Managing and Spending Resource Revenues Well

By Andrew Bauer

Summary

While large-scale oil, gas or mineral production can be a blessing, generating revenues to accelerate economic growth and reduce poverty, it can also lead to major macroeconomic and structural challenges. These can include:

- Wasteful spending and mismanagement of revenues
- Real exchange rate appreciation (aka Dutch disease), which is harmful to exporters and can create dependence on natural resources
- Destabilizing government budget volatility
- Exchange rate and inflation volatility
- Debt crises fueled by resource revenues
- Conflict over control of resources

Parliamentarians can propose policies to overcome each of these challenges and can ensure that revenues are managed in the public’s best interest. For example, parliamentarians can introduce or improve natural resource funds or revenue-sharing regimes, as well as ensure that the government invests for the benefit of present and future generations.

Revenue management strategies

Natural resource funds

Natural resource funds (NRFs) are government investment accounts funded through oil, gas and mineral revenues. In 2009, there were at least 48 active NRFs in 34 countries, representing more than $2 trillion in assets. While these funds have often reduced volatility or saved money for the benefit of future generations, many have mismanaged or squandered resource revenues. In some cases, they have even contributed to debt crises.

NRFs have a variety of objectives. Stabilization funds are designed to reduce exchange rates, inflation and/or revenue volatility and to provide governments with a steady stream of revenue for the annual budget. Savings funds are designed to save revenues for future generations through smart investments. To protect the nation’s inheritance, withdrawals are generally made only under strict conditions, like when resource revenues are exhausted. Development funds assign oil revenues to development projects in high-return sectors, such as infrastructure, health or education. If designed with appropriate transparency and oversight mechanisms, NRFs can safeguard revenues from mismanagement and theft and reduce the negative impacts of destabilization exchange rate volatility.
Table 1: Examples of Natural Resource Funds

<table>
<thead>
<tr>
<th>Country or Province</th>
<th>Current Name</th>
<th>Objective</th>
<th>Date Established</th>
<th>Total Assets (billion USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abu Dhabi (UAE)</td>
<td>Abu Dhabi Investment Authority</td>
<td>Savings</td>
<td>1976</td>
<td>627</td>
</tr>
<tr>
<td>Norway</td>
<td>Government Pension Fund-Global</td>
<td>Savings</td>
<td>1990</td>
<td>520</td>
</tr>
<tr>
<td>Kuwait</td>
<td>Kuwait General Reserve Fund</td>
<td>Multiple</td>
<td>1953</td>
<td>296 combined</td>
</tr>
<tr>
<td></td>
<td>Reserve Fund for Future Generations</td>
<td>Savings</td>
<td>1976</td>
<td></td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>National Fund</td>
<td>Stabilization</td>
<td>2000</td>
<td>39</td>
</tr>
<tr>
<td>Chile</td>
<td>Pension Reserve Fund</td>
<td>Savings</td>
<td>2006</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Economic and Social Stabilization Fund</td>
<td>Stabilization</td>
<td>2007</td>
<td>13</td>
</tr>
<tr>
<td>Alberta (Canada)</td>
<td>Alberta Heritage Savings Trust Fund</td>
<td>Savings</td>
<td>1976</td>
<td>15</td>
</tr>
<tr>
<td>Timor-Leste</td>
<td>Petroleum Fund</td>
<td>Savings</td>
<td>2005</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>Infrastructure and Human Capacity Development</td>
<td>Development</td>
<td>2011</td>
<td>1</td>
</tr>
<tr>
<td>Botswana</td>
<td>Pula Fund</td>
<td>Savings</td>
<td>1996</td>
<td>7</td>
</tr>
<tr>
<td>Mexico</td>
<td>Oil Revenues Stabilization Fund</td>
<td>Stabilization</td>
<td>2000</td>
<td>6</td>
</tr>
</tbody>
</table>

A poorly designed fund can lead to spending on large, wasteful projects, known as “white elephants,” or significant losses from bad investments. The Libyan Investment Authority is a case in point: it paid millions in fees to externally managed funds only to accrue millions in losses.

In countries where a NRF exists, parliament could ensure that rules and investment strategies reflect the fund’s objectives, revenues are spent on development projects, fund spending does not bypass parliamentary approval, and the government does not make risky bets with public money. In countries without NRFs, parliamentarians could consider whether NRFs are an appropriate tool to address domestic challenges.

Revenue sharing and cash transfer programs

Almost every resource-rich country shares oil, gas and mineral revenues between the national government and local governments or other groups, either by redistributing from the national to sub-national levels or sharing taxation rights among jurisdictions. However, systems differ in terms of whether or not revenues are fairly distributed, reduce or increase inequality and conflict among regions, and cause waste.

Revenue-sharing regimes should have clear objectives (e.g., compensation to producing areas for costs of production and reducing inequality among regions), and they should be designed to meet their objectives. For example, if the goal is to promote equality among regions, an objective formula could be used to determine how much revenue goes to each region. The formula could include poverty, education and population indicators, as in Indonesia and Mexico.

Any regime should also be predictable, transparent and accountable as well as promote good management of resources. In Bolivia and Ghana, subnational governments claim they are not getting their fair share due to a lack of transparency. In Indonesia, where regional governments receive 80 percent of mining royalties and 15.5 to 30.5 percent of oil and gas revenues, producing districts generally spend lavishly when resource prices are high and cut their budgets in poor years.

Transferring revenues directly to citizens is another form of distribution. Direct cash transfer programs, like those in Alaska, Bolivia and Mongolia, can improve public monitoring of extractive companies, quickly and efficiently ensure that citizens benefit, and reduce corruption and vote-buying. However they can also hinder financing for large public investments, such as roads, electricity grids, and health and education systems.
Parliamentarians should ensure that revenue-sharing regimes meet the following criteria:

- Have clear objectives
- Have a design that achieves objectives
- Balance national priorities and local autonomy
- Promote fair distribution
- Provide relatively predictable, stable allocations
- Be simple and transparent

Parliamentarians could also publicly discuss whether cash transfers are an appropriate strategy for managing resource revenues in their countries and whether direct transfers to the poor would reduce poverty and improve livelihoods quickly and efficiently.

**Spending strategies**

Resource-rich countries face a special set of spending challenges. Unlike most low-income countries, their governments often have a lot of money. The result is often overspending on large, expensive infrastructure projects or monuments with limited benefits for citizens or the economy. Additionally, large inflows of foreign money often lead to a strong currency, making domestic exporters uncompetitive. The most effective way to overcome these challenges in the long run is to invest well and diversify the economy.

**Investing well**

Since countries tend to spend on large, expensive infrastructure projects, it is crucial that projects be properly designed and implemented at a reasonable cost to taxpayers. Several steps are needed to guarantee this happens:

1. **Development Planning and Prioritization**: Governments should create a coherent national development plan that outlines the country’s approach to development and the projects needed to achieve its objectives. The plan should receive widespread support and be formally linked to the annual budget process.

2. **Appraisal of Costs and Benefits**: The decision to undertake a specific project should be based on an analysis of the social, economic and environmental costs and benefits in the short- to long-term.

3. **Independent Technical Review**: Projects should be reviewed by an independent and specialized technical agency before contracts are signed.

4. **Competitive Procurement**: Contract bids should be public and competitive. Bids should be ranked based on a combination of criteria including cost, quality, speed of delivery and past history of the contractor.

5. **Monitoring of Execution**: Infrastructure specialists should oversee every aspect of construction to see that the contract is being fulfilled. Action should be taken against contractors who are not delivering.

6. **Operations and Maintenance**: Adequate funding and training should be provided to ensure the proper operations and maintenance of the infrastructure.

**Investing for diversification**

Diversification can take several forms. Governments can invest in nonresource sectors, such as agriculture or tourism, to make them internationally competitive. Governments can also invest in the overall well-being of people by improving infrastructure, health and education systems and enhancing economic productivity and international competitiveness. These types of investments not only help people now, but also establish conditions for future growth. Finally, countries can diversify within the resource sector by creating a downstream industry (e.g., refineries and
plastics) or developing skills to market to other countries. Whichever strategy is chosen, annual budget decisions should be linked to a medium- and long-term national development plan.

**What parliament can do**
Parliament can attempt to persuade the government to use resource revenues efficiently and for the public good or force the government by legislating rules. Specifically, parliamentarians can:

- Encourage critical debate on government policies by holding media briefings and informational hearings.
- Build political consensus around the need for reforms of revenue and expenditure policies.
- Shed light on the revenue management system, large infrastructure project cycle or economic diversification strategy by producing a committee report assessing the strengths and weaknesses of each.
- Develop an alternative plan or policy to share with the government.
- Exercise powers to monitor the cost, quality and speed of delivery of large infrastructure projects. When projects are poorly constructed or managed, contractors should be sanctioned or replaced.
- Sanction officials who act unethically or disregard the public interest.
- Introduce legislation creating or modifying a natural resource fund, revenue-sharing regime or cash transfer system.

**Questions parliamentarians can ask**
- Does my country have a coherent medium-term national development plan? If not, why? If so, does it address my country’s challenges, and is it used in annual budget planning?
- If my country has a natural resource fund:
  - What are the deposit, withdrawal and investment rules? Are these the right rules?
  - Are there any indications that funds are misused or not used effectively for the betterment of the country? What actions can be taken to address these problems?
  - Are its investments safe from risky bets, and are citizens getting a good return?
- If my country does not have a natural resource fund, should it create one?
- If my country has a revenue-sharing regime:
  - Does the regime promote fiscal responsibility and accountability of officials?
  - Is the revenue fair to different regions and groups? If not, what changes need to be made?
  - Would direct cash transfers be an appropriate policy?
  - Is the government actively pursuing a policy of economic diversification?

**Further learning**
Parliaments can improve their understanding of revenue management and development plans by:

- Ask civic groups or parliamentary staff to prepare briefings that identify options, challenges and available tools for managing and spending revenues well.
- Reach out to parliamentarians from other countries that share similar challenges to see how they addressed the issues.
- Contact Revenue Watch or reading our publications on revenue management and economic diversification at revenuewatch.org/issues/economic-diversification or revenuewatch.org/issues/revenue-management.

---

**Successful Economic Diversification in Malaysia**

Malaysia is an example of a country that successfully diversified. By keeping inflation low and stable, managing the exchange rate and controlling fiscal deficits, the government created a growth-friendly macroeconomic environment. The government also encouraged growth in target sectors, specifically palm oil and electronics, by creating business incentives (e.g., building infrastructure and low trade tariffs), and directly subsidizing production.