Revenue Sharing and Fiscal Management
Discussion paper

This paper was prepared for the U.N. Special Representative to the Secretary-General on business and human rights, Professor John Ruggie. It does not necessarily reflect the views of the Special Representative, but has been written to invite input. Most helpful would be responses to the questions posed in the last section and additional best practices or initiatives not already mentioned, but any sort of feedback would be welcome. This paper and others will inform the Special Representative's ongoing work, and may also serve as a resource for business and human rights practitioners and observers.

Please send comments to humanrightsandbusiness@ohchr.org by 10 October 2006.

Additional papers and materials related to the U.N. Special Representative can be found at the Business and Human Rights Resource Centre: www.business-humanrights.org.

The issue

1. In considering the potential impacts of business on human rights, one must examine the revenues that governments receive from companies operating in their countries. The state is expected to use such funds – which far outweigh discretionary spending by companies – in part to realise development goals and protect and promote the human rights of its citizens.

2. However, the record in many countries with a wealth of natural resources indicates that revenues can a) induce rent-seeking behaviour that exacerbates social tensions and inequalities – for example, having to do with distribution of revenues or jobs; and b) have adverse economic effects such as a rise in inflation and exchange rates and dependency on a volatile commodity sector.

3. **Revenue transparency** – disclosure of taxes and royalties paid into government by industry – is important for ensuring that companies pay the correct amounts in a timely fashion and for promoting an understanding of these payments among the public.

4. But revenue transparency is only one element of achieving better overall **fiscal management**. One can envision total transparency with bad outcomes: for example, if political pressures result in unsustainable spending and poor macroeconomic policy.

5. The factors that underpin strong fiscal management – e.g. rule of law, government capacity, and absence of corruption – are the same factors that contribute to the protection and promotion of human rights more broadly.

6. To achieve fiscally responsible spending, the challenges for governments are a) determining the right balance between current consumption expenditures, capital expenditures, and long-term savings; b) setting spending priorities, a national

budget, and revenue distribution mechanisms; and c) ensuring that the money is managed as agreed. The first two challenges require expertise at the national level; the third is a longer-term effort, requiring capacity and discipline at regional and local levels as well.

7. Determining appropriate levels of **fiscal federalism** – sharing of revenues between the national and local governments – is not easy: On the one hand, residents have a fair claim on some share of revenues from resources in their area; on the other hand, it is the responsibility of the national government to determine what is best for the whole country in terms of macroeconomic policy and equity. Many countries have agreements to redistribute project revenue collected by central government to sub-national governments: For example, 50% of the 2004 income tax paid by Newmont's Yanacocha mine in Peru, totalling $90.7 million, was returned by the Ministry of Economy and Finance to the provincial and district councils.[1]

Current activity, initiatives, tools, and good practice

8. The **Extractive Industries Transparency Initiative** has encouraged full publication and verification of company payments and federal government revenues from oil, gas and mining. EITI's tri-sector participation has enabled companies to take on this difficult issue with governments, and in some countries the Initiative has proved to be a helpful convenor of dialogue. Following its Extractive Industries Review, the **World Bank** is supporting the EITI and other efforts to strengthen fiscal management around its investments.[2]

9. The **International Monetary Fund** (IMF) has produced a Guide on Resource Revenue Transparency that prioritizes (i) clarity of roles and responsibilities; (ii) public availability of information; (iii) open budget preparation, execution, and reporting; and (iv) assurances of integrity. The IMF has an ongoing program in Angola, and published a report in 2004 suggesting better practices for sub-Saharan African countries.[3]

10. The **Publish What You Pay** coalition of NGOs campaigns for mandatory disclosure of payments by extractive companies to governments and other public agencies, focusing on multilateral agencies such as the World Bank and IMF, home and host governments, and lending banks.[4]

11. The **Resource Endowment initiative** of the International Council on Mining & Metals, UNCTAD and the World Bank Group has produced useful analysis of this issue. The initiative identified success factors at macro and project levels: For example, multi-sector partnerships and capacity at all tiers of government proved more important than formal revenue-sharing mechanisms. The study compared Chile, which has no such arrangements but has seen positive economic outcomes from its mining industry, with Peru and Ghana, which do have such mechanisms but haven't seen the same degree of positive impact.[5]

12. In Uganda, the pioneering of **public expenditure tracking surveys** in the late 1990s enabled residents to see how much money was allotted for education, and making it easier to hold their officials accountable. Oxfam is designing mechanisms for direct public participation in budgeting processes at the local level in Azerbaijan, where state and local authority budgets were shared in public hearings and newspapers in 2004.[6]

13. In West Papua, Indonesia, the governor and local universities are working with the World Bank to **build understanding and capacity** as the province prepares for a major influx of wealth. This partnership published a report that established the province's fiscal priorities: clarification of funding priorities and the purposes of various allocations, decentralization of authority, and improvement in the coordination of programs and reporting and timeliness of spending.[7]

14. Communities can also take part in project profits directly, through oil funds as in Alaska and Norway or other **profit-sharing schemes**. Some companies have experimented with giving communities equity stakes to ensure local benefit and give residents a vested interest in a project's security and long-term success. In the construction of South Africa's Kruger-Mpumalanga International Airport, for example, ABB allotted the local community a 10% stake and a fixed fee for each passenger departure and established a trust to manage accruing funds.[8] Arrangements of this sort do require capacity for fiscal management at the local level.

15. The Papua New Guinea government created a **tax credit scheme** that allowed mining companies to spend a small percentage (over the years, ranging from 0.75% to 2%) of their taxable income on local infrastructure projects. The mining companies have been more successful in building schools and bridges than the government, which may have a positive short-term impact but begs the question as to what happens when mining ceases and these functions revert to public authorities.[9]

16. The issue of **corruption** is obviously relevant to this topic – and being addressed by many other initiatives (the OECD and UN conventions, the World Economic Forum's Partnering Against Corruption Initiative, and organizations such as Transparency International, to name a few). The UN Global Compact has a guidance document on implementation of the Compact's principle on anti-corruption which provides a helpful overview of the issue, including current good practices and examples.[10]

Issues for further discussion

17. There is an ongoing debate over the extent to which industry payments should be **disaggregated** when revenues are published. Some argue that the total inflow of revenues is the only figure that matters and that the focus should be on how governments manage their revenues, while others argue that companies

should disclose their individual payments. What are the relative merits and demerits of these arguments?

18. Business should recognize the impact that their revenues have on their host governments and communities and offer **technical advice** (such as finance or project management skills). But business should not attempt to influence how governments manage their revenues. Of course, companies can make their views known, but policy assistance should come from entities such as the World Bank, the IMF, UNDP or consortia of bilateral donor governments that can advise and provide training on responsible fiscal management. How can all stakeholders ensure that the expertise of companies is optimally leveraged in an appropriate manner?

19. Countries may have revenue-sharing mechanisms or agreements that revenues from particular industries or projects will fund particular public services. But what recourse is there **when governments renege** on such commitments? How can civil society hold its governments accountable, particularly when the worst offenders are likely to employ intimidation tactics to stifle opposition?

Additional sources:

- Terry Lynn Karl, *The Paradox of Plenty: Oil Booms and Petro-states (Studies in International Political Economy)*, 1997.

- K. McPhail, "The Revenue Dimension of Oil, Gas and Mining Projects: Issues and Practices", presented at the Society of Petroleum Engineers International Conference, March 2002.

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[1] See http://www.newmont.com/en/pdf/nowandbeyond/NB2004-Yanacocha.pdf.
[2] See http://www.eitransparency.org/ and http://www.ifc.org/eir.
[3] See http://www.imf.org/external/pubs/ft/grrt/eng/060705.htm, and M. Katz *et. al*, *Lifting the Oil Curse: Improving Petroleum Revenue in Sub-Saharan Africa*, International Monetary Fund (Washington, D.C., 2004), available at http://www.imf.org/external/pubs/nft/2004/loc/index.htm.
[4] See http://www.publishwhatyoupay.org/.
[5] See http://www.icmm.com/project.php?rcd=16.
[6] See http://www.oxfam.org.uk/what_we_do/where_we_work/azerbaijan/programme_overview/. For more information on public expenditure tracking surveys and other related initiatives, see W. Easterly, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*, 2006, and S. Mallaby, *The World's Banker: A Story of Failed States, Financial Crises, and the Wealth and Poverty of Nations*, 2005.
[7] See "Papua Public Expenditure Analysis: Regional Finance and Service Delivery in Indonesia's Most Remote Region," September 2005, available for download from the World Bank's Indonesia web page.
[8] See "ABB in Southern Africa: Sustainability in Focus: Kruger-Mpumalanga International Airport", www.abb.com. For more information about Norway's Government Pension Fund, formerly the Petroleum Fund, see http://www.norgesbank.no/english/petroleum_fund/. For more information about the Alaska Permanent Fund, see http://www.apfc.org/.
[9] See http://www.iied.org/mmsd/mmsd_pdfs/capacity_building_png.pdf.
[10] See http://www.unglobalcompact.org/Issues/transparency_anticorruption/index.html.