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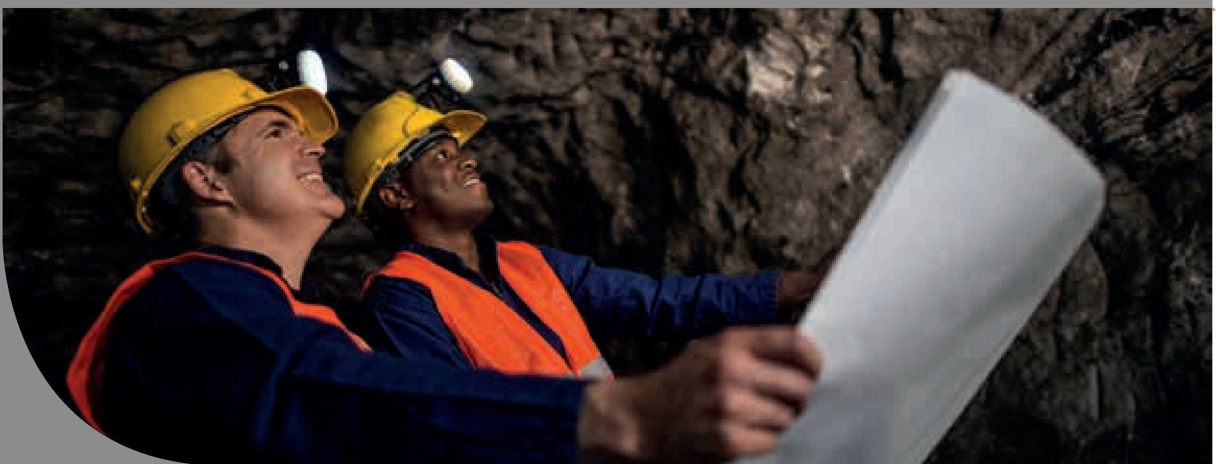
GETTING RESULTS FROM RESOURCES

HOW DEVELOPING COUNTRIES CAN OVERCOME THE "RESOURCE CURSE" THROUGH IMPROVED GOVERNANCE AND INCREASED TRANSPARENCY



This article draws from the experiences of the International Council on Mining and Metals (ICMM) in many of the countries it works with in an effort to identify lessons that could be applied to resource-rich countries in transition in the EBRD region.

A prospering resource extraction industry is often seen as a blessing for developing countries, offering a springboard for economic and social development. However, many of the countries that possess enviable natural resource bases are not successful in translating this advantage into social and economic progress. This issue, broadly referred to as the "resource curse" can be due to a range of factors, but has increasingly been correlated with the quality of host-country governance. In other words: for countries to translate resource revenue generation to improvements in social and economic conditions requires carefully designed governance reforms and increased capability.[1]

In 2013, the Natural Resource Governance Institute launched a Resource Governance Index (RGI), with an initial coverage of 58 resource-rich countries internationally. The Index was designed to highlight that good governance of natural resources is necessary for the successful development of countries with abundant oil, gas and minerals. The RGI covers 15 natural resource-dependent countries in Africa, only three of which had partially satisfactory governance (Ghana, Liberia and Zambia). The rest exhibited either poor or failing levels of resource governance. ICMM also examined the eight countries in Africa that are mineral-dependent to see whether the relative position of these countries on the RGI mattered in terms of development outcomes. A clear connection became apparent when comparing these countries, indicating that weak governance was strongly correlated with lower human development outcomes, greater vulnerability to state failure and increased perceptions of corruption.

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The Resource Governance Index (RGI) has an initial coverage of 58 resource-rich countries internationally. The Index was designed to highlight that good governance of natural resources is necessary for the successful development of countries with abundant oil, gas and minerals.

One of the greatest risks associated with economic development in resource-rich countries is overdependence on resource revenues. Mining investment can trigger economic growth and poverty reduction in developing countries, but comes with a plethora of governance and economic management challenges. Further research by ICMM in partnership with the United Nations Conference on Trade and Development (UNCTAD) and the World Bank Group indicated that mining investment is most effective when accompanied by appropriate policy and institutional reforms, indicating that carefully designed governance reforms can enhance the impact of mining investment at both the national and local development levels.

A study[2] completed by the McKinsey Global Institute in 2013 indicated that the number of countries where minerals are the main driver of economic activity has increased dramatically over the last 20 years and is now dominated by low- and middle-income countries. In response to this growing challenge, donor agencies have emphasised improving governance through building capacity and robust institutions, as well as encouraging transparency and accountability.

The taxation of natural resources is a particular challenge in developing economies. Governments of developing countries urgently require tax revenues in order to pay for basic goods, services and infrastructure for their citizenry. However, mining is a capital-intensive industry and it can take over a decade for a mining project to evolve from exploration to operation. Even once a mine is operational it can take a number of years for it to become profitable and for the company to start paying corporate income tax. It is difficult for a government to make long-term plans when short-term needs are so acute. This problem is exacerbated by the fundamental time horizon disconnect between a mining company, which sees its mine as a 30- to 100-year investment and a government, which may be up for re-election in three to five years, by which time it needs to be able to point to improved social and economic outcomes in order to be re-elected.

While mining companies typically contribute as much as 20 per cent of government revenue in low and middle income mineral-driven economies, that figure is just one element of mining's contribution to social and economic development. Based on research undertaken by ICMM, in mineral-driven countries mining can typically account for 30 to 60 per cent of export earnings and 60 to 90 per cent of foreign direct investment. In addition, the returns to investors and to host governments (in the form of taxes and royalties) are broadly similar – at 15 to 20 per cent of total earnings. However, capital and operating expenditures typically account for 50 to 65 per cent of a mining company's total earnings, in the form of wages, infrastructure and procurement. When the opportunities provided by these investments are properly harnessed and supported by an appropriate fiscal regime, the multiplier effects can have a transformative effect on social and economic development outcomes. However, too often mining's economic contribution is reduced to a narrow focus on effective tax rates which are liable to change when commodity prices fall or when an election looms.

ICMM INITIATIVES

ICMM's Resource Endowment initiative was a multi-year research project, overseen by an independent international advisory group that started in 2004 in collaboration with UNCTAD and the World Bank. The initiative assessed the performance of 33 mineral-driven countries across a range of socio-economic indicators. It then developed an analytical framework that was applied to Peru, Chile, Ghana and Tanzania to identify the critical success factors that have enabled some countries to benefit from substantial resource endowments and avoid the "resource curse". The initiative demonstrated that the resource curse is not an inevitable consequence of mineral investment: mining investments can and do drive economic growth and reduce poverty nationally and locally.

The three critical success factors were found to include:

- the presence of a favourable investment climate
- reasonable standards of governance nationally
- sound national macro-economic management.

However, the quality of governance at the sub-national (regional and local) level was also identified as an important factor. The research also found that companies alone cannot unlock the development benefits from mining – governance is key and multi-stakeholder partnerships to address issues such as revenue management or enhancing economic opportunity can help fill capacity gaps.

This project led to ICMM's publication of the *Mining: Partnerships for Development (MPD) Toolkit*.[3] The application of the toolkit in a given country enhances our understanding of mining's overall contribution to sustainable development and poverty reduction through: foreign direct investment; exports; revenues and royalties; gross domestic product; direct, indirect and induced employment; local enterprise development; economic diversification; and enhanced revenue management.

ICMM's MPD work focuses on enhancing mining's economic and social contribution as a concrete and pragmatic way of avoiding the resource curse. It is based on the premise that mining's contribution to broad-based social and economic development can be enhanced through collaboration among companies, government, local communities and development agencies – particularly at the local level.

RISKS AND CHALLENGES IN DEVELOPING ECONOMIES

An array of challenging conditions associated with governance and company behaviour can be the obstacle in translating resource wealth into lasting prosperity and improved livelihoods for a resource-rich country's citizens. A commitment by companies and government to transparency is a powerful means of preventing the misappropriation of revenues and the economic distortions caused by corruption.

As a consequence all ICMM members are required to support the Extractive Industries Transparency Initiative (EITI),[4] a global standard to promote open and accountable management of natural resources. Through an innovative multi-stakeholder approach, the initiative seeks to strengthen government and company systems, inform public debate and enhance trust. At its core is a simple but effective process: companies disclose the payments that they have made to the government of the country in which they operate and the government discloses the payments that it has received. The two sets of figures are then independently reconciled and publicly disclosed. While EITI is not a "silver bullet" to reverse the resource curse, the information contained in an EITI report and the public debate that it spurs, can provide a timely boost for governance reforms and ultimately, development effectiveness.

Another key transparency pillar for resource-rich countries is the disclosure of an extractive company's beneficial owner. This mitigates the risk of corruption, particularly in the licence allocation stage of the value chain. Without beneficial ownership information companies could unwittingly partner or enter into contract with a company or supplier owned by a corrupt individual. Non-disclosure of beneficial ownership is also thought to have enabled the use of shell companies by government officials or their associates to misappropriate public funds. Consequently, mining and metals company representatives on the EITI International Board have encouraged the disclosure of beneficial information to become part of the EITI Standard.

Misunderstandings around the content of contracts and mistrust among stakeholders can often lead to tensions. As a result, the disclosure of contracts, licences and agreements that govern the exploration and exploitation of natural resources should be encouraged wherever possible. This allows for commitments between governments and companies to be transparent, highlighting how resource-rich countries and companies agree to share the risk and rewards of a project over its lifetime.

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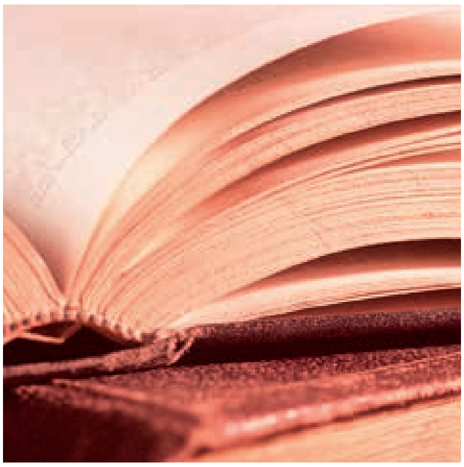

OPPORTUNITIES FOR PROGRESS

Enhanced governance and transparency can address the risks and challenges associated with resource-dependent developing countries. This reinforces the potential opportunity for capital-scarce countries to finance their development efforts, stimulate public investment and promote economic growth and social development.

As mentioned earlier, ICMM's own research has demonstrated that the factors that help national-level benefits trickle down to the local level include: sound national macro-economic management and mineral fiscal regime; revenue transparency; engagement in and implementation of key international initiatives; and quality of governance at the sub-national levels, such as regional and local institutions.

Success also depends on the quality of collaboration among the government, companies, development partners and civil society organisations to enhance benefits. At the sub-national level, for example, the promise of greater economic opportunity and equitable social development depends on institutional capacity to drive change through effective planning and implementation of programmes and projects.

Some governance reforms result in policy changes that, if inappropriately applied, can have a detrimental effect on the performance of the industry and returns to all stakeholders, including host governments and communities. For example, dramatic fiscal regime changes, which may be motivated by a government's desire to ensure mineral resources generate the maximum economic and social benefit for the population, can lead to companies reducing investment and, in some cases, placing their mine under care and maintenance if a mine's profitability is threatened.

1. See http://www.resourcegovernance.org/sites/default/files/rgi_2013_Eng.pdf
2. http://www.mckinsey.com/insights/energy_resources_materials/reverse_the_curse_maximizing_the_potential_of_resource_driven_economies (last accessed 15 January 2016)
3. See http://www.icmm.com/mpd (last accessed 15 January 2016)
4. See https://eiti.org/ (last accessed 15 January 2016)

The methods by which the changes are introduced can also have unintended adverse consequences. For example, the application of policy changes could be viewed as inappropriate if changes are imposed by the host government without adequate consultation and/or are enforced over too short a timeframe for industry to adjust. Governance reforms should be designed in light of the constraints and opportunities facing individual countries, taking into consideration the factors that influence competitiveness.

ACTIONS TO ENHANCE GOOD GOVERNANCE AND TRANSPARENCY

It is the responsibility of governments, mining and metals companies and civil society organisations to push for enhanced governance and transparency.

Responsible governments are obligated to commit to high standards of transparency related to the extractives sector, and this should be linked to a forum where debate can take place on the information disclosed. It is important that all stakeholders, including the general public, are involved in this process, ensuring government accountability for both the revenues and expenditures.

Governments also need to ensure that they avoid a narrow focus on fiscal terms, incorporating other elements that influence competitiveness, such as the political risk environment and the quality of infrastructure in support of mineral investments.

Leading mining and metals companies are responsible for engaging in governance reforms, balancing the legitimate desire of host governments to ensure that mineral resources generate the maximum benefit for the country, with the legitimate need of companies to profitably invest for the long term. Mining companies also need to engage constructively in appropriate forums to improve the transparency of mineral revenues – including their management, distribution and spending – or of contractual provisions on a level playing field basis, either individually or collectively.

Lastly, civil society organisations should continue to advocate for governance reforms and improved transparency to enhance the benefits of mining developments to host countries. For their efforts to be successful, they should work collaboratively with governments, development agencies and companies to support capacity building at the national and sub-national levels.