as *direct access* to resource-revenues, and (ii) *transfers*, in which intergovernmental revenue-sharing arrangements entitle SNGs to a share of resource-revenue collected by the national/federal government, which we will consider here as *indirect access*. There is a great variety of revenue-sharing arrangements among countries, ranging from limited decentralization in unitary countries to broad SNG autonomy in federal countries. In most of the cases, resource-revenue sharing has been done primarily through transfers rather than through direct collection by SNGs. In general, resource-revenue transparency is key for improving governance of extractive industries, but its importance is

especially relevant in regions hosting large oil, gas, and mining operations. There is where EITI can make a strong contribution.

Relevance of the Subnational Dimension for EITI

The subnational dimension of EITI is relevant for countries that have either a direct or indirect resource-revenue-sharing system or one that encompasses aspects of both. In these cases, SNGs arise as a highly relevant stakeholder for EITI for one or both of the following reasons:

- **Significant payment flows**—the impact that SNGs with direct access to resource-revenues can have on EITI reports: If “material,” these revenue flows should be included in the EITI national report. Otherwise, the disclosed data will be inaccurate and partial. The issue that needs to be addressed is how to include these payments under EITI rules.
- **Significant transfer flows**—the impact that EITI at the subnational level can have on those regions with access to significant resource-revenue transfers. The issue here is whether the flow of transfers should be included as part of EITI report and how.

Potential Countries for EITI Subnational Implementation

A practical way of estimating whether countries would benefit from a subnational EITI is to consider the updated list of countries that participate or could potentially participate in EITI. Of the 35 countries already participating, a subgroup of 14 have the potential to implement EITI at the subnational level, among which DRC, Ghana, Mongolia, and Peru have already taken concrete steps forward. Indonesia and Nigeria have anticipated preparatory work on disaggregating their EITI reports at the subnational level as stated in their national multistakeholder group (MSG) working plan.

EITI Rules

As a result of interest expressed by countries, companies, and civil society stakeholders, the EITI Board at its 2010 meeting in Dar es Salaam agreed to discuss how to include SNGs’ resource-revenue flows as part of EITI. As a result, the new EITI rules edition, which became effective in July 2011, specifically addresses the subnational dimension of EITI. Under the new rules, countries are encouraged to include SNGs’

resource-revenues as part of their reporting framework (EITI 2011). The challenge ahead for EITI supporting structure would be to encourage and support implementing countries by providing consistent guidance and quality assurance for EITI subnational country processes.

It is important to consider possible implications of these changes being introduced into the EITI rules. To reach an in-depth understanding of whether the EITI should be implemented at the subnational level, we should make a distinction between direct payments (direct revenue sharing) and indirect payments (indirect revenue sharing). If the direct payments to the SNGs are considered “material” in EITI terms, then including the subnational level is a requirement for candidate countries. If these payments are not included, data and information aimed at providing a complete picture of material payments may be affected. Including the transfers to the SNGs is not a requirement but rather an option for each individual country and its MSG. Consequently, it is clearly never a condition either for validation or for retaining the status of “compliant country.”

Emerging Experiences: Specific Examples

Reviewing the six country experiences on EITI subnational implementation yielded some significant differences in the contexts in which SNGs have access to resource-revenue. These differences have major implications that need to be taken into account when implementing EITI at the subnational level. However, this review also identified a number of common features that the EITI implementing countries face regarding transparency when dealing with SNG resource-revenues. Although under different conditions and regulatory frameworks, the SNGs from the revenue-producing regions in the six countries have both direct and indirect access to the resource-revenue. The differences arise mainly when looking at the amount and main types of revenue. In each case, characteristics of the SNG’s processes proved to be essential to extractive industries’ governance in the producing regions, a significance that goes beyond the actual amount of revenue available.

Three different forms of possible subnational EITI reconciliation can be identified. First, the reconciliation process focused on direct EI revenues collected by the subnational governments and compared them to companies’ payments (revenue collection). Second, the process focused on revenue transfers from the central to the subnational governments and compared them to the rules that should be applied (revenue distribution

process). Third, the effort focused on revenue transfers from the central to the subnational governments and compared them to the subnational governments' receipts (revenue distribution cash flow). In addition to these subnational EITI reconciliation processes, some governments have decided to unilaterally disclose subnational governments' expenditures.

Subnational EITI can be relevant for EITI validation¹ in cases where EI payments directly paid to subnational governments are material. In countries where direct EI payments to subnational governments are not considered material, the national EITI secretariat and the multistakeholder group (MSG) can still decide that they would like to extend EITI implementation to the subnational level because they deem it essential to improving transparency in the sector. In this case subnational EITI can be an additional element *that is not taken into account for validation*. Several constraints may have to be overcome to implement subnational EITI successfully. They range from local administrative capacity, legal uncertainty, funding, logistics, and specific political issues to lack of engagement with local and/or regional civil society organizations.

Key Lessons from Emerging Experience and Factors to Consider

Although there have been numerous lessons learned in efforts to begin implementing EITI at the subnational level, the following arise as common and important:

- The six country examples illustrate how some countries approach the revenue transparency issue at the subnational level. These experiences can provide inspiration to other countries facing similar challenges, but they cannot necessarily be replicated. Perhaps the most important lesson is that each country's EITI subnational program will be unique, based on its own regulatory framework, priorities, and the funds available to undertake the task.
- In terms of EITI subnational reporting, the issue of which resource-revenue streams are material and which are not should be treated under different criteria, depending on the country's issues in relation to revenue transparency. Though each country may have its own

¹EITI validation is the external quality review of the national EITI process required by EITI rules.

definition of materiality for subnational revenue streams, all need to define clear criteria to determine which subnational revenue streams will be reported, what the threshold level for selecting reporting regions will be, what provinces or districts to report on, which companies will need to disclose data, and most importantly, which SNG and national government entities will be considered for implementing the reconciliation process.

- The overarching lesson that emerges from reviewing the experiences of the six countries is that a common operational framework is required if countries are to get the most out of EITI subnational reporting. Even taking the different country profiles into account, the general structure of revenue streams that provide SNGs with access to resource-revenues and the emerging experiences make it possible to design specific reporting options based on common grounds that support any revenue sharing system that involves SNGs. Within a common framework, countries can define their own EITI subnational program according to their context, improving how they plan their program, how they assess its implementation, how they share knowledge and experience with other implementing countries.

Operational Framework

The proposed operational framework for EITI implementation at the subnational level considers four areas for reporting SNG access to resource-revenues. The key criterion to defining these is materiality, a core component of EITI that defines the content of the disclosing and reporting exercise. The operational framework is not intended to be a one-size-fits-all solution to the complex issue of revenue transparency at the subnational level. The four components can be easily adapted to different country contexts and implemented gradually as needed. How subnational reporting is done in each country will vary depending on the existing policies on intergovernmental revenue sharing and the aim of subnational reporting. Likewise, the subnational EITI reports may evolve and be adapted to reflect changes in income streams or the number of SNGs covered.

On a final note, there are some key steps that global EITI will need to consider in order to advance the agenda on EITI subnational implementation.

- **Momentum:** EITI subnational implementation is a reality that has been implemented based on country needs, and will be addressed

in an increasing number of EITI implementing countries. All six countries studied have plans to continue and strengthen their reporting efforts at the subnational level. This trend highlights the need for practical and continued guidance and technical assistance for implementing countries by EITI global stakeholders and partners, so that countries can get the most out of their efforts to include the subnational dimension of resource-revenue transparency.

- **Knowledge sharing:** Subnational EITI poses new challenges to country-based stakeholders. Technical assistance will be needed for implementation and further work to address issues and recommendations that arise from the reports. Sharing experiences among implementing countries and learning from each other is key at this initial stage of implementation. A tailored knowledge-sharing network and learning platform on subnational EITI implementation could bring together good practices and concrete, focused examples of ways to implement EITI at the subnational level.
- **Capacity/Resources:** EITI global stakeholders and implementing countries will require capacity and resources to deepen the existing EITI process through subnational implementation. Typically, a subnational EITI program will entail a medium-term effort, three to four years, to cover the relevant sectors, resource-revenue streams, and producing regions considered to have a high degree of materiality. Incremental funds for subnational implementation, in addition to current existing funds for EITI national process, will be needed. In particular, additional resources for reconciliation and dissemination will become new areas for EITI national budget requirements and potential donor contribution.

Further Resources

In addition to the information in this report, abundant information may be found at the following sources:

- The World Bank's Role in Implementing the EITI: <http://www.worldbank.org/eiti-mdtf>.
- The World Bank's Oil, Gas, Mining Unit: <http://www.worldbank.org/ogmc>.
- The EITI website, especially reports from Ghana and Mongolia: <http://eiti.org/>.

**“Billions of dollars come out of the ground each year;
yet our schools, our children, our clinics don’t benefit.
Where does the money go? We have the right to know.”**

(Testimony from a community member in Nigeria,
excerpted from OXFAM’s “Follow the Money” campaign)

Chapter 1

Introduction

This paper deals with the Bayelsas, the South Gobis, the Cajamarcas, the Ashantis, the Katangas, and the Sumatras of this world. These are the locations where a major portion of the relevant country’s oil, gas, and mining revenues are being generated. Though extremely different in many senses, these localities share key features: they are rich in resources; they host large oil, gas, or mining investments; and their local governments have access to significant resource-revenues. While the Extractive Industries Transparency Initiative (EITI) is a story about revenue transparency in resource-rich countries, EITI subnational is a story about resource-rich regions within resource-rich countries.

Subnational issues emerge in resource-rich countries notably because of the frequently uneven spatial distribution of these resources. For instance, while 95 percent of Nigeria’s export earnings and 65 percent of government revenues come from the oil and gas sector, only 9 of a total of 36 states are producing states. In Indonesia, one island (though admittedly the largest one, Sumatra) of a total of 17,508 islands holds approximately 70 percent of the country’s proven and probable oil reserves and accounts for more than half of its oil production. (Within Sumatra these are in turn mostly concentrated in Riau province and in central Sumatra.) Sumatra also holds over two-thirds of the country’s coal reserves. A similar situation can be found in Peru, where out of 24 regions just 8 hold 85 percent of mining revenues transferred to sub-

national governments (SNGs) and just 1 (Cusco) hosts more than 90 percent of gas production.²

Rationale

In countries with a significant resource-revenue-sharing system in place, using EITI at the subnational level provides a clear opportunity to address governance and lack of trust issues within the producing regions. This is the level at which a lack of transparency directly affects the interests of the local population and the operating conditions under which companies invest and develop natural resources. Failure to include revenue-sharing payments in an EITI risks damaging the perceived relevance of the initiative in those countries. From the EITI perspective, implementation at the subnational level could help anchor the initiative in a given country and help it achieve its expected impact on accountability. Making the subnational as well as national flows of resource-revenues transparent would be a logical extension of an EITI's role, with significant gains for the country and for EITI itself.

EITI is founded upon principles of transparency, accountability and anticorruption. At the national level in many of the compliant countries, one of the benefits of implementation has been an increase in engagement among stakeholders—a strengthening of social capital. Where there are legal provisions in a country for either direct payments by extractive companies to subnational government tiers or for the distribution of centrally collected revenues back to producing regions, it seems logical to seek to use EITI to increase transparency, accountability, and trust at a regional level and between national and regional stakeholders.

The subnational dimension of EITI has emerged among EITI stakeholders at a very early stage of the initiative, around 2005–2006. Since then, it has been a recurrent issue discussed at several EITI Board meetings. Three developments have brought subnational transparency to the forefront of the global EITI agenda:

²Subnational government by definition is anything below the national (central or federal) level and thus includes the state and local government sectors. A state, province, or region is defined as “the largest geographical area into which the country as a whole may be divided for political or administrative purposes. These areas may be described by other terms, such as provinces, cantons, republics, prefectures, or administrative regions” (World Bank 2008).

- The recent update to the EITI rules (which includes explicitly subnational revenue streams under EITI) (EITI 2011)
- The need to “deepen” EITI in compliance countries that wish to go further than core EITI
- Possibly most important, the fact that EITI implementing countries that have started to extend their national EITI process to the subnational level want to share and learn from existing experiences and have concrete plans to expand their initial efforts

Implementing EITI at the subnational level means applying the EITI principles and criteria to revenues flows that occur at government levels below the national or federal level. Implementing countries of subnational EITI can so far only draw on little international experience with the matter. Hence, the present paper is a dedicated effort to provide guidance and help countries to share knowledge and experiences in relation to subnational EITI.

Objective

The objective of this report is to take stock of these emerging experiences and conduct a preliminary analysis of them. Based on this, we will propose a common framework for implementing EITI at the subnational level, in turn laying the ground for further practical guidelines on deepening or strengthening what implementing countries are doing / plan to do in relation to subnational EITI.

Source Material: Six Case Studies on EITI Subnational Implementation

In order to study the experience of EITI countries in implementing subnational EITI, six countries have been selected as case studies: Democratic Republic of Congo (DRC), Ghana, Indonesia, Mongolia, Nigeria and Peru (table 1). These countries’ direct payment methods of resource-revenues to subnational government (SNG) and revenue-sharing mechanisms, as well as their emerging experience in implementing subnational EITI, have been studied. Ghana, Mongolia, and Peru have undertaken concrete implementation steps. DRC, Indonesia, and Nigeria are at a very early stage of subnational EITI scoping and still have to decide what subnational revenue streams will be reported on.

Table 1. Subnational EITI Reporting among the Case Study Countries

Type of subnational reporting	Countries currently reporting	Countries planning on reporting
Collection	Mongolia, Ghana, Nigeria	Mongolia, Ghana, Nigeria, Indonesia
Distribution – process	Ghana	Ghana, Nigeria
Distribution – flows	Ghana, Peru (Cajamarca), Nigeria (unilateral)	Ghana, Peru (Cajamarca), Nigeria, possibly Indonesia
Expenditures	Ghana, Peru (Cajamarca)	Ghana, Peru (Cajamarca), possibly Nigeria

The selection criterion for these countries was that all of them have an emerging experience with subnational EITI implementation. This experience may consist of having undertaken subnational EITI reporting, which is the case of Mongolia, Ghana, the Cajamarca region in Peru, and in a limited way of Nigeria, where companies disclosed unilaterally direct subnational payments. This first group of countries offers valuable insights from early lessons and good practice regarding subnational EITI implementation. Subnational EITI experience can also consist of discussing and scoping subnational EITI implementation in order to prepare for a first EITI report that includes subnational EITI information. This is the case with the second group of countries: namely Nigeria, DRC, and Indonesia. This set of countries provides valuable examples for direct subnational payments, revenue-sharing mechanisms, and drivers for subnational reporting, mandates, and possible constraints for subnational EITI reporting that must be considered before embarking on a subnational EITI exercise.³

Audience

This paper is targeted mainly for consultation and discussion with EITI global stakeholders and countries that are implementing subnational EITI or are thinking of doing so, as well as with other concerned EITI stakeholders, donor partners, or other relevant EITI practitioners.

³More than a third of 35 implementing countries as well as some countries potentially interested in joining EITI have mentioned some transparency issues at the subnational level as a main concern. Some—Philippines, Colombia, Papua New Guinea, and even Australia—have cited it as a reason for possibly not choosing to adopt EITI.

Structure of the Report

This report is divided into four parts. Part 1 is the introduction. Part 2 provides a framework for understanding the ways in which subnational governments may access resource-revenues, distinguishing notably between direct and indirect access to resource-revenues. Part 3 lays out the emerging experiences with subnational EITI implementation in various EITI-implementing countries, discussing, for example, drivers, mandates, reconciliation processes, or constraints encountered and summarizes the main findings and early lessons from emerging experience. Part 4 discusses the broader context for subnational revenue transparency/EITIs, including the broader benefits from subnational EITI for implementing countries or the relevant evolution of EITI rules. The section ends with a forward-looking conclusion proposing an operational framework for subnational EITI implementation, and key points are highlighted for an agenda to advance EITI at the subnational level.

Understanding SNG Access to Resource-Revenue Sources

SNG access to revenues derived from extractive industries has become a critical feature in many resource-rich economies. Although public finance theory suggests a number of reservations regarding the transfer of resource-revenues to SNG, both revenues and controls of resource-revenue are often decentralized. Resource-revenues play an increasing role in financing SNG worldwide, often reflecting country context and political economy considerations. According to an International Monetary Fund report (IMF 2007), there appears to be a trend toward stepping up the use of SNG revenue sharing.

Giving SNG access to resource-revenue brings up some special considerations and, from the point of view of EITI, goes beyond simply accounting for payments from the companies. It is helpful to understand the different sources of revenue the SNGs receive and some important features of preparing and designing implementation of EITI at the subnational level. This section (i) compares and contrasts current points of view on SNG access to resource-revenue; (ii) describes examples of the main revenue flows to SNGs from oil, gas, and mining operations in their regions; and (iii) discusses implications for implementing EITI at the subnational level.

2.1 Rationale for Resource-Revenue Sharing

The fundamental rationale behind EITI is that increased transparency and knowledge of revenues from the extractive industries will empower citizens and institutions to hold governments accountable. By implementing EITI, countries could reduce opportunities for mismanagement or diversion of funds from sustainable development purposes. EITI implementation at the subnational level has exactly the same rationale

but focused on specific SNGs, especially SNGs from prominent oil, gas, or mining producing locations.⁴

2.1.1 Arguments in Favor of Resource-Revenue Sharing

Allocative efficiency

Assigning revenue to SNGs is generally considered likely to improve accountability and expenditure assignment, because SNGs can determine the needs and requirements of their populations better than central governments can. SNGs serve as the medium for determining what local services will be provided and how they will be financed, but assigning resource-revenue is a particular case of fiscal decentralization. What are the specific issues regarding decentralizing resource-revenues to SNGs, and what is the overarching promise of making resource-dependent states more accountable and responsive to their populations overall by means of decentralization? A number of arguments for benefit sharing focus on considerations of heritage type or compensation arguments.

Heritage

This argument calls for the need to replace an exhausted natural resource with another source so that the economy of a particular region may rely on some other new economic base in the future. A share of the proceeds from exploiting this resource could be used to finance this new source for regional or local development. Ultimately, this argument responds to the question of ownership of natural resources. It suggests that financial assets based on resource-revenues are to be earmarked for these regions or that these resources finance investments in these localities.

Cost reimbursement

A region that hosts oil, gas, or mining operations is often subject to environmental degradation, spends more on maintaining available infrastructure, requires more—and more complex—infrastructure and services, attracts continued migration flows, and experiences structural social and cultural changes. These costs associated with the presence of

⁴The discussion presented here is based on Bahl and Tumennasan (2002) and Bird (2000).

extractive industries provide a strong argument for sharing resource-revenue with SNGs as a way of compensating for the adjustments needed.

Uniform tax regime

Resource-revenue sharing can prevent “backdoor” approaches to resource-revenue raising that could contradict a central-government-defined tax regime for extractive industries. In the absence of shared resource-revenues, SNGs would tend to create special charges on or enforce contributions from operating companies as a way of receiving what they consider to be a fair share of resource-revenue.

Increasing trust and reducing the likelihood of conflict

Whether well founded or not, in many regions where there is a substantial endowment of minerals, oil, or gas, it is common to find that local people and institutions have expectations to derive some specific benefit from this endowment. Such expectations may take the form of increased separatist feeling or of communities being reluctant to give their consent to mining or oil and gas developments if no revenue-sharing provisions are made by the Government. The development of such projects may well be a significant in a national government’s overall economic development plans, but such development may not occur if people’s expectations of equitable treatment are not addressed at the subnational level.

2.1.2 Arguments against Resource-Revenue Sharing

National budget flexibility

Central governments should operate with a high degree of budget flexibility in order to cope with fiscal stress events. Resource-revenue streams can help address national deficit issues and keep the domestic tax burden down. The higher the share to an SNG from resource-revenues, the lower the flexibility central governments have to deal with deficits and financial crises.

Volatility

Resource-revenue is highly unstable, and SNGs are not as well equipped as the national/federal government is to deal with an unstable revenue flow. SNGs must provide essential services on a continued basis, and

severe revenue fluctuations will have a direct impact on the population's access to basic services.

Geographical disparity

In addition, if all resources or a large portion of resource rents are decentralized to producing regions, the central government and nonproducing regions might not have adequate revenues to fulfill their functions, while producing regions are able to provide more public services and investment. This creates vertical and horizontal disparities in addition to inefficiencies, given that the social return rate of investment may be lower in SNGs than in other jurisdictions (McLure 2003).

Capacity

A major concern when deciding on resource-revenue sharing is SNG administrative capacity and financial accountability. Very often SNGs lack capacity for public financial management, planning, and investment. This conditions their capacity to deliver services even when they have access to significant resource-revenues.

Corruption

Financial control systems are fragile and in some countries nonexistent. Combined with certain degree of autonomy that local/regional elected authorities exert, this feature poses serious challenges to furthering transparency and accountability from SNGs in producing regions.

2.1.3 Main Decisions When Deciding to Share Resource-Revenues with SNG

Resource-revenue sharing with SNG seems hard to resist where oil, gas, and mining industries are significant. When designing or reforming their resource-revenue policy framework, governments must face the following decisions or trade-offs:

- What/which resource-revenue streams should be shared from a wide range of taxes and transfers?
- What share should SNG have access to?
- What principle will rule revenue distribution?
- Should producing regions be privileged?
- Should an equalization scheme be created?

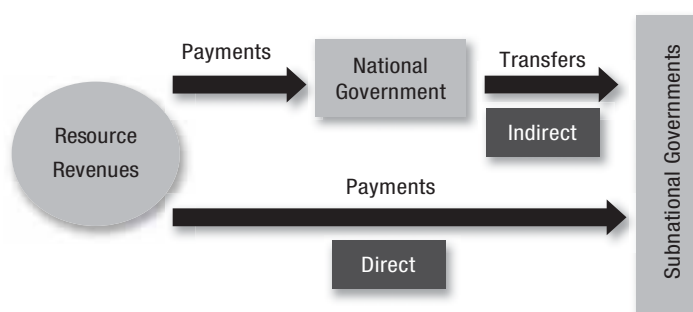
Since most governments seek a uniform policy regarding extractive industry investment through overall uniform tax regimes, SNGs are not often allowed to raise sector-specific taxes directly from extractive industry companies. Resource-revenue sharing is achieved primarily from transfers, rather than from direct taxation by SNGs.

2.2 Resource-Revenue Sources for SNGs

Figure 1 shows a simplified version of the most common resource-revenue flows to SNGs. Subnational governments access nonrenewable natural resource-revenues (resource-revenues onwards) through two main fiscal arrangements: (i) *local payments*, in which central legislation assigns specific collection responsibilities to SNGs, which we will consider from an EITI perspective as *direct access* to resource-revenues, and (ii) *transfers*, in which intergovernmental revenue-sharing arrangements entitle SNGs to a share of resource-revenue collected by national/federal government, which we will consider here as *indirect access*.⁵

There is a great variety of revenue-sharing arrangements among countries, ranging from limited decentralization in unitary countries to broad SNG autonomy in federal countries. In most of the cases, resource-revenue

Figure 1. SNG Access to Resource-Revenues



⁵In theory, resource-revenue sharing can also be done through a third channel, which is sharing a tax base between different government levels, to raise separate elements of the same tax (piggy-backing), or to raise different taxes. But it is barely used in relation to extractive industries. For specialized references on this subject, see Martinez-Vazquez and Searle (2007), Ahmad and Brosio (2006), and Otto et al. (2006).

sharing has been done primarily through transfers rather than through direct collection by SNGs. In general, resource-revenue transparency is important for improving governance of extractive industries, but especially in regions hosting large oil, gas, and mining operations its importance cannot be overemphasized. There is where EITI can make a strong contribution.

2.2.1 Direct Access to Resource-Revenue

In some countries, SNGs may be able to collect revenue from companies that make direct payments to them (table 2).

Tax revenue

Local taxes could be in the form of a general purpose local tax or a sector-specific local tax. In these cases SNGs control the tax base and tax rate and are responsible for collecting the tax. General local taxes would refer to land rents, surface tax, and property tax (Otto et al. 2006). Sector-specific taxes would be royalties and surcharges on the national tax base (i.e., corporate income tax).

Nontax revenue

Local nontax revenue instruments could also be general to any business or be sector specific in relation to oil, gas, and mining operations, with SNGs defining the base and rate and collecting the revenue. General nontax revenue is available to all SNGs and would consist of business charges, registration fees or levies, and license payments. Sector-specific nontax revenue is reserved for extractive-industries-producing regions and would come via contractual obligations from operating companies to SNG, dividends, or donations (frequently referred as “social payments” or “voluntary payments” among EITI stakeholders).

Examples of direct access to resource-revenue by SNGs in some of the countries analyzed in the EITI implementation case studies are presented

Table 2. Resource-Revenue Going Directly to SNGs

Payments	General	Resource specific
Tax revenue	Local business tax, property tax, land rent	Shared royalties, surcharge on income tax
Nontax revenue	Charges and fees, licenses	Contractual obligations, proceeds, donations

below, along with the context of the EITI implementation. Initial results will be examined later.

Direct access: Mongolia

In Mongolia, the General Tax Law (GTL) and Consolidated Budget Law (CBL) define the subnational taxes and neither the *aimag* nor the *soum* (regional and local government levels, respectively) can introduce additional taxes. According to the CBL, the sources of revenue at the aimag/regional level include the following taxes: city tax, land payment, immovable property tax, and transport and vehicle tax. At the soum/local level, taxes include livestock taxes, gun tax, stamp duty, taxes on self-employment, payment for hunting, and use of natural resources, natural plants, timber and water. Thus, soum and aimag have direct access to their own tax revenues. However, the revenue proceeds of these taxes are limited.

Moreover, in 2002, the parliament passed the Public Sector Finance and Management Law (PSFML), as a result of which subnational governments have access to fewer direct revenue sources than before. Thus, the financial position of the lower level of governments, soums, and districts depends mainly on transfers from the aimag government, which depends on the central government's transfers. In addition, the current system does not give SNGs incentives to increase revenue collection. In fact, any increase in subnational revenues is equalized by reductions in either the tax sharing or transfers. Therefore, the current system encourages sub-central governments to find extra-budgetary sources of revenue (such as donations, especially from large mining companies) and to underestimate their tax revenues.

As the EITI reports from Mongolia have shown, mining companies make substantial additional payments to subnational governments, such as donations. These donations are monetary or in-kind contributions (instruments, services such as construction work) to soums and aimags as well as to numerous government-run organizations (kindergarten, hospitals, schools).⁶ They are not mandatory but are included in some agreements between companies and government entities. Since there is no efficient reporting system for these donations, they represent the

⁶The third EITI report gives a comprehensive list of the type of all the donations (monetary and in-kind) reported. See MEITI's third reconciliation report (EITI 2008b, 270).

payment flow where most discrepancies were revealed through the EITI reports (EITI 2006, 10). These extrabudgetary revenues are often the only financial source for subnational capital expenses as well as local services assigned to subnational governments by the PSFML. More recently, Resolution No. 272, passed by the government in November 2006, just after having signed the new Minerals Law, specifies that royalties for the exploitation of some natural resources (all natural resources other than gold, copper, and copper concentrate) are to be directly paid to subnational governments by the companies (Government of Mongolia 2006).

Direct access: Ghana

There are two types of direct payments from extractive industry (EI) companies to subnational government entities in Ghana: property rate tax and ground rent payments. EI companies pay the property tax directly to the respective District Assemblies and ground rent to the respective regional Office of the Administrator of Stool Lands (OASL). In 2008, the property rate payments received by the District Assemblies amounted to ~\$760,819, accounting for 1 percent of the total revenue generated by the mining sector. Although they represent minor amounts compared to total central government mining revenues, these revenues often have significant incidence on meager SNG budgets.

Direct access: Nigeria

There are some direct payments by companies to the SNGs in Nigeria, for example, the personal income tax (of which the pay-as-you-earn tax—PAYE—is relevant for companies) (see FIRS), which is imposed on individuals and businesses. This tax is collected by the State Boards of Internal Revenue. The reconciliator representing the National Stakeholder's Working Group (NSWG) also lists other subnational payments: namely the withholding tax (WHT), business premises permits, tenement rates, and levies.⁷ These payments might represent limited amounts of money, but they could be significant for the SNG's budget. While they are not specific to the EIs, a significant proportion comes from EI companies. In the EITI report for 2006–2008, companies reported on PAYE as well as on withholding tax. However, the report did not disclose government figures; the figures were thus not reconciled (Hart Nurse 2011).

⁷Input by Ubaka Emelumadu of Shell and executive director of the Oil Producers Trade Section of Lagos Chamber of Commerce and Industry.

Direct access: DRC

In DRC, both the Mining Code and the Constitution granted the provinces autonomy and confirms the method of “retrocession” of the mining revenues to the provinces (central government transfer to SNGs derived from extractive industries). Nevertheless, these payments have never been made to the provinces, which poses a serious challenge to the provinces and the management of the sector. Since the mining revenue payments by retrocession were necessary to allow the provinces to function, the provinces started to impose their own decrees in order to collect their own revenue from the mining sector. This means that, although the Mining Code stipulates that all mining taxes are paid at the national level, there are in reality also de facto direct payments to the provinces; some of them in contradiction with the code. Since the mining sector has a different structure in every province, the provincial governments impose different decrees. Thus, direct payments for mining operations vary widely from one province to another. In Katanga for example, the mining sector includes a great number of multinationals, whereas in other provinces (such as in Kivu, Kasai, and Orientale) the mining sector consists mostly of informal artisanal mining. Another concern is that these decrees are issued when there is a short-term need for cash in the provinces.

A detailed overview of different types of direct payments to the Katanga government concerning copper and cobalt products and concentrates illustrates the type of local taxes or charges imposed on companies:⁸ Provincial tax for rehabilitation of urban road and drainage infrastructure of Katanga province, (\$50 per ton of exported product); the Lubumbashi-Likasi-Kolwezi toll road tax (\$150 per truck); the Katanga Province provincial tax on external commerce (1 percent of the cost, insurance, and freight value of each product); the provincial tax on the export of cobalt hydroxides (\$60 per ton); the tax on parking on public roads instituted by the Transportation and Communications Department of the Territory of Lubudi; the double taxation levied by the General Directorate for Administrative, Judicial, Property and Share Revenues (DGRAD) in Fungurume and by Pacific Trading, the DGRAD subcontractor in Kasumbalesa, for the same merchandise at export; the FONER fuel tax (tax on fuel for road rehabilitation); and a number of fiscal and administrative tax penalties from public provincial services.

⁸Estimation by Delphin Tshimena, World Bank.

Direct access: Indonesia

A key subnational issue related to mining in Indonesia is the proliferation of district-licensed mining permits. The establishment of such permits is allowed (or at least said to be allowed) under the provisions of Indonesia's 2000 decentralization law. A recent public statement by the Director General of Minerals and Coal mentioned that there are now an estimated 10,500 district-licensed mining permits. This entails a problem associated with public financial management. In Jakarta, the Ministry of Energy and Minerals is basically unaware of the details of the majority of these permits. The Director General of Minerals and Coal said recently that of the estimated 10,500 district licensed permits (of which two-thirds are for coal), he possesses adequate levels of information on only about 4,000 of them. It stands to reason that if the central government does not have sufficient information on district level mining permits, then it cannot collect revenues from them.

This may be one of the reasons that the contribution of the mining sector to Indonesia's revenues is so small vis-à-vis the size of the resource and the number of operations: 30 percent of Indonesia's millionaires are reported to be coal tycoons, and 18 percent of the capitalization of the national stock market is from coal companies, but only 1 to 2 percent of national revenues come from the coal sector—in the midst of a global commodities boom and world record coal prices.

Some other revenues (provincial and district taxes) that are conveyed directly from EI firms to local governments are not believed to be material (from an EITI perspective), but they are considered to be of policy significance because the way they are handled by local governments, especially district governments, is thought in some cases to be irregular. As a separate matter, locally paid "direct" revenues are growing as a percentage of all revenues paid by extractive industries. Although EITI Indonesia will initially be focused primarily on national revenue streams, and secondarily on subnational revenue streams, there is a widespread view held by all stakeholders in the initiative, including those in the mining industry, that the proliferation of district-licensed mining permits must, at some point, be addressed.

2.2.2 Indirect Access to Resource-Revenues

Many resource-rich countries have adopted intergovernmental transfers as their option to share resource-revenues with SNGs; resource-revenues

Table 3. Resource-Revenue Going Indirectly to SNGs

Transfers	Statutory	Discretionary
General	Grants from a tax pool including resource-revenues	
Resource specific	Grants derived exclusively from resource-revenues	

are collected at the national level and then assigned to SNGs in the form of grants (see table 3). These transfers are generally from the central government to the SNGs (regional or second level) or to third-level governments—municipalities or districts. Through this means, SNGs indirectly access a portion of revenues generated by the extractive industries.

Grant revenue: Tax pool

SNG grant revenue could be funded by national/federal government from a pool of different national taxes, including revenue resource collected from oil, gas, and mining activities. Often these transfers are universally distributed among SNGs (all SNGs regardless of the origin of resource-revenues) and provide the funding basis for SNGs. These transfers are often distributed through simple (per capita equal shares) or complex (social, economic, and demographic combined indexes) formulae. Some countries have an equalization formula in place.

Grant revenue: Single resource tax

SNG grant revenue could also be funded by national/federal government exclusively from a specific tax or nontax resource-revenue source. Most times the largest proportion of these transfers are distributed to SNGs in producing regions using the derivation principle (*vis-à-vis* the proportion each region contributes to total national oil, gas, or mining production). In these cases, it is very likely that resource-revenues would become highly concentrated in few producing regions. If the country has an equalization formula in place, the SNGs might reduce the corresponding tax-pool-funded grant. Revenues distributed by derivation are commonly transferred to SNGs, but countries can also consider other types of local entities and even individual citizens as beneficiaries.

As noted, in most cases there is a legal or constitutional formula for redistributing revenues from central government to SNGs. A high degree of revenue uncertainty, however, can result from discretionary transfer decisions by higher levels of government or from volatility of particular

resource-revenues given the industries' price and production volatility. A fixed royalty share for SNGs may vary significantly due to price fluctuations, variable rates of extraction over time, or variability in payment from the producing company to the state depending on the nature of the contracts. This feature is particularly relevant in those regions within countries where oil, gas, or mining operations are located, due to the spatial concentration of resource reserves.

Examples of indirect access to resource-revenue by SNGs in all six case study countries follow:

Indirect access: Nigeria

After deducting “first line charges” (including joint venture cash calls to finance the Nigerian Petroleum National Corporation), 13 percent of the Federation Account pool is paid to Nigeria's producing states by derivation. The remainder is distributed according to a formula, which is decided by an ad hoc commission, and has not changed since 1999. Fifty-two percent of this is allocated to the Central Government and to Special Funds (which include a stabilization fund, an ecological fund to mitigate environmental damages, and a fund for the development of the Natural Resource sector), and an extra allocation goes to the Federal Capital. The other 48 percent is distributed according to a formula that allocates funds at both the state and at the municipal levels, with the following weights: 40 percent equally across all states, 30 percent by population, 10 percent by extension, 10 percent by revenue-raising effort, and 10 percent by social development effort. As a result, about 26 percent is distributed among all 36 states and about 20 percent among all municipalities.

As data of the Ministry of Finance for June 2010 show (the latest month available), of the total resources allocated to SNGs from the Federation Account, including the effect of derivation, the nine producing states in the Niger Delta (Abia, Akwa Ibom, Bayelsa, Cross River, Delta, Edo, Imo, Ondo, and Rivers) receive 40 percent of the revenues allocated to all state governments in the final horizontal distribution (see table 4). One of the reasons that they receive this high share is that among these nine producing states are some of the most highly populated states in Nigeria. State governments control and apportion these funds today, but oil-producing communities and municipal governments argue for direct control over them (Revenue Watch Institute 2008). The tables show that Cross Riv-

ers, which produces very little oil, does not receive any share of the 13 percent derivation.

The total revenue of the Federation Account for the month of June 2010 amounted to ~\$3 billion, of which 22 percent have been transferred to the state governments in July 2010.

Table 4. Extract of Table on Revenue Allocation from Nigeria's Federation Account

	NGN	USD	Oil-producing states' share of state allocations	All state allocations' share of FA
Abia	2,071,774,499.65	12,430,647.00	2%	0%
Akwa Ibom	14,381,949,935.45	86,291,699.61	11%	2%
Bayelsa	4,596,800,583.02	27,580,803.50	3%	1%
Cross River	2,599,404,365.44	15,596,426.19	2%	0%
Delta	7,190,830,435.01	43,144,982.61	5%	1%
Edo	2,464,858,160.54	14,789,148.96	2%	0%
Imo	2,784,487,150.24	16,706,922.90	2%	0%
Ondo	4,450,148,941.77	26,700,893.65	3%	1%
Rivers	13,082,236,299.36	78,493,417.80	10%	2%
Oil-producing states total	53,622,490,370.48	321,734,942.22	40%	9%
All states total	134,072,575,728	804,435,454.37	100%	22%
Federation Account Total	607,385,766,136.39	3,644,314,596.82		

Source: Nigerian Ministry of Finance, Summary of revenue allocation by FAAC for the month of June 2010, Table I-II.

Note: With average conversion rate from NGN into USD of 0.006 in 2010.

Indirect access: Mongolia

Royalties payable on the sales of extracted gold, copper, and copper concentrate are to be paid to the central government budget. Every month, the Ministry of Finance is to transfer 30 percent of these royalty payments to the budget account of the aimag or soum/district where the mineral deposit is located. Royalties payable on the sales value of minerals other than gold, copper, and copper concentrate are to be paid to the aimag and soum governments. Every month, those units are to transfer

70 percent of these royalty payments to the central government budget account (Government of Mongolia 2006).

The example of the Omnogovi aimag shows that the revenues generated through royalty payments and license fees to the SNG represent a large portion of its revenue. Over 50 percent of Omnogovi's revenue is derived from mining licenses, fees, royalties, etc. Under the policy of sharing mining royalties, in 2008, the aimag received its share of 20 percent (~\$1.6 million)⁹ and the soums a share of 10 percent (~\$0.8 million) from the six mining companies operating in the aimag. The royalty budgeted for 2009 was even higher—~\$3.3 million for the aimag and ~\$1.7 million for the soums. In addition to this fiscal revenue-sharing arrangement, it has been agreed as per the resolution of the Great State Khural (Parliament of Mongolia) that ~\$400 per year would be given to each citizen in the mining area over the coming four years. So far a total of ~\$196,200 has been paid to 49,178 citizens in the mining areas under the aimags/soums (Government of Mongolia and ADB 2009, 13). This resolution is valid for all citizens living in aimags and soums with mining areas.

Indirect access: Ghana

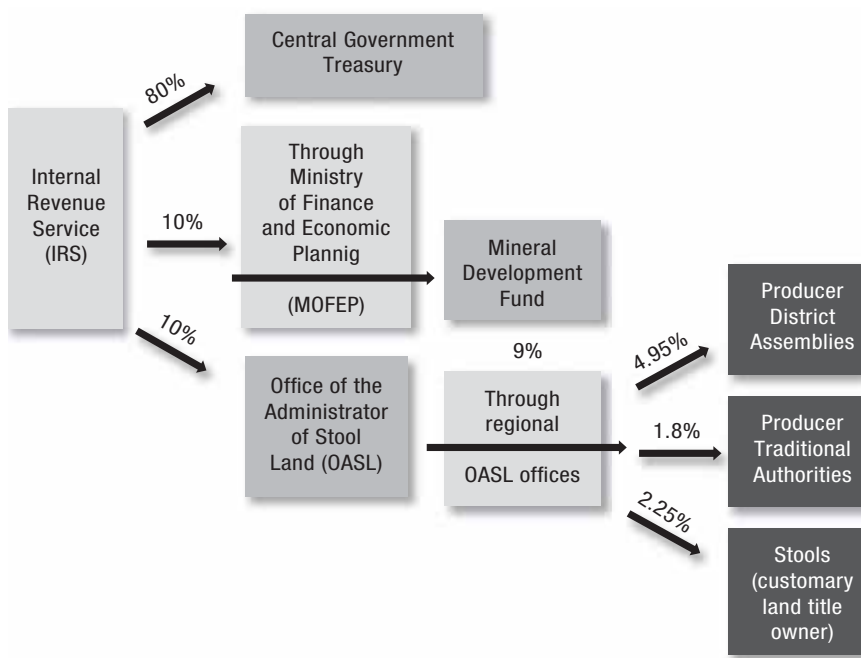
In Ghana, the mining legislation was recently updated through the new Minerals and Mining Act 2006 (703), which set royalties at a rate that shall not be more than 6 percent or less than 3 percent of the total revenue of minerals obtained by the holder (Government of Ghana 2006). Since then, Ghana's EITI reports have shown that companies have resorted to paying no more than the 3 percent royalty, which has raised a national debate about royalty rates, especially since royalties account for the largest share of the central government's mining revenues. As a result the Parliament of Ghana has declared the royalty rate for new projects to be fixed at 6 percent (EITI 2010a).

As illustrated in figure 2, the royalty payments are collected by the Internal Revenue Service (IRS), which transfers the following:

- 80 percent to the Central Government Treasury

⁹Note that the following average conversion rates are used: from January 1, 2006 to January 1, 2007 it is US\$0.0009 for Tog 1, and from January 1, 2008 to January 1, 2009 it is US\$0.0008 for Tog 1.

Figure 2. Mineral Royalty Redistribution in Ghana



- 10 percent to the Mineral Development Fund, which is to be used by mining-sector agencies for research and special projects
- 10 percent to the Head Office of the Administrator of Stool Lands (OASL). Of these 10 percent, the OASL retains 1 percent and forwards the remaining 9 percent to its regional OASL offices. The regional OASL offices distribute the money to the actual beneficiaries in the mining communities—namely district assemblies, traditional authorities and stools (EITI 2006–2008, section 2006, 10).

Thus, the system centralizes most of the royalty payments; only 9 percent of the royalty payments are assigned to subnational entities by derivation.

In 2008, royalties accounted for 64 percent of the central government’s mining revenues, followed by corporate tax, which represented 35 percent. The dividend and property rate accounted for only 1 percent each of the government’s receipt. In total, royalty payments amounted to ~\$56 million, corporate tax to ~\$29 million, and central government’s dividends to ~\$1.3 million (EITI 2006–2008, section 2008, 12, 15).

Table 5. Redistribution of Revenues in Peru

Income tax: 50%		
	Beneficiary	Criteria
10%	Municipalities in which resources are being extracted	
25%	Municipalities of the province in which resources are being extracted	Population Basic Needs
40%	Municipalities of the department in which resources are being extracted	Population Basic Needs
20%	Regional government	
5%	Universities	

Mining royalty: 100%		
	Beneficiary	Criteria
20%	Municipalities to which the concession belongs (50% to be invested in the communities in which extraction is taking place)	
20%	Municipalities of the province to which the concession belongs	Population Basic Needs
40%	Municipalities of the department to which the concession belongs	Population Basic Needs
15%	Regional government	
5%	National universities of the department to which concession belongs	

Indirect access: Peru

In the mining sector in Peru, 50 percent of income tax is redistributed through the Canon Minero and equally 100 percent of royalty payments through the Ley de Regalia Minería according to the same distribution key across all regions (Government of Peru 2010). See table 5.

At the local level, it is mostly regional or local governments and regional universities that receive the funds. Regional governments include the executive branches in the 25 regions, former departments, or the ones that actually receive funds through the redistribution system, i.e., those regions with EI activities). Local districts and municipalities include the mayors' offices (*alcaldías*) in larger municipalities, and smaller municipalities are often combined to become one district. Some funds go directly to regional universities.

Indirect access: DRC

The indirect payments to provincial governments, namely the retrocession (redistribution) of mining revenues in DRC, are regulated by the Mining Act of 2002. According to Article 242 of the act, the holder of the mining exploitation title has to pay the mining royalties to the Public Treasury. The latter is in charge of distributing the receipts of the mining royalties as follows: 60 percent remain in the hands of the Central Government; 25 percent is paid into an account designated by the Provincial Administration where the project is located; and 15 percent is paid into an account designated by the town or the administrative territory in the area where the exploitation activities take place.

The Mining Act further specifies that the funds resulting from this redistribution in favor of the Decentralized Administrative Entities (DEA) are allocated exclusively to the building of basic infrastructure in the interest of the community (Government of DRC 2002). Furthermore, Article 402 of the Mining Regulations from 2003 determines that the Mining Registry (Cadastre) has to redistribute the annual surface area fees collected from each mining or quarry title. Ten percent of the revenue from the annual surface fee is destined to local community development in communities where the mining and quarrying activities take place (Government of DRC 2003). The decentralization process further emphasizes the autonomy of the provinces and confirms the method of retrocession of the mining revenues to the provinces. Nevertheless, these payments have never been made to the provinces.¹⁰

Indirect access: Indonesia

Revenue sharing from natural resources in Indonesia is regulated within the overall decentralization legislation (Fiscal Balance Law 2004 and Government Regulation 104/2000), except for regions with special status, which benefit from special regimes defined by specific laws. Royalty revenues are distributed on the basis of “derivation.” Beneficiaries include provinces (regions), producing districts, and all nonproducing districts within that province (to satisfy considerations of social equity). The presidential regulation on transparency of EI revenues recognizes that local revenues from extractive industries constitute a right of local governments (Government of Indonesia 2010).

¹⁰The following is based on a discussion with Delphin Tshimena, World Bank, Kinshasa.

Most major extractive industry revenues in Indonesia are conveyed by EI producers to the central government and then redistributed by the central government to the provinces in which production sites are located as well as to all of the producing and nonproducing districts within those provinces. Of approximately \$100 billion in revenues collected by the government from all sources, approximately a quarter originates from EI companies. Of that amount, about a third (\$8 billion) is distributed back to producing provinces and all districts within them.

Indonesia assigns 15 percent of oil and 30 percent of gas revenues to regional levels of government. The sharing arrangement further foresees that the provinces of origin will get 3 percent of oil and 6 percent of gas revenues. Also, 12 percent of the oil and 6 percent of the gas revenues are provided to the districts/cities of origin. Oil and gas account for 25 percent of fiscal revenues, while revenues from other EI resources account for only 1 percent (World Bank 2007). The main exception to this arrangement is the revenue distribution mechanism for the resource-rich provinces with special status (Aceh, West Papua, and Papua). Under provisions of special autonomy laws, for onshore oil and gas operations located within their jurisdiction, the provincial governments receive 55 percent of the monetary value of after-cost recovery oil and 70 percent of the monetary value of after-cost recovery gas.

Another peculiarity of the Indonesian case is that EI revenues are redistributed at the subnational level also indirectly through the overall fiscal transfers system. The amount of EI revenues collected locally by derivation discounts half of a province's entitlement to the General Grant (Dana Alokasi Umum). The DAU is the main intergovernmental transfer, which accounts for 60 percent and 16 percent, respectively, of the revenues of local and provincial governments (World Bank 2007, 120). Half of a province's share in the DAU Central Pool is calculated as the difference between a formula-based "expenditure need" minus the province "collected revenues." The expenditure needs are based on objective criteria including population, size, and per capita GDP. The other 50 percent of the DAU is based on the wage bill that each region had at the time decentralization was first implemented.

Table 6. SNG avenues of access to Resource-Revenue

	–	Transfers materiality	+
+ Payments materiality	1. Mongolia (mining) DRC (mining)		4. Indonesia (mining)
	2. Ghana (mining)		3. Nigeria (oil) Peru (mining, oil) Indonesia (oil)
–			

2.3 Common Features Among EITI Subnational Implementing Countries

Reviewing the six country experiences on EITI subnational implementation yielded some significant differences in the ways SNGs have access to resource-revenue. These differences have major implications that need to be taken into account when implementing EITI at the subnational level. However, this review also identified a number of common features among the EITI implementing countries regarding transparency.

2.3.1 SNG Resource-Revenue Profile

Table 6 shows the profiles of the six countries studied using the EITI materiality criteria in order to show how each provides the SNGs access to resource-revenue. It considers materiality for each country/sector based on analysis and comparison of six country cases. Countries have not been explicit in defining materiality prior to or in the reports, hence the new more explicit requirement in the new rules to do so. The criteria applied refer to whether the revenues generated by direct payments from extractive industries or transfers from the central government have a high or low level of materiality. Understanding the profile of SNG access to resource-revenues could be useful when preparing the scoping study on whether to implement subnational EITI and what type of resource-revenues to cover.

Although under different conditions and regulatory frameworks, the SNG from the revenue producing regions in the six countries studied have both direct and indirect access to the resource-revenue. The differences arise mainly when looking at the amounts and main types of revenue. In each case the, SNGs are essential to governance of extractive industries in the producing regions, a significance that goes beyond the actual amount of revenue available. Below are the SNG resource-revenue profiles of the six countries studied and outlined in table 6:

Profile 1: Mongolia and DRC

The revenue collected directly from the mining companies by the SNGs are the most significant, whereas the amount received through transfers is of little or no significance. In Mongolia, the greatest source of revenue comes from specific nontax revenue raised from the mining companies (donations), and in DRC, from specific tax revenue, applied to the mining companies (a large range of locally defined taxes).

Profile 2: Ghana

The revenue directly collected from the companies is much less than the taxes paid by the companies to the central government, with the amount transferred being rather low although much high in comparison to how much is collected from other taxes. Nevertheless, this revenue is the most important source of revenue that the SNGs have in the different mining regions.

Profile 3: Nigeria, Peru, and Indonesia (oil)

The revenue collected directly by SNGs from the companies is much less than what the companies pay in taxes to the central government, but the amount the SNGs receive from national transfers is highly significant. In these three cases a significant amount of the revenue generated by the extractive sector is added to a tax pool that funds transfers to all the SNGs. However, revenues distributed to the producing regions, based on the derivation principle, make their SNGs considerably richer than those of nonproducing regions.

Profile 4: Indonesia (mining)

The revenue collected directly from issuing licenses to the mining companies is significant for the SNGs, and the amount received by way of transfers from the royalties paid directly to the central government is also highly significant and amounts to much more than what the SNGs receive from direct payments.

2.3.2 Features of Payments to SNG

- The SNGs in the producing regions in all of the six countries studied have direct access to resource-revenues.

- In some countries, such as Mongolia, Indonesia, and DRC, this type of revenue is often significant (material) and the SNGs' main source of revenue. The most significant types of payment vary from country to country. In Mongolia and Indonesia, nontax revenue from the mining industry is the main source of revenue—from donations and exploitation licenses, respectively.
- In Ghana, Peru, and Nigeria, revenue from general tax revenue and donations is limited compared to other sources (transfers).
- The SNGs in the producing regions in the six countries rely on a range of general and sector-specific taxes. An overview of each country shows that the SNGs generally concentrate on a limited number of taxes, depending on their administrative capacities. One case in point is DRC, where the SNGs collect a wide range of locally created taxes using complex administration and accounting structures.
- Donations are a type of revenue that needs particular attention, particularly when they are the most important source of revenue for SNGs in producing regions, such as in Mongolia. Accounting for and administering donations is extremely complex. They tend to be off-budget, especially when the central government discounts these amounts from transfers to the SNGs as a way of achieving equity for nonproducing regions. This indirectly encourages the SNGs not to report this revenue, and so it is managed arbitrarily and is unaccounted for.
- Direct access to resource-revenues can provide SNGs with truly additional revenues or not, depending on the transfer system that is in place. In two of the six countries studied, Mongolia and Indonesia, the transfer system has provisions that attempt to balance direct access to resource-revenues by a reduction in the national revenues transferred to producing regions. The larger the funds that SNGs access directly from extractive industries in relation to their budget seize, the higher the probability that access to resource-revenues will be a net gain for producing regions.
- It becomes even more complicated when the donations are in kind and agreements are made on an ad hoc basis in which only the companies have some sort of reporting system for how much is being donated. These payments are generally voluntary and sporadic (not on a yearly basis, for example), and the SNGs have no legal backing to ensure that these agreements are complied with.

2.3.3 Features of Transfers to SNG

- In the six countries studied, the SNGs in the producing regions have indirect access to resource-revenues.
- Even though the SNGs in all of these countries receive transfers of resource-revenues (from a tax pool) from the central government, the SNGs in the producing regions have access to statutory transfers exclusively derived from mining in Ghana, Mongolia, and DRC; oil in Nigeria; and mining, gas, and oil in Peru and Indonesia.
- In most cases, except DRC and Mongolia, transfers by derivation represent by far the largest revenue source.
- In all of the countries, the central government uses a revenue-sharing formula whose complexity varies from country to country. Most countries apply the derivation principle, in which the amount transferred is some factor of the proportion of total revenues originating (derived) from the recipient jurisdiction.
- This type of distribution leads to a high concentration of resource-revenues in the producing regions or districts and in certain SNGs. This concentration of resource-revenue arises as a result of the revenue being distributed among the SNGs in a specific producing region. How relevant EITI could be and what impact it may have is especially relevant in those SNG dependants on this high concentration of resource-revenues.
- The systems imply the involvement of different government institutions in completing the distribution process. The effectiveness of this process can vary greatly from country to country.
- How credible the system is can also vary, and so it makes sense to consider how important it is to ensure transparency, not only in when and what transfers are made but also how they are distributed. This requires a certain level of agreement, especially between the central and the subnational layers of government, although all too often the different layers of government do not cooperate with each other. The challenge involves not only the disclosure of how much the SNG receive but also whether they are receiving the amount expected and if the payments are being made on time in line with existing regulations.
- Revenue may be distributed among different government layers and also to different beneficiary institutions.

Chapter 3

Emerging Experiences from EITI Implementing Countries

According to EITI rules,¹¹ where the MSG determines that company direct payments to regional and local government entities are material,¹² these payments and receipts must be covered in the EITI report. The rules also encourage MSGs to consider including transfers between national and subnational tiers of government, although it should be clear this is not a requirement. Several implementing countries have taken the initiative to include the subnational dimension as a way of adapting the EITI to their own country's approach to managing resource-revenue. Each country has come up with its own way of dealing with the problems they face at the subnational level that takes into account the regulatory framework to collect, earmark, and distribute resource-revenue.

This section presents examples of how EITI is being implemented at the subnational level. It reviews SNG access to resource-revenues and the country profiles as per the previous section, and pays particular attention to understanding how each country has addressed or aims to address problems facing transparency in their resource-revenue-sharing mechanisms when implementing EITI at the subnational level.

The six countries studied cover different extractive industry sectors. Nigeria and Indonesia offer valuable insight into big oil- and gas-producing

¹¹Requirement 9(e) (EITI 2011).

¹²Material/Materiality: A threshold amount or percentage used to determine if a company or a payment is significant to an outcome, that is, materially affects the outcome if included or excluded. EITI implementing countries often set materiality levels based on company or payment size. A materiality level for a company would define the size of company above which companies are required to participate in a national EITI process. A payment materiality level would define the size of payment above which those payments should be included in the EITI process (EITI 2008a).

countries. Ghana, Mongolia, and Peru are examples of countries with significant mining exploitation activity. DRC, as well as Ghana and Peru in the future, provides insights into countries endowed with large mining as well as oil and gas resources.

The following aspects were considered in the analysis:

- Stakeholder drivers
- Mandates for subnational EITI implementation
- Subnational representation in multistakeholder groups (MSGs)
- Data reconciliation
- Information dissemination
- Validation
- Constraints

3.1 Stakeholder Drivers

Local communities and civil society organizations (CSOs) often express their discontent with the lack of local development benefits from extractive industries activities. These criticisms mainly point to benefit-sharing issues, environmental degradation, and lack of employment possibilities for the local population in these capital-intensive (rather than labor-intensive) activities.

- CSOs support subnational EITI in Ghana because of local benefit concerns. The public debate about mining focuses mainly on the industry's impact on local communities, the environment, and on fair compensation. Due to uneven social responsibility practices by mining companies, the relationships between communities and mining companies are often strained. Communities have grown increasingly wary of new mining investments and want to know how much the companies contribute to their development (World Bank 2010). The use of these funds is not defined, and CSOs claim that they are frequently captured by community chiefs (Global Greengrants Fund 2004).
- In Mongolia, CSOs support the subnational EITI because they believe that there is significant leakage in resource-revenue flows at all levels of government. Over the past decade, the number of CSOs doing mining-related and environmental work grew steadily. Corrupt behavior of local government administrations in their relationships with mining companies was one issue that prompted the rise of civil society activ-

ism. Civil society successfully argued for reporting on all donations and grants to central and subnational governments, which were often alleged to participate in corrupt and nontransparent uses (EITI 2009).

- In Nigeria, some key motivations of CSOs for addressing EITI implementation at the subnational level become clear in the EITI validation report. The report notes that one issue highlighted by many stakeholders is the need to have more subnational presence and to take the country's EITI to the more rural communities of Nigeria, which are significantly affected by extractive industries. Many CSOs indicated in interviews with the validator that these communities expect to receive disaggregated data in order to know how much the state or local government is supposed to get from the extractive industries. CSOs argue that the increased efforts at revenue transparency introduced by the government since 2003 (mainly the disclosure of monthly allocations from the federal to the state and local governments on the Ministry of Finance website and in local newspapers) should be matched with a disclosure by state and local governments (Government of Nigeria 2010).

Central/federal governments consider that disclosure of intergovernmental revenue flows can enhance mutual trust between local communities and the central government. However, they could find it challenging to disclose under subnational EITI how they determine the share of resource-revenue to be distributed and how much and when they actually transfer their share to SNG.

- The main motivation of the central government in Peru is to get an overview of the expenditure side and to use the multi-partite approach to disseminate information about the mining revenue, how it is being used and possible conflict resolution.
- The government of Ghana decided to implement EITI at the central, as well as at the subnational level. The main reason for the central government to include subnational governments into the reporting process was that it was concerned about the subnational governments' expenditures. Moreover, the central government wanted to make sure that the communities receive the correct amounts from the distributing agency OASL to which the central government transfers SNG shares.
- In Indonesia, a possible motivation behind the presidential regulations requiring the reporting of information on resource-revenues

collected by SNG is the perception in the central government that these revenues may at times be mismanaged, and that making this information transparent could decrease mismanagement in the future. With respect to the requirement that information on the national government's sharing of revenues with SNG be made public, the motivation was both the belief that shared revenues are mismanaged by SNGs after they receive them as well as the belief that by making information more clear on what was shared, with whom, and why would increase the confidence of SNG that they are receiving the correct amounts (i.e., making availability of information the basis of accountability).

SNGs have shown great interest in central government disclosing transfers accounted to them. However, accountability and disclosure practices vary hugely among SNGs. Their response to subnational EITI will diverge accordingly.

- There is an enormous interest among provincial governments in DRC to document the payments to the central government and from the government to the regional governments in future EITI reports, because they believe that the central government does not respect the constitution regarding the derivation of mining revenues. The determination to create local EITI structures was expressed by the governors of resource-rich provinces during the EITI conference in Lubumbashi.
- Subnational governments in Ghana suffer from the lack of timeliness and predictability of central government transfers, which makes it impossible for them to anticipate the amount they would receive and to plan their budgets. Further motivations among local governments likely include their need for income predictability and a better understanding of the origins of their revenue flows. Subnational EITI can also help remove substantial distrust by SNGs concerning revenue-sharing data by the central government (Tawiah 2010).
- Oil-producing states in Nigeria, wanting to receive their share of taxes and royalties paid to the federal government, push for better tracing of the revenue redistribution from the federal government to the states and municipalities. The Revenue Watch Institute reports that allocations to the states from the National Federation Account increased from \$1 billion to \$6 billion between 2000 and 2004, with nearly one-third of this windfall reportedly going to the major oil-

producing states: Delta, Rivers, Bayelsa, and Akwa Ibom (Revenue Watch Institute 2008.). The share of derivation was increased in light of instability in the Niger Delta. Moreover, revenue volatility is a significant challenge for subnational governments, which are dependent on natural resource earnings for their annual budgets—another reason for them to try to get the necessary data in order to be able to provide accurate projections (S.E.B. Strategy Ltd. 2009).

The companies' main interest in subnational EITI is to show a wider public that they are among the most relevant taxpayers, to counter the widespread belief that the country gets too little revenue from the extractive activities in terms of tax revenue, and to demonstrate that they are positive on transparency. This is particularly relevant for their relationship with communities at the subnational level. Companies also have an interest in the increased trust that tends to be generated through transparency about the payments made to central government and then returned to the regional/local level.

- Companies operating in DRC often suffer from double taxing. If payments were effectively decentralized (meaning that the system of derivation would be abandoned) or if the derivation rules would be applied correctly, provincial governments might renounce their separate local taxes, because they would get their share of the taxes paid by the mining sector. There seems to be an interest from the company side to consider payments at the local level in the EITI reports. As mentioned before, five companies told the validators that social payments (for rehabilitation/building of schools, hospitals, etc.), which they are asked to pay, should also be included in the reporting process (Government of DRC 2009).
- In order to improve their relations with local communities in Ghana, they want to show the local communities where they operate and how much their activity contribute financially to the development of the community and the country as a whole. The companies also want to make sure that the central government transfers the correct amount to the communities, because they are interested in the community seeing direct benefits from their mining activity (which in turn helps the companies to keep their “social license to operate”). It should also be noted that the Chamber of Mines advocates that 30 percent of the mining royalties should be returned to mining communities, claiming that the 9 percent currently returned to

subnational governments is inadequate (Ghana Broadcasting Corporation n.d.).

- There is an increasing interest in Mongolia in using transparency of payments to show companies' contributions to local development. Several stakeholders from companies voiced their concerns about a number of discretionary payment demands at the level of subnational government—both for donations and for meeting apparent licensing requirements. These concerns were also raised in several MSG meetings. This shows that companies have a strong interest in better government reporting at the subnational level; this would limit the subnational government's justification in asking for additional unofficial payments.¹³

3.2 Mandates for Subnational EITI Implementation

Subnational EITI implementation has been formalized to varying degrees by the national EITI secretariat together with the MSG. Possible mandates have ranged from the least formalized mandate for subnational EITI laid out in an EITI work plan (as seen in the example of DRC) to a highly formalized subnational EITI mandate in the form of a legal act (as in Mongolia, Nigeria, Indonesia, and Peru).

3.2.1 Low Level of Formalization of Subnational EITI Mandate: The EITI Work Plan

The MSG and Comité Executif of DRC agreed on a triennial work plan for 2011–13 which lays out in which provinces provincial “EITI antennas” are to be established and when. The work plan shows that the MSG plans to establish provincial EITI committees in five provinces in the second half of 2011, after the deadline for EITI validation in June 2011. Terms of reference are planned to be drafted in order to establish these committees. In 2012 provincial committees should be in place in the following provinces: Katanga, Nord Kivu, Sud Kivu, Bas-Congo, Orientale, and Kinshasa. According to the work plan, \$200,000 has been earmarked to establish these five provincial EITI committees.

¹³The following is based on the validation of EITI in Mongolia report (EITI 2010b), especially page 20.

3.2.2 High Level of Formalization of Subnational EITI Mandate: An EITI Act

In Mongolia, the central government, companies, and civil society organizations agreed to report on company payments and government receipts at the subnational and the central government level in a tripartite memorandum of understanding (MoU) signed before Mongolia became an EITI candidate country in April 2007. The government then passed Resolution no. 80, which requires all government entities (including all subnational governments, namely aimag and soum offices) to issue an EITI report, to coordinate relevant activities, and to monitor on whether entities with extractive industries licenses and operating in their respective territories produce EITI reports. This also includes a specific requirement for subnational authorities to establish a subnational EITI branch office and work towards EITI implementation at subnational levels through partnerships between subnational governments, NGOs, and companies. Although the mandate for subnational EITI in Mongolia thus applies to all regions, it is expected that mainly mining regions will participate.

Similarly, Indonesia plans to include transparency of revenues accruing to the subnational governments from the beginning of its EITI implementation. This is stipulated in Presidential Regulation no. 26 of 2010, which represents the general EITI mandate in Indonesia.

In Nigeria, when the Nigerian EITI Act was implemented in 2007, the reach of EITI was mainly meant to be limited to payments to the federal government. Consequently, the NEITI Act states that the objective of the NEITI is to ensure due process and transparency in payments made by all extractive industry companies to the federal government and statutory recipients. However, Article 3e of the NEITI Act refers to the NEITI's right to ask for disclosure of payments received and revenues paid by states and local governments and Article 3g refers to NEITI's duty to undertake measures that will enhance the capacity of local governments having statutory responsibility to monitor revenue payments made by EI companies. To date, NEITI is hiring a consultant to undertake a review of the NEITI's revenue-monitoring mandate; the objective is to develop a framework for monitoring EI companies' payments to the Federation Account (which is Nigeria's main EI revenue distribution tool) and to undertake a disbursement audit for distributed revenues from the Federation Account to its end beneficiaries (states and local governments).

An example for a formal but regionally limited subnational EITI mandate is **Peru**, where the central government decided to implement pilot projects for subnational EITI in two regions (Cajamarca and Cuzco). In April 2005, a multistakeholder meeting agreed on an action plan to implement EITI in Peru, which aimed at increasing transparency at the central and regional level of planning to disclose EI revenues collected by local and regional governments as well as the use of these revenues. The regional EITI mechanism has made progress in Cajamarca, but has come to a standstill in Cuzco. In 2008, the central government formalized the objective for subnational EITI in a cooperation agreement with the Regional Government of Cajamarca (Convenio Marco de Cooperación Interinstitucional entre el Ministerio de Energía y Minas y el Gobierno Regional Cajamarca). In this agreement the central government offered financial (\$30,000) and technical support to the regional government, which committed to implementing the objectives laid out in the Convenio, such as the creation of a regional MSG and the disclosure of all EI revenues accruing to the regional government, universities, and public institutions and of the use of these revenues. In 2009, the regional government of Cajamarca passed Resolution no. 359 defining the members and tasks of the regional MSG. The subnational EITI pilot project in Cajamarca issued a first report in April 2010.

3.3 Subnational Representation in Multistakeholder Groups

This section lays out different ways of structuring subnational representation in the MSGs. Usually the collaboration of the MSG members is formalized through an MoU, which commits a certain number of representatives of all three stakeholder groups (governments, companies, CSOs) to participating in the process of implementing EITI.

3.3.1 Varying Structure of Subnational MSG

The structure of subnational MSGs has been found to vary. The countries with previous experience in subnational EITI found two different ways to ensure subnational representation in the MSGs, either by integrating members of the subnational government in the national MSG, or by creating local MSGs responsible for monitoring EITI reporting in specific pilot regions. The decision on how to structure subnational representation in the MSG can have implications for the process. Including subnational representatives in the national MSG has the advantage of reinforcing the national EITI reporting process. However, the engagement

with subnational actors is not as strong as it might be in a separate subnational MSG structure where subnational government representatives collaborate with locally engaged CSOs and companies. A separate MSG structure runs the risk that its subnational authorities are not sufficiently involved in the national EITI process.

In Ghana, Nigeria, and Indonesia, subnational governments are represented in the national MSG. In Ghana, the country with most experience in subnational EITI implementation, the MSG (National Steering Committee, NSC) includes representatives of the two subnational institutions that report on the EI revenue transfers they receive from the government: (i) a representative of the Office of the Administrator of Stool Lands and (ii) a position that rotates between the district/municipal assemblies in mining areas and the district assemblies in the areas of an oil find.

Similarly, the new governing body of NEITI in Nigeria, the National Stakeholders Working Group (NSWG), includes representatives of the six Nigeria geopolitical zones. Moreover, the Federal Character Commission, an arm of the federal government, also requires a balanced subnational representation among NEITI staff coming from all the different regions.

In Indonesia, Presidential Regulation no. 26 of 2010 reserves three seats for subnational government officials on the EITI Indonesia multistakeholder working group, known as the Implementation Team or Tim Pelaksana. In addition, the minister of home affairs appointed the regional secretaries (Sekretaris Daerah) of three resource-rich provinces: Riau (top oil-producing province), East Kalimantan (top gas- and coal-producing province), and East Java (predicted to become the top oil-producing province in the future).

In Peru, instead of saving seats on the national MSG for subnational government representatives, the government agreed with the regional governments of Cajamarca and Cuzco to create separate subnational MSGs since these two had previously been designated as pilot regions for subnational EITI. The regional government of Cajamarca thus instituted a regional MSG (Grupo Promotor Regional).

3.3.2 Formalization of Subnational Participation in the MSG

Subnational participation in the EITI MSG can be formalized through an MoU or a regulation stipulating who is represented at the MSG.

In Peru, the regional government of Cajamarca appointed the 12 members of the regional MSG in its Resolution no. 359 of 2009. Among these members are representatives of the regional government, two municipalities, civil society groups, companies, and universities, thus covering the major emitters and recipients of EI revenues in the Cajamarca region: companies operating in the region on the one hand, and the regional government, public institutions and universities that receive EI revenues on the other hand.

In Nigeria, the NEITI Act formalizes the participation of the NSWG members, including the representatives of the six Nigerian geopolitical zones. Thus, the NEITI Act guarantees the participation of subnational governments. However, no locally based CSO is represented at the NSWG.

3.4 Data Reconciliation

As discussed in previous sections, three different forms of possible subnational EITI reconciliation have been found. First, the reconciliation process focused on direct EI revenues collected by the subnational governments and compared them to companies' payments (revenue collection). Second, it focused on revenue transfers from the central to the subnational governments and compared them to the rules that should be applied (revenue distribution-process). Third, it focused on revenue transfers from the central to the subnational governments and compared them to the subnational governments' receipts (revenue distribution-cash flow). In addition to these subnational EITI reconciliation processes, some governments have decided to unilaterally disclose subnational governments' expenditures.

3.4.1 Reconciliation of Subnational EI Revenue Collection

The first component of subnational EITI reporting is thus the reconciliation of *direct EI revenues collected* by subnational government entities. Mongolia, Ghana, and Nigeria have disclosed this type of subnational payment.

The multistakeholder working group in Mongolia agreed to create separate reporting templates for all direct payments and revenues accruing to the subnational governments from mining companies. Mongolia is administratively divided into the capital Ulaanbaatar (a *khota*, which has provincial status), and 21 aimags (provinces), which are in turn

subdivided into 329 soums (districts). Direct payments to subnational governments related to the extractive industries in Mongolia consist of stamp and other charges; of fees for land rent, water use, forestry and fire woods, exploitation of mineral resources (of which 30 percent go to subnational budgets), for use of mineral resources of widespread deposit. Company donations also go to government organizations. Since the revenue proceeds of these subnational payments are limited, the financial position of the lower level of governments, soums and districts depends mostly on transfers from the aimag government, which depends itself on the central government's transfers (in the form of shared taxes, equalization transfers, or conditional transfers). The problem is that the current system does not give subnational governments an incentive to increase revenue collection. In fact, any increase in subnational revenues is equalized by reductions in either tax sharing or transfers. Therefore the current incentives from the transfer system work against transparency, in the sense that subnational governments tend to find extrabudgetary sources of off-budget revenues (such as donations from operating companies) and to underestimate their tax revenues.

In the 2008 EITI report, 6 districts (of the 9 districts that sub-divide Ulaanbaatar), 18 aimags, and 57 soums reported on their company receipts. There has not been a deliberate selection of these soums and aimags; rather, they were spontaneously selected from company reports and the government involved in the reconciliations.

All three EITI reconciliation reports issued to date revealed major discrepancies in data accounting for direct payments by companies to subnational governments. Since then, the CSOs have repeatedly voiced their concern about the unresolved discrepancies revealed in the 2006 report at the subnational level amounting to Tog 25 billion (about \$22.5 million). Aggregated company payments largely exceeded aggregated government receipts, indicating that the government agencies did not report all taxes, fees, charges, dividends, and donations paid by mining companies. Aimags and soums did not report on a considerable number of receipts or they provided incomplete and inaccurate data. Moreover, the EITI reporting shows mining companies make additional substantial payments to subnational governments, such as donations. These donations are monetary or in-kind contributions (instruments or services such as construction work) to numerous government organizations (kindergarten, hospitals, schools). They are not mandatory but

are included in some agreements between companies and government entities. Since there is no efficient reporting system for these donations, they represented the payment flow where most discrepancies were revealed in the EITI reports. These extrabudgetary revenues are often the only financial source for subnational capital expenses as well as local services assigned to subnational governments by the Public Sector Finance and Management Law.

Similarly, in Ghana subnational governments are asked to report on specific direct EI revenues, namely, ground rent and property rate payments, which represent minor shares of the total EI revenue of the central government of Ghana. In Nigeria, in order to make a first step toward subnational EITI reporting, companies were asked to report on pay-as-you-earn and withholding taxes. However, in the case of Nigeria these payments have not yet been reconciled with the disclosure of subnational government receipts.

3.4.2 Reconciliation of Subnational EI Revenue Distribution, both Process and Cash Flow

The National Steering Committee of Ghana agreed to disclose subnational payments for both collection and distribution. Ghana's experience with *subnational revenue distribution, both process and cash flow*, is presented in this detailed account. In Ghana, mineral royalties are collected by the IRS and 10 percent is transferred according to the following redistribution scheme.

OASL retains 1 percent for administrative costs, and the regional OASL offices redistribute 49.5 percent of the remainder to the district assemblies in which production took place, 18 percent to the traditional council of the producing mining district, and 22.5 percent to the *stool* of the land on which production took place. The EITI reconciler not only compared the governments' transfers with the district assemblies' receipts (distribution) but also with the statutory formula given for mineral royalty transfers (allocation). The reconciler gives a detailed account of the reconciliation process. In order to check if the correct amounts had been distributed, the reconciler checked the declared disbursements by IRS with the receipts of the OASL head office. These payments were cross-checked with the corresponding payment of the royalties made by regional OASL offices to beneficiaries (district assemblies, traditional councils, and stools). Disbursements to the beneficiaries were analyzed by applying the appropriate percentages to the mineral royalties paid by the mining companies. District assemblies' receipts for royalties were also checked against pay-

Table 7. Transfers of Mineral Royalty Shares to Ghana’s District Assemblies by Regional OASL (in GHC)

In GHC	Received by regional OASL	District assemblies	Transfers due from regional OASL to district assemblies	District assemblies receipts
Ashanti Region				
29/01/08	86,260	Obuasi Municipal	257,636	248,800
14/05/08	166,975	Adansi South	74,883	83,455
14/05/08	162,357	Adansi North	41,953	33,990
17/07/08	215,610	Amansie East	36,394	44,030
22/10/08	188,540	Amansie Central	67,589	92,510
Total	819,742		410,867	502,785

ments made by the regional OASL. However, to date the EITI reports have disclosed only the allocation and disbursement mechanisms for district assemblies and not for traditional authorities and stools.

As shown in table 7, based on the 2008 report, there were significant discrepancies regarding the amounts of mineral royalty money the regional OASL offices were supposed to transfer and the amounts the district assemblies received. These discrepancies consisted of both under- as well as overpayments. For instance, in total, the regional OASL of the Ashanti region seems to have transferred too much money to the different district assemblies; however, individually some district assemblies were still under-paid (Obuasi Municipal district and Adansi North).

Moreover, the OASL offices did not transfer the amounts promptly but rather with a considerable time lag. For instance, the OASL office transferred payments for the period of June–August 2006 for the Ashanti region in December 2006. These time lags and the lack of clarity regarding the calculation of the amounts make it impossible for district assemblies to understand if the amounts they receive are correct or not. There is a lack of information at the district assembly as well as at the OASL head office level. The report states that the OASL head office does not have any information on how much has been paid to the IRS by the mining companies, which means that it does not know if it receives the correct share. There is therefore an urgent need to improve information sharing between the mining companies and OASL, which often has regional offices in the districts where the mining companies operate.

Moreover, in order to enable district assemblies to prove if the regional OASL office disburses the correct amount to them, the reconciler recommends that the OASL head office should communicate its disbursements to the regional OASL offices to the district beneficiaries. Efforts should also be made to publish the formulae for disbursements of mineral royalties for each district so that the communities understand what their district assemblies are entitled to.

3.4.3 Reconciliation of Subnational EI Revenue Distribution-Cash Flow

Unlike Ghana, which, as we have seen, decided to reconcile EI revenue *collection and the two sides of distribution*, EITI in the Cajamarca region in Peru decided to focus on the reconciliation of central government transfers with receipts by the subnational governments. It thus focuses on the distribution without reconciling these transfers with the statutory formula that would determine if the transfers correspond to the share to which subnational governments are entitled (reconciliation of EI revenue allocation). However, it publishes the distribution scheme that is applied for the Canon Minero, royalties, and the Derecho de Vigencia, thus enabling the reader to check if the right amounts were disbursed.

The Cajamarca EITI report reconciled transfers of the central government with receipts of seven participating entities of the Cajamarca region: the regional government of Cajamarca, the provincial municipality of Cajamarca, the national University of Cajamarca, the provincial municipality of Hualgayoc-Bambamarca, and three district municipalities. For each of these entities the report reconciled the central government's transfers and the subnational entities' receipts and disclosed the exact date of the payments for which discrepancies emerged. In general, discrepancies were not significant.

Moreover, the report reconciled the payments of Yanacocha Gold Mine, the only company which was exploiting in 2004–07 and the respective income declared by the Central Government during this period.

3.4.4 Going Beyond Disclosure of Access to Revenues: Disclosing Expenditures

Both Ghana and the Cajamarca region in Peru also decided to disclose expenditures of the respective subnational governments. In Ghana, two

of the three regions had a separate budget account allowing for disclosure of expenditures of mineral royalty transfers. In the Cajamarca region, selected municipalities reported on their expenditures, and the disbursement rate of the revenues for projects was taken as measure for efficiency.

3.5 Information Dissemination

The results of subnational EITI implementation can be communicated either through a separate subnational EITI communication campaign or by integrating the subnational communication campaign into the national EITI communication strategy.

3.5.1 Communication Campaign Integrated in National EITI Communication Strategy

To date, most of the countries implementing subnational EITI have communicated the results of the subnational EITI implementation as part of their national EITI communication campaign. Specific tools have been used such as enhancing the cooperation with regional government representatives and disseminating the reports in local languages.

In Nigeria, NEITI organizes road shows in the country's six geopolitical zones. At these road shows, the NEITI audit reports are disseminated to CSOs, community leaders, state government officials, subnational government officials, and traditional leaders within the zones. The validation report states that these road shows provide CSOs (including community-based CSOs) and representatives of companies and government with an opportunity to network and interact. Moreover, NEITI tries to enhance its dialogue with the state governments through the Nigeria Governors' Forum (NGF), which is a coalition of all the governors in Nigeria. NEITI intends to use engagement and dialogue to get the governors acquainted with the NEITI process and the implications of its functions on the revenue accruing to them from the payments made to the Federation Account by EI companies.

In DRC, the EITI Committee makes a particular effort to improve communication with the regions, e.g., by disseminating the reports in local languages. Thus, shorter versions of the report have been produced in Lingala, Kikongo, and Tshiluba and were being disseminated in the regions of Katanga, Kinshasa, and Bas Congo at the time when the validation report was written.

3.5.2 Separate Subnational EITI Communication Campaign

To date, only in Peru has there been a separate subnational EITI communication campaign, in the Cajamarca region. The campaign was led by a national communication committee hired by the Ministry of Energy, Mines and Petroleum. The campaign consisted mainly of a parade meant to draw attention to the EITI process in Cajamarca and a presentation showing its results. According to the representative of the Yanacocha mine (the sole reporting company) in the Cajamarca EITI working group, the parade did not reach the desired target audience or have the expected impact, but only got the attention of passers-by. The presentations also attracted only a few people and did not have the expected results, namely to inform the population about what tool EITI can represent for them in order to influence politics and the development of the region.

There have also been interviews in the media, which seemed to have worked well. However, here again the impression is that neither the urban nor the rural population of Cajamarca has really been reached fully in order to inform them about the revenue and payment flows.

The reconciler of the first EITI Cajamarca report also undertook a non-representative enquiry to record the local knowledge and perception with regard to the use of Canon Minero funds by the regional and the municipal governments. The result showed that interviewees were informed about the fact that these governments receive revenues from EI activities. However, they were not informed about the use of these funds. Moreover, they perceived them as being rather badly managed by the regional and municipal governments.

3.6 Validation¹⁴

3.6.1 Subnational EITI as a Required Part of Validation

Subnational EITI can be relevant for EITI validation in cases where EI payments directly paid to subnational governments are material. This has been the case for Mongolia, where the MSG had decided to report on company payments to subnational governments because these payments

¹⁴Validation should be considered in relation to EITI requirements, especially requirement 9(e) in the EITI rules (EITI 2011).

were considered material. EITI reports then revealed major discrepancies regarding these company donations to soums and aimags. The EITI International Board therefore requested in April 2010 as a response to the validation report of MEITI (and while the third EITI report was still under preparation) that the MSG address, among other issues, the question of company donations and any material payments to subnational government authorities, and ensure the participation of subnational government authorities that receive material payments in the reporting process in order to be designated a compliant country.

Thanks to the EITI reports it has become obvious that some government entities did not have records for certain payments made by companies, in particular for company donations to government organizations and subnational governments (soums or aimags). The difficulty for subnational governments regarding these donations is that companies make these donations to various government bodies. Moreover, they are often in-kind, and while companies can provide a monetary value for the donation, governments often do not have this information and report only on cash payments received through bank accounts. The 2006 report identified discrepancies amounting to Tug 25 billion (~\$22.5 million) that could not be resolved by the reconciler. The 2007 and 2008 reports, although also identifying discrepancies, could resolve some of them. Under the 2008 reconciliation process, the reconciler undertook field visits to several soum and aimag government offices in order to resolve part of the discrepancies at the subnational level. As a result of the reconciliation, the initial reported figure of ~\$800,000 for company donations could be adjusted to ~\$3.920 million (showing under-reporting from subnational governments and over-reporting of companies, in case their donations were in-kind or services, for example). After having improved the reporting of subnational governments, among other points, Mongolia was designated EITI compliant in October 2010.

3.6.2 Subnational EITI as Additional Quality Improvement for EITI Reporting

In countries where direct EI payments to subnational governments are not considered material, the national EITI secretariat and the MSG can still decide that they would like to extend EITI implementation to the subnational level because it is essential in order to improve transpar-

ency in the sector. In this case, subnational EITI can be an additional element that is not for a part of validation. This is the case of Ghana, where subnational EITI has been implemented at revenue collection and distribution stages. Both the reconciler and the validator make recommendations for improving subnational EITI implementation in Ghana, but subnational EITI has not been taken into account for the validation indicators other than in a positive way—as additional quality improvement of EITI implementation. Thus, it does not make EITI validation more difficult.

3.7 Constraints

Several constraints may have to be overcome to implement subnational EITI successfully. They range from local administrative capacity constraints, legal uncertainty, funding, logistics, and specific political issues to lack of engagement with local/regional civil society organizations.

3.7.1 Local Administrative Capacity

Administrative capacity is often lower at subnational levels than at the central level due, for instance, to underfunding, staffing deficiencies, lack of training, and lack of IT equipment. This results in a lack of supervision of subnational flows, in insufficient revenue collection capacity, and in a lack of available data and of recorded revenues, thus becoming an obstacle for subnational EITI implementation, which relies on data from subnational governments.

In DRC, for example, the lack of an official nomenclature for payments from EI companies to the government makes EITI reconciliation very difficult. Reconciliation becomes extremely complicated if the same payments are labeled differently in every agency and these agencies are not equipped with computers or any system of cataloging. In Mongolia, subnational reconciliation was slowed because the underdeveloped communication systems of some subnational governments (no Internet, no fax) hampered communication with the reconciler and did not allow for timely responses. The lack of any reliable form of electronic communication made the transfer of information slow and cumbersome, because the data had to be transferred by post.

Revenue collection and revenue management capacity can be strengthened through EITI. For this the necessary investment into training and capacity building must be undertaken. Moreover, the data collection

responsibility of the different agencies at the different levels can be clarified if necessary and mechanisms and procedures such as a nomenclature can be refined.

Additional unilateral disclosure of expenditures can reveal capacity deficiencies to account for and execute resource EI revenues. Unilateral expenditure disclosure can thus be used as an instrument in order to improve resource-revenue expenditure planning and budgeting, as it has been done in district assemblies in Ghana.

3.7.2 Legal Uncertainty

The lack of clarity in legal and constitutional terms with regard to subnational EI revenue distribution can become another obstacle to subnational EITI.

The Mining Act from 2002 of DRC is supposed to regulate the redistribution of mining royalties (so-called retrocession). According to this act, the Public Treasury, which collects the mining royalties, is in charge of distributing receipts from the mining royalties as follows: 60 percent remains in the hands of the central government; 25 percent is paid into an account designated by the provincial administration where the project is located; and 15 percent goes into an account designated by the town or the administrative territory in the area where the exploitation activities take place. However, these payments have never been made to the provinces, which poses a serious challenge to the financial sustainability of the provinces and the management of the sector. The provinces started to impose their own local taxes in order to compensate for the nontransferred royalty payments. These local taxes vary from province to province which renders subnational EITI difficult to implement. It will be extremely challenging to find a way to capture all these payments in a template and to engage all these different entities into the reporting process. A similar problem is encountered in **Indonesia**, where there is also a significant variation in types of revenues collected from mining companies at the district level.

In Ghana, of the three end beneficiaries of mining royalty transfers only district assemblies—not traditional authorities nor stools (customary land title owner)—report on their receipts of royalty transfers from the central government. In the validation report, some stakeholders raised concerns about whether traditional authorities would comply with reporting due to the legal separation of their power from the state. Another difficulty

in Ghana is that some subnational revenue transfers lack legal backing. The payments to the Mineral Development Fund, which amount to 10 percent of all mineral royalties and which should be used for development projects, are for example not required by law, thus weakening the Mineral Commission's capacity to assert and enforce its right to receive them.

3.7.3 Financial Constraints

Subnational EITI implementation can be costly, depending on the number of subnational governments that participate in the reporting process. Government stakeholders, therefore, voiced the concern that subnational EITI might not be sustainable, given that it is operationally dependent on donor funds.

Countries would need to overcome the challenge of financing subnational EITI reporting as an additional cost to the whole EITI national exercise. In the case of Mongolia, Ghana, and Peru, the funds have come from MDTF grants channelled by the Bank. In Mongolia and Ghana, the reconciler did the work as part of its reconciliation work defined on its TOR/contract for the national EITI report. In the case of Peru, a local reconciler was hired separately, with the aim of producing a specific EITI subnational report for one pilot region. Another possibility would be to finance subnational reconciliation through the national or subnational government's budget. In DRC, where subnational EITI has become a process driven mostly by subnational governments, some provincial governors declared their willingness to cover the costs of the local EITI structures in their province at the EITI conference held in Lubumbashi from 12 to 14 January 2011. Since the Ministry of Planning (Ministère National du Plan) pointed out the financial constraints it encounters in implementing EITI at the national level and underlined that it could be difficult to finance a subnational EITI structure, the governor of Katanga province offered to cover the costs for the local EITI structure in Katanga. In the case of Indonesia, a serious exercise covering key regions would require substantial funds in addition to the current MDTF grant.

3.7.4 Logistical and infrastructure constraints

Large distances and lack of infrastructure can pose challenges for EITI implementation at the subnational level. In Mongolia, some aimag governments are difficult to reach because of the vast distances and the

lack of road infrastructure to aimag capitals. One solution envisaged is to choose several pilot aimags with which an in-depth reconciliation is undertaken, as it is done to date in the South Gobi aimag.

Moreover, at the subnational level, material payments do not derive only from large companies but can also come from artisan miners. In DRC, for example, EITI and the reporting process so far concentrated on Katanga and Bas-Congo, where the large and better regulated companies operate. But a fact which is often overlooked is that 80 percent of Congolese mineral production is undertaken by artisanal miners at sites all over the country, some of which cannot be reached other than by boat because of the lack of infrastructure (e.g., in some parts of North and South Kivu). A large number of them are not registered. The size of the country (2,345,000 square kilometers), the lack of regulatory oversight of artisanal miners, and the lack of infrastructure represent a significant challenge for subnational reporting in DRC.

Similarly, efforts to address subnational issues in Indonesia will also be logistically complicated, in the sense that there are now about 502 districts and mayoralities which collect a growing amount of district-specific direct taxes (known as *retribusi daerah* or local retribution) from mining companies. Capturing this information will be a challenge, and makes it important to design a manageable subnational EITI framework (notably of incremental complexity).

In order to improve oversight of the intergovernmental revenue flow the NEITI, Nigeria wants to move the EITI process to an automated one that will allow for an online and real-time information flow with the relevant actors in the EITI process, namely companies and government regulatory agencies. The absence of a communication interface has hitherto made the process of EITI reconciliation an arduous task. Presently NEITI is developing a physical process for data retrieval and will likely follow that up with an automated process. The availability of a central technology platform will facilitate the open flow of communication with relevant actors at the state level, which has been hampered to date due to this lack of technology.

3.7.5 Political Issues

Political issues, such as lack of political support at the national or subnational level or intergovernmental communication deficiencies, can also

hamper subnational EITI implementation. In Peru, for example, lack of political will at the subnational level (not necessarily of government actors but rather of the political leadership in regions) has been seen as an obstacle for subnational EITI implementation. The whole procedure of the regional reconciliation study in Cajamarca was lengthy. In the end the product had many interesting aspects and was positively acknowledged at a regional information and outreach forum. However, the group's work seemed previously completely unknown even to the civil society representatives interested in extractive industries and transparency issues. In Nigeria, stakeholders raised the concern that state governments might support measures to achieve accuracy of payments made to them from the Federation Account, but that they are at the same time likely to resist the incursion of the process in state-level operations. It is also considered to be likely that they will resist any process that will provide access to information to CSOs and that they might see the demand for accountability as a political threat.

In Mongolia, it has been insufficient intergovernmental communication rather than political will that has hampered subnational EITI implementation. Lack of cooperation and communication between the central government bodies and subnational bodies was cited as a major concern by central government bodies, particularly given the discrepancies found by the EITI report at the aimag and soum levels. The exchange of information and networking between central and subnational tax authorities have to be improved. Resolution no. 80 was the first step, but now it might be necessary to update it; consultations with various stakeholders are being held in this respect. An EITI Act would help make reporting requirements more effective with all stakeholders.

3.7.6 Lack of Engagement with Local Civil Society Organizations

In order to implement EITI at the subnational level, the national EITI secretariat and MSG must properly engage with local CSOs in the regions where subnational EITI is implemented. This is currently a concern in Nigeria, since NEITI's engagement with CSOs is presently limited to nationally based CSO groups. Because NEITI's formal engagement with CSOs and community-based organizations operating at the state government level is quite limited, such participation would require start-up and capacity-strengthening.

3.8 Findings and Key Issues

As seen in previous sections, rather than following one specific model with its own set of linear procedures, there are many different ways to implement EITI at the subnational level. The approach to subnational EITI used by implementing countries has been flexibly adapted to each country's specific situation (revenue-sharing mechanisms, spatial concentration of resources etc.); they are also dynamic and can evolve and shift focus, for example, from focusing on direct revenue collection at the subnational level to revenue distribution mechanisms. Table 8 summarizes the different processes of extension EITI to SNG: from the elaboration of a mandate for subnational EITI implementation to subnational representation in the MSG, the reconciliation process, dissemination, and the validation process. Different ways of addressing these issues have been discussed based on the sample of six EITI implementing countries, which have already moved forward with subnational EITI.

In addition to these features, which need to be considered while planning scoping work on subnational EITI, to complete this section we will go over the main issues that the six countries reviewed have shown as the most relevant in terms of findings.

Table 8. Processes for Extending EITI to SNG

Extending EITI to the subnational level			Examples
Mandate	Informal	Work plan	DRC
	Formal	Legal Act	Mongolia, Nigeria, Indonesia
MSG	Structure	Integrated in national MSG	Ghana, Nigeria, Indonesia
		Separate subnational MSG	Peru (Cajamarca)
	Participation	MOU, regulations	Peru (Cajamarca), Nigeria
Reconciliation	Access to resource-revenue	Collection	Mongolia, Ghana, Nigeria
		Distribution-process	Ghana
		Distribution-cash flow	Ghana, Peru (Cajamarca)
	Use of resource-revenue	Expenditures	Ghana, Peru (Cajamarca)
Dissemination	Communication strategy	Integrated in national EITI campaign	Nigeria, DRC
		Separate SN EITI campaign	Peru (Cajamarca)

3.8.1 Main Issues Considering Specific Country Context

Issues from the **Mongolia** case are relevant for countries where donations from firms to SNG entities are prevalent or where there is no enforceable right to obtain payment data from companies.

- Arguably the key measure was the Ministry of Finance's Ministerial Order requiring subnational authorities to register, account for, and report on revenues. The order has been passed and several (though not all) subnational authorities have registered. This Ministerial Order was complemented by outreach to and training at the SNG level and by the formulation of SNG-specific templates for both SNGs and companies.
- As for the issue of donations, all three Mongolian EITI reports showed that company donations (goods or services) to SNGs are the single most important discrepancy identified so far. The difficulty for SNG governments is that companies make these donations to various government bodies. Moreover, these donations are often in-kind, and while companies can provide a monetary value for the donation, governments often do not have this information and report only on cash payments received through bank accounts. Potential solutions suggested in the EITI reports focus on unilateral disclosure, and include companies issuing a "no charge invoice" indicating the cost of the donation to the government or reporting donations without indicating any value, given that cost information is available only to companies. Suggestions for monitoring the donations include entrusting the central government with the overall role of monitoring the government entities to ensure completeness of the information submitted.

Issues from the **Ghana** and **Nigeria** cases are particularly relevant for countries with revenue distribution systems that require efforts toward higher levels of transparency and credibility. Important time lags in receiving relevant funds at SNGs from the central EI revenue collection level, lack of knowledge about companies' payments to central government, as well as the complexity of the calculation systems in the Ghanaian revenue distribution system continue to make it difficult for SNGs (notably, district assemblies) to understand whether they are receiving what they are due. At the most general level, therefore, the following lessons for potential improvements have been suggested by stakeholders or in validation reports:

- A first step to remedy these problems has already been made, by designing a specific template aimed at capturing revenue flows at

the district level. However, an in-depth review of the distribution process is needed.

- The formulae for disbursement and the step-by-step process through which the amounts due are determined and allocated should be published and simplified.
- Even though the federal government, as in the case of Nigeria, discloses its monthly allocations from the Federation Account to the federal, state, and local governments on the Ministry of Finance website and in local newspapers, there is still strong local demand for an independent reconciliation to identify possible discrepancies, and especially to identify potential leakages in the distribution process. According to the MSG-authored reconciler terms of reference, reconciliation should also cover distribution of oil revenue to states as required in the EITI act. However, this has not been done so far.
- The amounts received by intermediary entities along the distribution and disbursement chain should be transparent so that final beneficiary entities know whether they are receiving what they are due.
- Confusion arising from time lags can be avoided through publishing the relevant payment calendar and also potentially shortening the time lags themselves.

The experience in **Peru** has led to a number of insights into what else could be done to improve the EITI process at the SNG level. The following list relates to the subnational work/issues in Peru and may demonstrate that the major problems are not strictly speaking part of the core EITI mandate but rather part of broader issues, more general governance, and/or a public finance management agenda.

- While allowing a broad public to understand whether the right amount has been disbursed, the subnational reporting process does not include a system to check for discrepancies or to see whether SNGs are receiving what they are due. The Peruvian subnational EITI efforts so far (in the Cajamarca region) reconciled central government transfers with receipts, focusing purely on distribution (and finding few discrepancies). The exercise did not reconcile these transfers with the statutory formula, which would determine if the transfers correspond to the share to which subnational governments are entitled.
- Volatility of revenue creates major problems for budget planning at the local level. Technical assistance needs could be identified using the EITI subnational reporting process as a diagnostic tool.

In particular, links to governance, public financial management, accountability practices and codes, and institutional and capacity development in relation to resource-revenue management could be explored.

- Low capacities in local government are an obstacle for efficient and effective development planning and implementation of EI revenues.
- Lack of communication platforms between local populations, companies, and government hinder advancement.
- There is scope for designing (i) more effective revenue-sharing schemes and programs and (ii) stabilization and investment funds for making a better use of resource-revenues over time. The latter could also be relevant for the local level, i.e. one could think about local or regional funds.

The issues from the **DRC** EITI national process apply to countries that have a dysfunctional central resource-revenue distribution system in which the central government collects payments from extractive industries companies but does not disburse the due shares to the SNG level. As a consequence, this could lead to a proliferation of local taxes varying across producing regions.

- One key issue is that subnational EITI will, in this case, have to create specific reporting templates for different regions through which payments can be reported in line with that region's specificity. Of course, this would lead to a rather disparate EITI process, in which reconciliation would look different for each reporting region. However, if this exercise shows that the size of the problem is significant, then at least one or two EITI reports along these lines, despite the administrative work involved, would help to gauge the size of the problem and thus help in the design of a subnational resource-revenue transparency system.
- Legal uncertainty about decentralization and about EI revenue distribution system to the SNG level has to be tackled to get to the root of the problem. While different EI revenue sharing systems (notably distribution from the central government versus direct taxation by SNG authorities) have both merits and shortcomings, inadvertently creating a double-taxation system (as currently the case in DRC) is arguably the worst possible outcome.
- Few things make reconciliation at the SNG level as difficult as the absence of an official nomenclature for EI payments and revenues.

While such nomenclature would have to be established in the medium term, in the short term relevant catalogs or databases may help to cope with this problem partially.

In the **Indonesia** case an emerging alternative is for the World Bank to assist the Ministry of Energy and Natural Resources to build a national mining register and map that captures the nation's more than 10,000 district mining licenses, as well as any royalties which they convey to the central government. This would also go some way toward resolving one of the most serious related problems in the mining sector, namely the proliferation of district licensed mining permits.

- One issue is that when faced with an impossible task, such as full SNG EITI implementation in a country as large as Indonesia with so many SNGs accessing resource-revenues, alternative approaches to EI revenue/payment transparency have to be sought and scoping work based on materiality becomes essential to define priority regions where subnational EITI could have a strong impact.
- Another key issue from Indonesia is the usefulness of defining and prioritizing key EI-rich regions early on in the game (in fact, in Indonesia this happened long before the advent of EITI). This enables and simplifies the MSG's task of taking a decision on the scope of the exercise and helps define a general action plan as well as the initial targeted regions to get the EITI subnational process up and running.

3.8.2 Issues that would Require Particular Attention if Subnational EITI were taken up

Donations paid directly to SNGs

- Direct payments made by extractive industries to SNGs could be an important issue, especially when dealing with sector specific nontax revenues, such as donations. This needs to be understood and considered within the current/classic EITI framework.
- When SNG receive extra-budgetary revenues such as donations, which are difficult to track, reconciliation of payments and SNG revenues can become an extremely useful tool to provide transparency and help improve tracking systems.

- There is no legal or enforceable right to obtain payment data from companies, which means that the reconciler is completely reliant on the goodwill of participating companies. Such problems are of course particularly acute in the case of significant donations made by companies to SNG governments.
- There is no incentive for SNGs to report revenues correctly, especially donations, because this might lead to a reduction of central government transfer allocations.

Transfer system and geographical distribution

- Attempts to establish transparency in a complex distribution system from central governments to SNGs require a proper understanding of institutional arrangements along the distribution chain of EI revenues to the SNGs.
- Key to EITI implementation at the SNG level is an analysis of the effectiveness of the functioning of this transfer system—or, put differently, whether SNG are receiving what they are meant to receive.
- The revenue transfer system in place is not being rigorously applied. Hence, provinces are not getting their share of the resource wealth and revert to taxing any mining companies in their territory. This may, of course, create a problem of double-taxation.
- When setting up subnational EITI implementation one needs to consider the country's size, the number of SNGs accessing resource-revenues, and the very uneven geographical distribution of extractive resources. Priorities need to be defined in relation to materiality and resource-revenue geographical concentration.

3.9 Early Lessons from Emerging Experience

1. The six country examples of the EITI subnational implementation process illustrate how some countries approach the revenue transparency issue at the subnational level. These experiences can provide inspiration to other countries facing the challenge of extending EITI to the subnational level, but they cannot necessarily be replicated. Perhaps the most important single lesson is that each country's EITI subnational program will be unique, based on its own regulatory framework, priorities, and the funds available to undertake the task.

2. Country profiles in terms of subnational resource-revenue streams will vary significantly, not just from country to country but also from one sector to another (mining, gas, or oil) within the same country. Each sector will have its own tax regime and issue specific types of concessions or contracts, in addition to SNG regulations in relation to local tax and nontax revenue legal frameworks. SNG access to resource-revenues will be an outcome of how all these regulations interact and how well they are actually applied by national and subnational government entities.
3. In terms of EITI subnational reporting, the issue of which resource-revenue streams are material and which are not should be treated under different criteria, depending on the country's issues in relation to revenue transparency. Though each country may have its own definition of materiality for subnational revenue streams, all need to define clear criteria to determine which subnational revenue streams will be reported; what the threshold level for selecting reporting regions, provinces or districts will be; which companies will need to disclose data; and most important, which SNG and national government entities will be considered for implementing the reconciliation process.
4. There will be significant differences regarding the degree to which subnational reporting will be implemented. Some countries may choose a consistent process of reconciliation in selected SNGs based on materiality criteria, implementing a more complete report. Other countries may prefer to implement reconciliation at the distribution system level, without directly involving the reconciler with each SNG.
5. Depending on the spatial concentration of the country's natural resources and the type of resource sharing mechanism applied, the MSG and the national EITI secretariat can either decide to implement subnational EITI in all producing regions of the country or in a few pilot regions to begin with. The MSG and the national EITI secretariat may decide to implement subnational EITI in all producing regions if these regions collect similar levels of direct extractive industries revenues or if similar amounts of centrally collected extractive industry revenues are redistributed to all or most SNGs. In this case, the subnational EITI mandate might become part of

the general EITI mandate, which is applied nationwide. If the MSG decides to implement subnational EITI gradually in selected pilot regions and not nationwide because of the high spatial concentration of extractive industries in certain regions, the national EITI secretariat and MSG might prefer to have a separate mandate applying only to the pilot regions. In sum, the mandate can vary but local institutions must be engaged to implement the reporting exercise.

6. Should the national MSG decide to undertake nationwide subnational EITI reconciliation, the reconciler for the national EITI can prepare subnational reporting templates to be used as part of the national reconciliation process. If subnational EITI reconciliation is only implemented in a pilot region and through a local MSG, this MSG will agree on reporting templates and choose a reconciler to prepare a template for the reconciliation of revenue and payment streams.
7. Leverage from central/federal government in relation to reporting responsibilities and data disclosure varies significantly from country to country. Generally, federal countries will have lower leverage on SNGs to convince them of the need for revenue transparency and will need a stronger political commitment from subnational government authorities. Nevertheless, the feasibility of a fruitful process in terms of subnational reporting will ultimately depend on political commitment from local authorities to embrace transparency and implement the EITI. In the end, the MSG will need to fully understand the existing incentive structure for SNGs to report on their access to resource-revenues.
8. The overarching lesson that emerges from reviewing the experiences of the six countries is that a common operational framework is required if countries are to get the most out of EITI subnational reporting. Even taking the different country profiles into account, the general structure of revenue streams that provide SNGs with access to resource-revenues and the emerging experiences make it possible to design specific reporting options based on common grounds that support any revenue-sharing system that involves SNGs. Within a common framework, countries can define their own EITI subnational program according to their context, improving how they plan their program, how they assess its implementation, and how countries share knowledge and experience with other implementing countries.

The Subnational Dimension of EITI: An Operational Framework

It is generally agreed that a fundamental requirement for the good governance of extractive industries is transparent disclosure of revenue streams generated by oil, gas, and mining operations. As fiscal policy frameworks have given SNGs greater access to resource-revenues in an important number of resource-rich countries, the demand for greater revenue transparency in the recipient localities has become increasingly notable.

This section discusses the broader context for subnational revenue transparency/EITI, including the broader benefits from subnational EITI for implementing countries and or the relevant evolution of EITI rules. The sections ends with a forward-looking conclusion by proposing an operational framework for subnational EITI implementation.

4.1 Need for Revenue Transparency at the Subnational Level

Due to the local footprint of oil, gas, and mining operations and their proximity to the community, active local demand for more information represents a major challenge for central governments and SNGs, as well as for investing companies. Citizens in these regions expect to access information about companies' payments, how much government revenue these operations generate, and how it is being channeled to sustainable development. In most cases, people in the producing regions do not have access to reliable and timely basic information on resource-revenues at their relevant scale. This deficiency prevents local organizations from engaging with subnational authorities and holding them accountable for taxes paid or revenues transferred to SNGs.

Where revenue-sharing systems are in place, the transparency of these revenue flows can become a highly politicized issue. If the SNG's access

to resource-revenue is not transparent, then it is more likely that disputes will arise and relations among civil society, the companies, and the government will be damaged. When problems arising from the absence of subnational revenue transparency are frequent they undermine society's trust in their government and may also threaten the stability of extractive industries' operations. The following problems may arise from a lack of local-level revenue transparency.

4.1.1 Direct Payment Issues

- If the payments or legitimate contributions made by the companies to the SNG are not transparently and publicly accounted for, resources may be misused or wasted. Subnational EITI could reduce opportunities for mismanagement and local corruption.
- If the payments are not properly registered in the SNG's budget, the monies are liable to be used "off the books" with no accountability or fiscal controls. Subnational EITI could reveal discrepancies and ensure payments become on-budget funds.
- If the public is not informed about whether the companies are actually paying local taxes, they become increasingly suspicious of the SNG and begin to ask what privileges are being granted to the companies. Subnational EITI could generate credibility on companies' contributions to SNG revenues, thus helping companies maintain their social license to operate vis-à-vis communities.

4.1.2 Issues with Transfers

- If the SNGs do not fully understand how the amounts to be transferred are calculated, they are more likely to use social pressure and political confrontation to increase or maintain the amounts previously transferred to them. A key concern is not just the amount and calculation but the predictability of resource-revenue transfers that subnational governments receive. Subnational EITI could make flows and fluctuation of transfers to SNG more transparent and understandable.
- If the transfers made to the SNG are seen as random, how the monies are managed becomes improvised and how they are used cannot be planned for. Subnational EITI could make the transfers transparent so that local CSOs can hold SNG accountable.

- If the transfer system and designated amounts are not managed transparently by the central government, cash transfer may be used discretionally by the central government or disbursements may be delayed. Subnational EITI could bring transparency to the distribution system used by central government to transfer funds to SNG.

4.1.3 SNGs as Relevant Stakeholders for EITI

In general, SNG access to resource-revenues needs to be transparent and predictable, as uncertainty about access to resource-revenues has been cited repeatedly as a central driving force to conflict and political instability in resource-rich countries (Herbst 2001).

The subnational dimension of EITI is relevant for countries that have a direct and/or indirect resource-revenue-sharing system. In those cases, SNGs arise as highly relevant stakeholders for EITI because of the following:

- The impact that SNGs with direct access to resource-revenues can have on EITI reports: If “material,” these revenue flows should be included in the EITI national report. Otherwise, the disclosed data will be inaccurate and partial. Therefore, the challenge that needs to be addressed is how to include these payments under EITI rules.
- The impact that EITI at the subnational level can have on those regions with access to significant resource-revenue transfers: The question arising here is, Should the flow of transfers be included as part of EITI report and how?

4.2 Potential Implementing Countries

As per global expert opinion, SNG access to resource-revenues “is not a major issue in every country in the world. But where it is an issue it can be a very big and very contentious issue” (Bahl 2000). Implementation of EITI at the subnational level could be highly relevant to a subset of resource-rich countries where the SNGs receive resource-revenues, whether from transfers or direct payments. Those countries were first identified in the study “Subnational Implementation of the EITI” (Warner and Alexander 2006), which estimated that of a total of 56 resource-rich countries, at least 17 have a specific fiscal system that provides SNGs access to resource-revenues. Likewise, some World Bank experts estimate that around a third of all resource-rich countries have an intergov-

environmental fiscal system based on sharing revenue received from the extraction of petroleum, gas or minerals.

A practical way of estimating whether countries would benefit from a subnational EITI is to consider the updated list of countries that participate or could potentially participate in the EITI. See table 9.

Of the 35 countries already participating in the EITI, a subgroup of 14 have the potential to implement the EITI at the subnational level (namely, those in the first three columns), among which Mongolia, Ghana, Peru, and DRC have already taken concrete steps forward. Indonesia and Nigeria have anticipated preparatory work on disaggregating their EITI reports at the subnational level as stated in their national MSG working plan.

Table 9. List of Countries with Potential for Subnational EITI

Compliant	Candidates		Potential
<ul style="list-style-type: none"> • <u>Mongolia</u> • <u>Ghana</u> • Kyrgyzstan • <u>Nigeria</u> • Niger 	<ul style="list-style-type: none"> • <u>DRC</u> • Kazakhstan • <u>Peru</u> • Iraq • <u>Indonesia</u> 	<ul style="list-style-type: none"> • Guinea • Guatemala • Mozambique • Madagascar 	<ul style="list-style-type: none"> • Philippines • PNG • Dominican Republic • Colombia • Australia

Note: Underlined countries are those used for case studies in this assessment.

Of the potential EITI countries, at least five were identified as having expressed some degree of interest in working with the EITI and have fiscal systems that allow SNGs access to significant resource-revenue flows. Together, all countries in table 8 are facing the challenge of increasing transparency of revenues derived from extractive industries. By implementing EITI at the subnational level, they could pro-actively respond to increased CSO demand for information, transparency, and accountability regarding the benefits their regions are receiving from hosting operating extractive industries.

4.3 Potential Benefits of Going Subnational

After an initial period of promoting a narrow approach to the scope of the initiative, EITI global stakeholders are currently considering options as to which areas EITI might be extended and linked. Implementation at the subnational level could help anchor EITI in a given country and

achieve its expected impact on accountability. While keeping the focus on resource-revenue transparency, promoting its extension to make the subnational flow of resource-revenues transparent would be a logical extension with significant gains for the country and for EITI itself.

From a country perspective, where oil-producing, gas-producing, or mining regions are facing the issue of lack of trust among government authorities, civil society, and companies, the subnational EITI has the potential to have a strong impact on accountability. Open and transparent subnational access to (resource) revenues is viewed as critical to the integrity of the subnational public sector and to citizen's trust in government (Shah 2007, 20).

Accountability of subnational government institutions is critical to ensuring that they are responsive to citizen demands. If CSOs from natural resource-rich countries are to discern the volumes of revenues accessed (taxes plus transfers) by subnational governments, and understand how this access is determined, then the contribution EITI can make is by disclosing disaggregated payments and intergovernmental transfers to subnational levels.

From an EITI perspective, subnational EITI, by expanding the scope and outreach of the initiative in an implementing country, is a way of strengthening EITI local ownership among stakeholders. In countries with a significant resource-revenue-sharing system in place, using EITI at the subnational level provides EITI implementing countries a clear opportunity to address governance and lack of trust issues in their producing regions. This is the scale at which lack of transparency directly affects the interests of the local population and operating conditions for companies to invest in and develop natural resources. Failure to include such flows risks damaging the perceived relevance of the EITI in those countries.¹⁵

¹⁵In addition to implementing countries, some countries potentially interested in joining EITI have mentioned some transparency issues at the subnational level as their main concern and reason for possible not choosing to adopt EITI (Philippines, Colombia, Papua New Guinea, and even Australia).

BOX 1. New EITI Rules for the Subnational Level

EITI Requirement 9
The multi-stakeholder group is required to agree on a definition of materiality and the reporting templates

“e) In agreeing on a definition of “material payments and revenues,” it is a requirement that the multi-stakeholder group clearly establishes whether payments to regional and local government entities are material. Where material, the multi-stakeholder group should take steps to ensure that the reconciliation of company payments to subnational government entities and the receipt of these payments are incorporated into the EITI reporting process. The multi-stakeholder group may wish to consider extending the scope of the EITI reporting and reconciliation process to transfers between national and subnational tiers of government, particularly where such transfers are mandated by a national Constitution or statute.”

Source: EITI Rules, 2011 edition.

4.4 Stakeholder Views

An important question is whether there is a consensus among EITI stakeholders on the potential of subnational EITI. Stakeholders/partners have made the case for EITI implementation at the SNG level, considering that an increasing number of EITI implementing countries are committed to collecting and disclosing data on SNG resource-revenues.

Country-level national EITI boards have been interested in engaging either local authorities or local CSOs on EITI multistakeholder working group (MSWG)s. There seem to be concrete incentives at the country level for EITI subnational implementation, since EITI extension to SNGs has been formally decided upon by the MSWG, but eventually some resistance may come from the government, both national and subnational.

In most of the cases, the central government would easily agree to disclose what resource-revenue has been transferred to the regions. However, it might find it difficult to agree on reporting the revenue sharing operating system and what SNG should receive, according to statutory fiscal arrangements. Some local authorities would not be keen to disclose what they have collected from operating companies and what they receive as resource-revenue transfers.

Overall, EITI implementing countries are lacking explicit guidance for their EITI process in relation to SNG revenues, and their transparency efforts may be incomplete and weakened if not mainstreamed as part of their EITI national process. EITI supporting institutional structure is being challenged to provide more explicit guidance on the approach needed to include material payments and transfers to SNGs.

4.5 Evolution of EITI Rules

Originally, EITI rules neither excluded nor included SNG revenues. (Although it should be noted that the EITI was originally designed to work at the national level.)¹⁶ This neutral stance was never a stumbling block for some countries, such as Nigeria, to include the subnational level when defining their legislative framework for implementing the EITI (the NETI Act). Likewise, Ghana, Mongolia, Peru, and DRC included a tailor-made subnational approach when working on the EITI, and Indonesia is now in the process of doing so.

The EITI and its different stakeholders have kept EITI implementation at the subnational level on the agenda. Formal discussions on how to treat material payments made or redistributed to SNGs have taken place among EITI stakeholders. At an early stage, the former International Advisory Group suggested that EITI give further consideration to this particular issue (EITI Secretariat. 2006), and requested a detailed report on issues and options to include the subnational level into EITI (EITI 2006). The reflection on EITI implementation in the mining sector shared among EITI stakeholders also pointed out the relevance of subnational revenue flows derived from the mining sector (EITI 2009).

More recently, as a result of interest expressed by countries, companies, and civil society stakeholders, the EITI Board agreed at its 2010 meeting in Dar-es-Salaam to discuss how to include SNG resource-revenue flows as part of EITI. As a result, the new EITI rules edition (EITI 2011a), which were scheduled to become effective in July 2011, specifically addresses the subnational dimension of EITI. Under the EITI's new rules, countries are encouraged to include SNG resource-revenues as part of

¹⁶The Extractive Industries Transparency Initiative (EITI) has been developed as a global minimum transparency standard for national revenues derived mainly from oil, gas and mining sectors. EITI has issued a Statement of Principles, six criteria, and 21 requirements, available at www.eiti.org.

their reporting framework. (See box 1) The challenge ahead for EITI supporting structure would be to encourage and support implementing countries by providing consistent guidance and quality assurance for EITI subnational country processes.

4.5.1 Subnational Participation Required for Payments When Material, but Optional for Transfers

It is important to consider possible implications as these changes have been introduced into the EITI rules. To reach an in-depth understanding of whether the EITI should be implemented at the subnational level, we should make a distinction between direct payments (direct revenue sharing) and indirect payments (indirect revenue sharing). If the direct payments to the SNGs are considered “material” in EITI terms, then including the subnational level is a requirement for candidate countries. If these payments are not included, data and information aimed at providing a complete picture of material payments may be affected. Including the transfers to the SNGs is not a requirement but rather an option for each individual country and its MSG. Consequently, it is clearly never a condition either for validation or for retaining the status of “compliant country.”

If a country decides to implement the EITI at the subnational level, would the exercise be considered a purely domestic EITI innovation or would EITI guide and validate its implementation? As we have seen in the previous sections, various countries have already implemented or are looking to implement the EITI at the subnational level. Experiences have been rather ad hoc and conducted on a pilot basis but have left us with significant insights and issues from which we can learn.

This document is based on six Country Notes that sum up the experiences of countries incorporating the subnational level in their EITI experience. The approaches taken across countries are quite isolated from each other, since they have not relied on a common analytical framework and therefore the EITI’s quality assurance process could not be applied. The EITI could boost these processes if it makes a common analytical framework available to the interested countries and if, as a result of implementation, it offers the possibility of validating the processes. This report seeks to contribute, along with other efforts, to preparing a common operational framework and identifying practical measures that allow the EITI to be implemented effectively at the subnational level.

4.5.2 No Subnational EITI Membership

Implementing the EITI at the subnational level is an integral part of the EITI national process. It aims at helping to consolidate and deepen EITI national process. Therefore, implementation at the subnational level is not a substitute for a national level EITI in those countries where the national or federal government owns natural resources, but rather should be seen as complementing the process. However, as part of a gradual process, EITI could start to be implemented at a subnational level as a way of gaining entrance to a national EITI process. But a candidate country can be considered compliant based only on national or federal implementation. There is no such category as an EITI candidate or compliant state or region. An exception would be where the resources are the exclusive property of one or more subnational governments (possible in federal states such as Canada). In this case, a national/federal EITI would be challenging given that each province usually has its own fiscal regulations and tax regimes (Bird and Vaillancourt 2001).

4.6 An Operational Framework for Subnational EITI Reporting

This section presents an operational framework that will prove useful to EITI stakeholders, especially to those implementing countries that decide to include the subnational dimension as a way to deepen EITI impact at the local level. Central to the framework would be the following questions:

- Do the SNGs in several EITI implementing countries have significant access to resource-revenues.
- Is SNG access to resource-revenues, direct (payments from the companies to the SNG), indirect (payments from the companies to the central government, which distributes to the SNG), or both?
- Due to the local impact of extractive companies at the local level, is there much demand for information and transparency about SNG access to resource-revenues in producing regions?
- Would a complete, detailed, ongoing, and legitimate disclosure process for SNG access to resource-revenues contribute to increasing levels of confidence among the public, governments, and companies in these regions?
- Could public access to this information
 1. for the SNG, reduce opportunities to misuse resource-revenues;
 2. for the public, provide opportunities to demand greater accountability from the SNG; and

3. for the companies, improve credibility in relation to what they contribute to fiscal income through the SNG to the producing regions?

The subnational EITI is a great opportunity to deepen the EITI national process, by further strengthening impact at the country level and making it more relevant to implementing countries, moving beyond the implementing countries' capital cities and participant civil society organizations already knowledgeable about extractive industries governance issues. By proposing an operational framework for EITI implementation at the subnational level, this section aims to provide some initial guidance to EITI implementing countries and stakeholders in the hope that it will help get the most out of subnational EITI reporting.

How company payments and government transfers are made to SNG is specific to each country and so there are as many subnational EITI models as there are countries and, as the review in previous sections showed, a single model would neither be desirable nor possible. A framework has been proposed as a common approach for implementing countries to plan and define the scope of reporting subnational access to resource-revenues based on a set of experiences and innovations at the subnational level from a group of implementing countries.

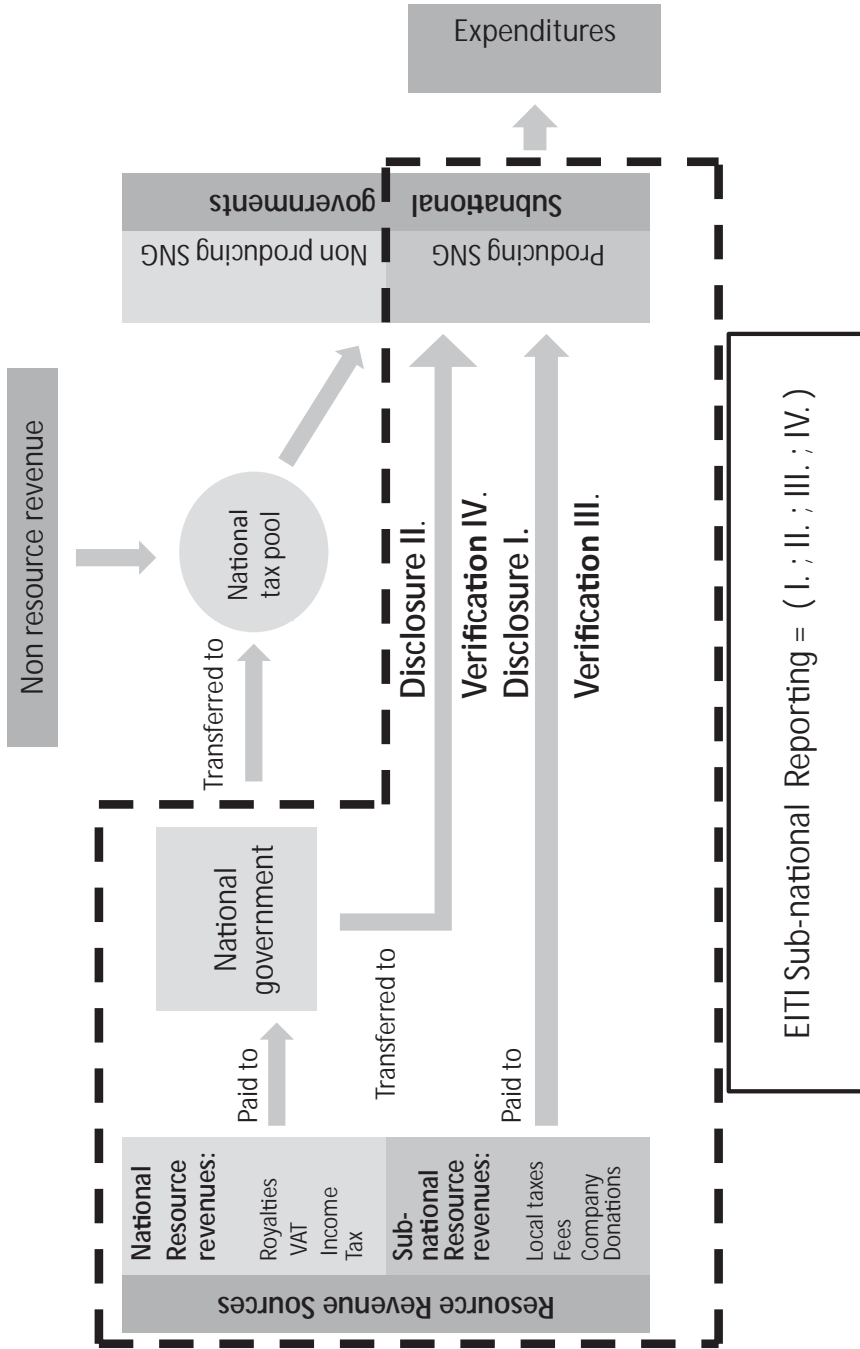
4.6.1 Experience-Based Approach

Figure 3 depicts main elements of resource-revenue to the SNG in resource-rich countries and define the elements of the subnational EITI.

The elements shown in figure 3 are the resource-revenue sources, how they reach the SNGs, and the SNGs that receive the resource-revenues. The resource-revenues are divided into national resource-revenues and subnational resource-revenues, with the different types of revenue for each. The receiving SNGs are classified as either producing or non-producing regions.

In general terms, the figure shows three different ways of allocating resource-revenue to the SNG. In the first the companies directly pay the SNGs in the producing regions. The second is the transfer of specific resource-revenues, collected by the central government, to the SNG in the producing regions. The third is the transfer from a pool of resources

Figure 3. EITI Implementation at the Subnational Government Level



collected by the central government, which may include resource-revenues, to all of the SNGs both in producing and nonproducing regions.

The dotted line shows the scope of the EITI at the subnational level. In line with the proposed operational framework, the elements that would be part of the subnational EITI are (i) direct payments to the SNGs in producing regions and (ii) specific transfers (by derivation) to the SNGs in producing regions. For different reasons, two elements in this operational framework would not form part of the subnational EITI: (a) transfers from a pool of resources to all of the SNG and (b) the expenditure/investment made by the SNG who receive direct payments and specific transfers.

Transfers to SNGs from a tax or revenue pool are not easy to associate with extractive industries operations and generally reach all or most of the SNG regardless of whether they host operating companies or not. Local demand for revenue transparency in those locations not hosting extractive industries could remain strong but is unlikely to be related to EITI, especially given that the tripartite approach to stakeholder engagement does not include producing companies. Although the need for SNG accountability is also important, policies and programs related to fiscal decentralization and local governance are better suited to those locations.

Four components of how EITI might be implemented at the subnational level are briefly described below. The framework for EITI implementation at the subnational level considers four areas for reporting and provides transparency to SNG access to resource-revenues. The key approach to defining this is materiality, the real core component of EITI which defines the content of the disclosing and reporting exercise.

These four components can be easily adapted to the country context and implemented gradually as needed. This framework is not intended to be a one-size-fits-all solution to the complex issue of revenue transparency at the subnational level. The elements in this framework should be considered in relation to each country context and the significance of each different resource-revenue stream. How subnational reporting is done in each country will vary depending on the context and existing policies on intergovernmental revenue sharing, the aim of subnational reporting, and what progress has been made in EITI by the implementing country. Likewise, the subnational EITI reports may evolve and be adapted to reflect changes in income streams or the number of SNGs.

Component I

Disclosure of Direct Revenue Flows to SNG in Producing Regions

A. What would be reported?

This component tells us how much money has flowed to selected SNGs in producing regions through direct payments from operating extractive companies. This component could be referred to as transparency of access to revenue resources through direct payments, which is basically transparency of locally collected taxes from extractive industries operations (transparency of subnational revenue collection). This component is now mandated in the 2011 version of the EITI rules.

B. What decision is needed?

A decision needs to be made by the MSG whether to include payments made by companies to subnational governments. If the MSG decides to include these payments, they need to be included in the EITI report and the timing/sequence also needs to be discussed. This reconciliation could take place either during the first round or during subsequent rounds of EITI national reporting.

C. Which country has implemented this component?

As seen in previous sections, this component has been implemented by Mongolia and is part of the core EITI standard considering materiality criteria, based on current EITI rules.

D. What kind of reconciliation work does this entail?

Reconciliation would compare companies' payments in relation to SNG receipts and explain possible discrepancies. Reconciliation would be undertaken for material payments. A materiality threshold can be defined (the higher the threshold, the lower the number of reconciliations) as a way of limiting the reconciliation to significant payments.

E. What data need to be provided?

Companies would have to provide data on all the relevant payments made to SNGs, and the SNGs would have to provide data on all relevant revenues they directly access from extractive industries.

Component II

Disclosure of Indirect Revenue Flows to SNG in Producing Regions

A. What would be reported?

This second component of subnational EITI would be focused on transfers of resource-revenues from the central government to SNGs, but only those transfers derived exclusively from resource-revenue (as presented in figure 3). EITI may help to make the distribution of receipts between the central government, regional governments, and local communities transparent. It might represent an extension of core EITI rules, as is explicitly mentioned in current EITI rules. It is important to note that this component is not a requirement mandated in the 2011 version of the EITI rules.

B. What decision is needed?

EITI stakeholders at the country level may want to know the full amount of sums paid and to whom these funds are transferred. Citizens of states and localities will want to know the amounts local governments have received so they can hold them accountable. Changes will be needed to the concept of reconciled accounts, so transfers should be included (government-to-government “payments”).

C. Which country has implemented this component?

As seen in previous sections, this component has been implemented by Ghana and Peru.

D. What kind of reconciliation work does this entail?

Based on materiality criteria, selection of entities for reconciliation could be those regions, provinces, or districts where the largest volume of transfers is concentrated. MSGs should assess carefully which regions would be invited to participate. But ultimately political decision by subnational authorities would be the determinants for deciding on the list of subnational governments that will participate. Focus on relatively large resource-revenue transfers would be highly desirable.

E. What data need to be provided?

National government entities would have to provide data on all the relevant transfers made to SNGs, and the SNGs would have to provide data on all relevant revenues they indirectly access from extractive industries.

Component III

Verification of Direct Revenue Flows to SNG in Producing Regions

A. What would be reported?

This review could demonstrate whether companies have paid what they should pay to SNGs in producing regions, considering the local tax regime and sector codes as well as oil, gas, or mining contracts.

B. What decision is needed?

Based on results from Component 1, MSGs could decide whether a more in-depth review of direct payments to SNG in producing regions would be of interest to local EITI stakeholders.

C. Which country has implemented this component?

This component has not been applied in any EITI country yet, but it has been applied successfully at the federal level in Nigeria. This third component would be a variation at the subnational level of what Nigeria did through physical and process audits in relation to payments and receipts. It went beyond just financial reconciliation of what has been actually paid/received but revising whether the payments made by companies correspond to what should be paid.

D. What kind of reconciliation work does this entail?

Reconciliation would compare payments and receipts in relation to amounts owed according to tax regime and sector regulations, explaining possible discrepancies. It would aim to verify whether selected SNGs in producing regions have received the revenues they should have collected.

E. What data need to be provided?

In addition to the data provided for Component 1, the skills needed to prepare relevant and aggregated information on SNG access to tax and nontax direct resource-revenue would have to combine a deep understanding of local government taxation and sector regulations and codes (petroleum code, mining code, etc.).

Component IV

Verification of Indirect Revenue Flows to SNG in Producing Regions

A. What would be reported?

A fourth component would be what we could refer to as a “distribution audit,” to enhance the transparency and accountability of resource-revenue distribution to SNGs located in producing regions. This fourth component would be an important contribution to enhancing the transparency of the system by which subnational governments in producing regions access resource-revenue transfers (transparency of intergovernmental resource-revenue distribution system). The transparency of the resource allocation system would cover how much is to be transferred.

B. What decision is needed?

MSGs would have to decide whether a serious effort to make the distribution system more transparent and comprehensible is necessary or demanded by the public. This would be especially useful for those countries whose local financing administration mechanisms are underdeveloped and where local government access is hampered by a lack of political will. In these cases there may be a consensus to have the auditors or aggregators map and publish the flows of specific (“derived”) resource-revenues to SNGs in selected producing regions.

C. Which country has implemented this component?

This would entail a process and in-depth review exercise, as Ghana has done for royalty transfers to SNG and Nigeria for national revenue streams.

D. What kind of reconciliation work does this entail?

The reconciliation would entail comparing transfers and receipts with due amounts according to revenue-sharing rules and distribution arrangements, and explaining possible discrepancies. It would not directly involve the SNGs and would be done prior to distributing the resources to the SNG.

E. What data need to be provided?

The following activities would be relevant:

- Identify the types of income to be distributed to the SNG.
 - Calculate and disclose how much of the total portion of resource-revenues are to be distributed by derivation to SNG.
 - Examine and disclose the distribution criteria and calculation of the specific portion to be distributed to SNG in selected producing regions.
 - Reconcile whether central government transfers to SNG are in line with revenue sharing regulations.
 - Examine and disclose the distribution process in terms of the distribution chain, role of different government entities, planned and actual timeline for transfer disbursements.
-

4.7 An Agenda to Advance EITI at the Subnational Level

On a final note, there are some key steps that EITI may want to consider in order to advance the agenda on EITI subnational implementation.

Here we summarize some of these steps:

Strengthen Subnational EITI Processes

- EITI subnational implementation is a reality that has been implemented based on country needs, and will be addressed in an increasing number of EITI implementing countries. As the six country notes have shown, all six countries studied have plans to continue and strengthen their reporting efforts at the subnational level. This trend calls for the need for practical and continued guidance and technical assistance for implementing countries by EITI global stakeholders and partners so that countries can get the most out of their efforts to include the subnational dimension of resource-revenue transparency.

Provide Specific Guidance for Scoping Exercises

- As EITI global stakeholders are looking for ways to enhance EITI's development impact, active promotion of subnational EITI seems to be an opportunity to deepen the existing EITI national processes. Implementing countries will be able to better plan, design, and implement subnational EITI if they can approach their scoping exercises with specific guidance on how to include resource-revenues streams under the national EITI process. Under existing EITI general guidance there is no specific material that provides clear orientation to implementing countries. This is a gap that EITI global stakeholders and partners should address in the short term.

Make Existing Experiences Known

- If EITI stakeholders decide to actively promote subnational EITI in implementing countries where it is relevant, along with other previous material and inputs, they should consider the experiences and the operational framework presented above. Some key tasks would

greatly benefit from clear practical guidance, such as program design and scoping the reports.

Create Knowledge-Sharing Network and Learning Platform

- Subnational EITI poses additional challenges to country-based stakeholders. Technical assistance will be needed for implementation and further work to address issues and recommendations that arise from the reports. Sharing experiences and learning from each other is key at this initial stage of implementation. A knowledge-sharing network and learning platform on subnational EITI implementation could bring together good practices and concrete examples on how to implement EITI at the subnational level.

Make the Case for Additional Funds and Resources

- EITI global stakeholders and implementing countries will need additional funds and resources to be able to deepen the existing EITI process through subnational implementation. Typically a subnational EITI program will entail a mid-term effort, three to four years, to cover the relevant sectors, resource-revenue streams, and producing regions that are considered as having a high degree of materiality. Specific funds for subnational implementation, in addition to current existing funds, will be needed. In particular, additional resources for reconciliation and dissemination will become new areas for EITI support and potential donor contribution.

Annexes

Annex 1. EITI Subnational Reporting Templates: Mongolia

Approved by joint order # 01/12/13 of Chairman of National Statistical Committee and Minister for Finance dated 2011/01/26

EITI TEMPLATE-4

The report of year on taxes and fees collected in local budget from minerals and petroleum extracting and exploring company

A. CONTACT ADDRESS

Registration number								
Company name								
Location	Name							Code
Aimag, city								
Soum, district								
Type of entity								
Type of owning								

1. Aimag's and capital city's government office should submit the report to Mongolian Tax Administration (MTA) before February 15.
2. MTA should consolidate the report and submit to Accounting policy department of Ministry of Finance no later than March 15.
3. Ministry of Finance should check reports and send it to EITI Secretariat no later than April 15.

B. BASIC INFORMATION

1. Taxes, payments, fees and dividends collected in local budget

Types	Amount /000 MNT/
1.1 Taxes collected	
1.1.1	Real estate tax
1.1.2	Tax on vehicles and self-moving mechanisms
1.1.3	Others

Types		Amount /000 MNT/
1.2 Payments collected		
1.2.1	Land fee	
1.2.2	Fee for water use	
1.2.3	Fee for forestry use and fire wood	
1.2.4	Fee for use of mineral resources of wide spread	
1.2.5	Fee for recruiting foreign experts and workers	
1.2.6	Supports received based on product sharing agreement	
1.2.7	License fee for exploitation natural resources except mineral resources	
1.3 Fees and service fees collected		
1.3.1	Stamp fee collected in local budget	
1.3.2	Service fee collected in local administration	
1.4 Dividends on local state property		
1.4.1	Dividends on local state property	
1.5 Other		
1.5.1	Penalty	
2. Donations received in local administration		
2.1	Aimags and capital	Monetary donations
2.2		Non cash donations
2.3	Soums and districts	Monetary donations
2.4		Non cash donations

C. VOLUNTARY BASIS INFORMATION

1	NGO's received	Monetary donations	
2		Non cash donations	
3	Other entities received	Monetary donations	
4		Non cash donations	
5	Community received	Monetary donations	
6		Non cash donations	

Deputy Governor of aimag and capital city /
 Chief of tax agency /
 Auditor /

STAMP

Types		Amount /000 MNT/
1.1.4	Excise tax on vehicle's gasoline and diesel fuel	
1.1.5	Tax on vehicle's gasoline and diesel fuel	
1.1.6	Fee and extra fee for exploitation of mineral resources	
1.1.7	License fee for exploitation and exploration of mineral resources	
1.1.8	Windfall tax	
1.1.9	Stamp fee on licensing of construction, modification, renovation, decommissioning of nuclear equipment	
1.1.10	Stamp fee on licensing of possession, utilization, sale, import, export, transport of nuclear substance, dumping treatment after utilization	
1.1.11	Stamp fee for licensing import, export, transport of nuclear minerals, dumping and reclamation of nature after utilization	
1.1.12	Stamp fee for licensing possess, utilization, sale, montage, place, rent, produce, decommission, demontage, store, transport, import, export of nuclear generator, dump treatment, deactivate and other related activities, and revenues.	
1.1.13	Social and health insurance charges paid from entity	
1.2 Payments		
1.2.1	Payment for deposit, exploration of which was carried out by the Government	
1.2.2	Payment for recruiting foreign experts and workers	
1.2.3	Bonus after signing contact /only year of contract/	
1.2.4	Bonus for commencement of production according to product sharing agreement	
1.2.5	Bonus for training according to product sharing agreement	
1.2.6	Field deposit according to product sharing agreement	
1.2.7	Admin service charges according to product sharing agreement	

Types		Amount /000 MNT/
1.2.8	Fee for supporting field office according to product sharing agreement	
1.2.9	Payment of air pollution	
1.3 Service fees and fees paid to state central administration and ministries		
1.3.1	Customs service fee	
1.3.2	Stamp fee	
1.3.3	Service fee	
1.3.4	Service fee for foreign experts and workers	
1.4 Dividends on state property		
1.4.1	Dividends on state property	
1.5 Government revenues and other revenues		
1.5.1	Petroleum income per Government according to product sharing agreement	
1.5.2	Of which: Royalty	
1.6 Other		
1.6.1	Penalty	
2. Taxes, payments, fees and dividends paid in local budget		
2.1 Taxes		
2.1.1	Real estate tax	
2.1.2	Tax on vehicles and self-moving mechanisms	
2.1.3	Others	
2.2 Payments		

Types	Amount /000 MNT/
2.2.1	Land fee
2.2.2	Fee for water use
2.2.3	Fee for forestry use and fire wood
2.2.4	Fee for use of mineral resources of wide spread
2.2.5	Fee for recruiting foreign experts and workers
2.2.6	Supports received based on product sharing agreement
2.2.7	License fee for exploitation natural resources except mineral resources
2.3 Fees and service fees collected in local administration	
2.3.1	Stamp fee collected in local budget
2.3.2	Service fee collected in local administration
2.4 Dividends on local state property	
2.4.1	Dividends on local state property
2.5 Other	
2.5.1	Penalty
3. Other revenues	
3.1 Advance to costs disbursed to environment protection	
3.1	In-kind contribution at rate of 50% to Environmental protection special account

Types		Amount /000 MNT/
3.2 Donations received in government organizations		
3.2.1	Ministries and agencies received	Monetary donations
3.2.2		Non cash donations
3.2.3	Aimags, capital city received	Monetary donations
3.2.4		Non cash donations
3.2.5	Soums and districts received	Monetary donations
3.2.6		Non cash donations
3.2.7	Other organizations received	Monetary donations
3.2.8		Non cash donations
C. VOLUNTARY BASIS INFORMATION		
1	Discounted and lifted taxes according to specific conditions of the contract	
2	Total investment	
3	Expenditures for capacity building and staff training	
4	Expenditures for geology and exploration	
5	Expenditures for environment protection	
6	Donations to NGOs	Monetary donations
7		Non cash donations

8	Donations to other entities	Monetary donations	
9		Non cash donations	
10	Donations to community	Monetary donations	
11		Non cash donations	
12	Expenditures for disaster mitigation and prevention		

STAMP

State Secretary of Ministry of Finance / /
Head of Accounting Policy Department..... / /
Auditor / /
Date

Annex 2. Input Template for Metropolitan, Municipal, District Assemblies: Ghana

Name of District Assembly _____

Reporting Period _____

a. Previously Unreported Projects/Royalties Payment

1. Mining royalty payment received and not reported for the previous period.

- a) Total amount
- b) Total expenditure (from the amount above)
- c) Total amount remaining after disbursement
- d) Indicate in the table below the disbursement for the amount expended (as in b above).

b. Property Rates

Total amount

Name/ location of project	Name and address of contractor	Duration	Estimated cost (¢)	Actual cost (¢)	Remarks/ progress of work

e) Indicate in this section (table below) and in kind payment received by your District Assembly

Nature of in-kind payment	Cash / in-kind payment	Name of providing institution	Duration	Remarks

c. Current Reporting Period

1. State in this section the disbursement received as mineral royalties.

- a) Total mineral royalties received
- b) Total expended from the amount above
- c) Total remaining after expenditure (f-g)
- d) Indicate in the format below the disbursement of the expended amount stated in (g) above.

Name/location of project/ investment made	Name and address of contractor	Duration	Estimated cost (¢)	Actual cost (¢)	Remarks/ progress of work

(j) Indicate in this section any form of in-kind payment received by your District Assembly

Nature of in-kind payment	Cash / in-kind payment	Name of providing institution	Duration	Remarks

Stamp

MMDA Sign Off

We acknowledge our responsibility for fair presentation of the reporting Template in accordance with the reporting Guidelines, with the exception of:

- _____ ;
 - _____; Name _____ Signature _____
 - _____ ;
- Position _____ Date _____

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World Bank Group's Oil, Gas, and Mining Unit

The World Bank Group's role in the oil, gas, and mining sectors focuses on ensuring that its current interventions facilitate the extractive industries' contribution to poverty alleviation and economic growth through the promotion of good governance and sustainable development.

The Oil, Gas, and Mining Unit serves as the Bank's global sector management unit on extractive industries and related issues for all the regions of the world. It is part of the Sustainable Energy Department within the Sustainable Development Network.

Through loans, technical assistance, policy dialogue, and analytical work, the Unit leads a work program with multiple sector activities in more than 70 countries, of which almost half are in Sub-Saharan Africa. More specifically, the Oil, Gas, and Mining Unit:

Advises governments on legal, fiscal, and contractual issues and on institutional arrangements as they relate to natural resources, as well as on good governance practices.

Assists governments in setting up environmental and social safeguards in projects in order to promote the sustainable development of extractive industries.

Helps governments formulate policies that promote private sector growth and foreign direct investments.

Advises governments on how to increase the access of the poor to clean commercial energy and assess options for protecting the poor from high fuel prices.

In essence, the Oil, Gas, and Mining Unit serves as a global technical advisor that supports sustainable development by building capacity and providing extractive industry sector related advisory services to resource-rich governments. The Division also carries out an advocacy role through the management of the following global programs:

The Extractive Industries Transparency Initiative (EITI) Implementation Support Facility, which supports countries implementing EITI programs

The Global Gas Flaring Reduction (GGFR) Public-Private Partnership, which brings governments and oil companies together to reduce gas flaring

The Communities and Small-Scale Mining (CASM) Partnership, which promotes an integrated approach to addressing issues faced by artisanal and small-scale miners

The Women and Extractive Industries Program, which addresses gender issues in extractive industries

The Petroleum Governance Initiative (PGI), which promotes good governance.

The Extractive Industries Technical Advisory Facility (EI-TAF), which facilitates "rapid-response" advisory services on a demand-driven basis to build capacity for extractive industry resource policy frameworks and transactions.



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