



Linking governance of the extractive sector with sound public financial management: the AfDB engagement with governance in resource rich countries

Information note to the EITI global conference's panel on EITI and expenditure management

Africa is well endowed with natural resources that can accelerate its development. The continent has 15% of the world oil reserves, 40% of its gold and 80% of the platinum metals, as well as a varied mineral base. New commercially viable discoveries have the potential to continue to support Africa's economic growth. At the same time, the well-known challenges of managing resource wealth underpin the importance of supporting prudent and transparent governance of these resources.

The African Development Bank's approach to governance in the Extractive sector is underpinned by the Governance Action Plan (GAP) (2008-2012) whose core objective is to assist Regional Member Countries (RMCs) to build capable and responsive states by strengthening transparency and accountability in the management of their public resources. Promoting accountable and transparent governance in RMCs is also among the strategic priorities of the African Development Fund 12 (ADF-12 covering the period 2011-2013). Within this strategic context, the governance of the extractive sector has emerged as key to harnessing growth in an inclusive manner. This note will briefly survey the AfDB's work on governance of the extractive sector and more broadly on supporting its regional member states, and make some considerations about future directions of travel.

1. The AfDB current work on the Extractive Industries and with the EITI

This section surveys AfDB work directly supporting governance in the extractive sector. Over the past 5 years, the Bank has approved 18 projects directly addressing governance issues in the extractive sector. The scope of support focussed on two main areas: a) support to the implementation of the Extractive Industries Transparency Initiative (EITI) and b) technical support to contract negotiation and modernization of legal frameworks in the extractive sector through the Africa Legal Support Facility (ALSF)¹. These two main prongs of support were supported by complementary support to demand side governance for greater accountability in the Management of Natural Resources. Eight of the fourteen beneficiary countries are fragile

¹ The ALSF began operations in 2010 as an independent institution, hosted by the AfDB.

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states, requiring a specific approach through a “fragility lens”; funding in such cases was provided by the dedicated Fragile States Facility of the AfDB.

The AfDB endorsed the EITI in 2006 and engagement with the initiative has been the anchor of its support to our RMC in the extractive sector. The AfDB has supported to date EITI implementation in 13 Regional Member Countries, and outreach activities in an additional one.

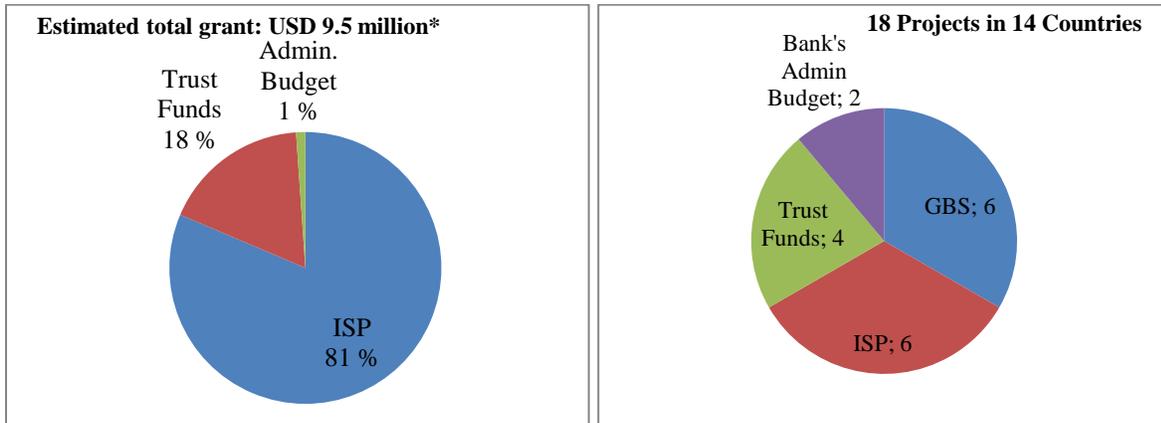
This work is further complemented by research on natural resources status, sustainable macroeconomic policies and natural resource management², and by investment through the AfDB private sector operations (see associated brochure on the AfDB private sector work). The AfDB’s private sector operations are focused on support of projects bringing high economic return to host economies and strong development outcomes regionally while trying to bring in Foreign Direct Investment to partner with local entrepreneurship. These operations adhere to the EITI principles and are subject to a review of their development outcomes. The AfDB has also facilitated high level dialogue among African policymakers – together with the African Union and UNECA, it has facilitated the preparation of the African Mining Vision. The Bank facilitated peer to peer learning and policy dialogue across the continent, notably with seminars in Mozambique and Uganda on oil and gas, and high level policy dialogue with the Kenyan authorities as they ready to open up significant oil findings to commercial exploitation.

Attention has been given to demand side accountability in the extractive industries – an important component of the EITI design. In partnership with the World Bank Institute, Revenue Watch Institute and the Publish What You Pay (PWYP) coalition, the AfDB provided financial and technical assistance for the training of 60 civil society representatives in analysis of EITI Reports and advocacy for greater accountability.

Funding is channelled through Programme Based Operations (PBOs, or budget support), Institutional Support Projects (ISPs), trust funds and the Bank’s own administrative budget. In the last five years 18 projects have been approved in support for governance of the extractive industries. If one excludes budget support projects, where it is not possible to trace the specific financial flows to the EI activities, between 2008 and 2012 the Bank has invested around USD 9.5m of financial resources in programmes directly addressing the Governance of the EI sector.

² <http://www.afdb.org/en/knowledge/>

Figure 1: AfDB's EI governance programmes



Source: AfDB

AfDB's work in resource rich countries addresses key issues on extractive revenue management without necessarily an explicit link to the EITI. The next section provides some examples.

2. "Beyond EITI": AfDB's work in tax administration, expenditure and fiscal management

The AfDB recognizes that in order to fully leverage the potential of the Extractive Sector to transform Africa, it needs to go "beyond transparency", to support both the maximization of rent collected by its RMCs while safeguarding a conducive investment environment, and supporting their ability to spend and invest these resources in an effective way that delivers inclusive growth.

The chart below shows a broad conceptualization of the value chain across the extractive industries, and how the AfDB can support its RMCs along each link of the chain.

Figure 2: The AfDB’s role in the extractive industries value chain



Source: AfDB Development Effectiveness Report 2012-Governance

The first two links in the value chain are specific to resource rich countries, and is where the activities referred in the previous section have focused.

However, the downstream links in the value chain are important to all African countries - putting in place the appropriate fiscal regimes to guarantee tax efficiency, maximize revenues and provide the right incentive to investments; and to allocate resources efficiently to stimulate growth and reduce poverty. However, they are particularly relevant for resource rich countries, for a number of reasons:

- The specific challenges to macroeconomic management, requiring particularly robust fiscal and expenditure frameworks to manage the adverse impact on competitiveness.
- The finite nature of extractive resources, meaning that expenditure policy need to take into account intra-generational equity issues – ensuring that future generations benefits from returns on resources extracted today.
- The high expectations generated by extractive resources, which require visible “wins” in terms of rising living standards, delivery of services and economic opportunities.
- The fragility angle, given the overlap between fragile and resource-rich countries in Africa.

As part of its Governance strategy, the AfDB has supported Public Financial Management reform across the continent. A large number of these are in resource rich countries. While in some cases no explicit link with EITI implementation was made, the specific challenges of managing financial resources from extractive resources were prominent in the rationale for projects. Modalities included provision of budget support, with specific agreed objectives on

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PFM reforms supported by conditionality and policy dialogue, and Institutional Support programmes, providing expertise, equipment, training and other capacity enhancing interventions

AfDB support to resource and expenditure management in resource rich countries can be typified along three categories:

- Supporting overall **macroeconomic management and fiscal discipline**, specifically to avoid losses in competitiveness associated with Dutch disease. This is a constituent element of all budget support operations, which take sound macroeconomic management as a pre-condition for a successful programme.
- Programmes supporting **tax policy or tax administration reforms**, which address all types of revenue heads (not just those coming from extractives) but leveraging the “transparency platform” provided by the EITI, and in some cases the support given in re-negotiating contractual and concessional arrangements in specific extractive agreements. The idea is that the improved collection of taxes and royalties from extractives is done in the context of an overall improved framework for tax collection, avoiding excessive reliance of revenues from extractives; allowing transparent trade-offs in tax policy (additional revenues from extractives allow fine-tuning of tax burden on the non-extractive sectors); and avoiding loopholes Good practice suggest that e.g. the fiscal regime for the extractive sector should be embedded in the broader fiscal regime, with income and corporate taxes applying uniformly to all sectors of the economy, and special fiscal instruments such as royalties used to extract rents from the extractive sector). Examples include work in Guinea, DRC, Liberia and Sierra Leone.
- Programmes focusing the improvements in the **budget formulation and execution** process, including procurement, and **accounting and reporting**, to ensure an orderly and auditable process of resource allocation, compliance with controls and effective system of cash releases and procurement to minimize leakages and maximize value for money.
- Programmes supporting the **improvement of allocative efficiency** of resources, to ensure that additional revenues from the extractives are utilized to generate growth in the long term, and benefit future generations. These programmes typically support RMCs to ground budget allocation decisions into the national development plans, improve investment planning and a management, capital appraisal systems and investment management, improving capital approval processes etc.

Box 1: Linking EITI with the downstream expenditure management and allocation in Guinea

A package of technical assistance programmes and budget support in Guinea – an EITI candidate country - provides an example of how the AfDB has covered the key stages of the public finances’ chain in a fragile environment. First, an Institutional Support Programme provided support to elaborate legal, regulatory and institutional frameworks for extractive sector (mining code, gas code, mining sector strategy) and support to implement EITI action plan, in order to maximize resource rents accruing to the state and ensure transparency of receipts. At the same time, support to the tax administration authorities helped the Government to avoid overreliance of the revenue base on the extractive sector. Downstream, the same package supported improved capacities in budget execution, particularly the financial control and internal audit. Going forwards, the AfDB is discussing with the authorities how to best support improvements to allocative efficiency, especially for public investment. Prioritizing public investment in infrastructures is a form of intergenerational savings, making sure that finite resources extracted today yield returns in the future.

- Support to **external oversight institutions** (especially Supreme Audit Institutions but also Parliaments), which monitor the executive decisions’ on the use of resources, and provide a “bridge” between the Government and citizens by analyzing, commenting and disseminating an independent assessment of Government’s financial and policy performance.

Box 2: Revenue management and external oversight in Liberia

The AfDB governance operation in Liberia – an EITI compliant country – is underpinned by a multi-year budget support operation (2010-2013; UA 30 million), providing an overarching umbrella for institutional reform in the areas of customs administration, business enabling environment, financial transparency and accountability, and extractive industry governance.

Complementing and leveraging the budget support, a technical assistance programme provides targeted support to independent oversight institutions tasked with monitoring the use of public resources. These include the public procurement oversight authority, to deliver on its mandate and support the establishment of transparent, competitive, and efficient public procurement processes in government; the General Audit Commission (GAC), to improve its ability to scrutinize and inform Parliament on government’s financial performance; and the Public Accounts and Audit Committee (PAAC), Legislative Budget office (LBO) and the Ways and Means Committees of the Legislature (WMC) to enhance the capacity of the Legislature to apply appropriate standards of PFM accountability to the executive branch.

3. Going forward

The recently approved Bank Group's Strategy (2013-2022) emphasizes the importance of good governance of the extractive sector to achieve inclusive growth and the transition to green growth. In particular, it highlights the importance of building on the EITI transparency work to scale up advisory and policy work on contracts, local value addition and sustainable use of resource flows. Crucially, the thrust of the strategy emphasizes the importance of scaling up our work on accountability – empowering citizens and institutions to hold Government into account. On the basis of the Bank Group's Strategy, the AfDB is in the process of operationalizing its governance and accountability elements in a new Governance Action Plan. Some initial ideas might include:

- a) Continuing the existing work supporting and advocating for EITI implementation, disseminating the new standard and helping its Regional Member Countries implement them. A process led by the EITI Secretariat in consulting implementing countries on capacity needs would be key in informing the AfDB and other supporting partners' work. The AfDB will continue its work supporting the review of contractual and concessional agreements and negotiations of new agreements to maximize resource rents for RMCs while preserving the incentives to invest.
- b) Working with other partners in agreeing international reporting standards to ensure the accessibility and the ease of use of the new data that will be made available by the new mandatory disclosure standards (Frank-Dodd Act, EU Accounting directive).
- c) Continuing the ongoing work on Public Financial Management, including budget management, investment planning, and external oversight, linking it with the challenges of resource rich countries. This might include addressing some of the specific demands on optimal savings strategies to address intergenerational fairness, including the feasibility, rationale and the design of sovereign wealth funds and stabilization funds; specific issues in tax policy and administration addressing issues of tax avoidance and transfer pricing; .
- d) Strengthen partnerships with civil society and community beyond strictly EITI-related activities, to engage Governments on allocation decisions and policy effectiveness. This work could build on the support to independent oversight institutions, facilitating true partnerships between Supreme Audit Institutions and Parliaments on the one hand and citizens, communities and civil society on the other.
- e) Consider what is the AfDB's comparative advantage in advising its clients on developing backward and forward linkages in the extractive sector, and promote "clustered development" around mining sites. This could include the appropriate contractual arrangements to promote local content and enhancing the value chain of investments, or how to integrate extractive companies' investment in infrastructures into national investment plans.

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