2015 Parliamentary Seminar Helsinki

Parliaments and revenues from Extractive Industries

March 24-26th, 2015

WORLD BANK GROUP
Governance

World Bank-Finnish Parliamentary Partnership

Contents

1. Seminar Overview

Each year the Parliament of Finland hosts an event in Helsinki that provides a unique opportunity for parliamentarians, parliamentary officials and their staff, as well as experts in governance and influential thought leaders from Finland and around the world, to come together to share experiences and knowledge on important global issues of concern for parliamentary development. This year's seminar, organized by The World Bank Group (WB) in partnership with the Parliament of Finland, took place March 24-26, 2015 and titled *The Role of Parliament and Extractive Industries Revenue*. The event brought together some 30 members of parliament (MPs) and key parliamentary staff from the legislatures of countries that either already have a substantial extractives industry, or are at the exploratory stages of developing the sector, to explore the role that parliaments can perform to harness and steward natural for the benefit of their national communities through ensuring effective revenue management. Delegations from Kenya, Ghana, Tanzania, Somalia, Zambia, South Sudan, Timor-Leste, Mongolia, and Iraq were represented.

Resource-rich developing countries face unique challenges to make sure that revenues from the extractive industries (EI) are efficiently used to foster economic development, reduce poverty and promote shared prosperity. Effective governance of extractive revenues is a precondition to ensuring that the 'development dividend' that should flow from the decision to extract becomes a reality. Good governance of the sector requires participation, transparency, and accountability across the entire EI value chain with a number of stakeholders contributing to the governance objectives including government agencies, the private sector, civil society and formal accountability institutions such as parliaments.

Parliament - as a constitutionally-mandated deliberative institution with direct responsibility for approving the annual budget and overseeing the government – is increasingly coming to the fore as a key stakeholder that can ensure extractive revenues are equitably shared and contribute appropriately to overall economic development and poverty reduction objectives. In particular, parliaments have the power to ensure that extractive revenues are accurately captured in budget forecasts and estimates, to confirm that appropriations are focused on delivering services to affected communities, and to exercise effective oversight of government management of the sector.

The 2015 Helsinki Seminar specifically set out to:

i. Equip legislators with the technical knowledge to design policies and frameworks that will optimize state revenue flows from extractive industries

ii. Enhance awareness of the different tools and processes that parliamentarians can use during the estimates process in order to better track revenue and expenditure related to the sector

iii. Strengthen the capacity of parliamentarians and parliamentary staff involved in the estimates process to undertake budget analysis.

2. Delegate Feedback

A series of discussions, panels sessions, case studies and exercises were led by speakers and practitioners, all being acknowledged specialists in the extractives sector and/or related financial and investment fields. High levels of satisfaction were expressed by many of the client country participants during the event and subsequently, who felt that they had benefited considerably from attending the seminar and had gained valuable and practical knowledge from the expert speakers, case studies and peer interaction and, as a result, are in a good position to improve the effectiveness of parliamentary oversight of the extractives sectors in their respective jurisdictions. Their participation, feedback and specific requests were also particularly helpful to the World Bank and other global-interest attendees in that they have assisted in the identification of future priorities and realignment of support strategies.

3. Introductory Remarks

During opening remarks by the Parliament of Finland and the World Bank, the importance of interaction and dialogue between the parliaments of different nations was emphasized. An overview of the Helsinki Seminar was provided, outlining the role the Annual Seminar plays in convening parliamentary leaders to discuss and exchange knowledge on matters of interest to parliamentary development. This year's theme, is concerned with how to better equip parliaments to plan, forecast and manage the significant revenues coming from the extractives sector, drawing on lessons and case studies involving revenue management models, financial forecasting and estimates and fiscal issues. The facilitators briefly previewed the presenters and specialist participants, all of whom had been selected for their expertise which would be of great interest and benefit to the attending parliamentarians, and explained how country case studies and specific experiences will be used as a tool to stimulate discussion, highlight the issues that need to be addressed and provide a basis for identifying potential solutions. Hassane Cisse, Director of the Governance of Global Practice Unit at The World Bank Group, added his welcome to all participants and thanked the Parliament of Finland for hosting the seminar and for their ongoing support for parliamentary democracy around the world.

4. Keynote Address: Finland's Role in the EITI process

Ambassador Pekka Hukka, from the Ministry of Foreign Affairs in Finland, member of the EITI International Board and involved in coordinating the Financing for Development Conference to be held in Addis Ababa in July 2015 which aims to develop an agenda for sustainable development, find solutions to the issues around financing the Sustainable Development Goals and obtain a global consensus on the approach, delivered the key note address. He began his presentation by observing that that for many countries –developed and developing – extractive industries make up a considerable part of gross domestic production, and are important sources of employment and income. He went on to describe how Finland's economic development had historically come about from the utilization of natural resources - originally forest products - and how mining has for some time constituted the main extractive industry with opening of new mines in recent years and rising output being a response to growing international demand for minerals. In fact, the extractive industry, refining technology industries and related research and development continue to represent a major growth area for Finland.

Ambassador Hukka outlined the Finnish government's program for the sector which aims to promote sustainable use of natural resources that focuses on domestic growth and well-being, as well as on developing solutions to address the global challenges of environmental damage mitigation and ecosystem preservation. He pointed out that sustainable extractive activities are, however, implemented by companies (not governments) and their commitment to measures that minimize environmental impact, create employment and welfare and improve international competiveness is needed in order to gain social support for their operations. Such support, known as *social license*, can only be earned and maintained through responsible conduct by the companies. He added that Finland has introduced new mining laws, mineral policies and a new bio-economy strategy that now form the basis of all extractive activities with government policy creating linkages to regulation, including land policy, that are necessary in a natural resource economy.

Finland's story, Ambassador Hukka confessed, has not always been one of flawless success, the impact of the recent economic downturn and lower global prices combined with difficult weather conditions having pushed the Talvivaara bioheapleaching nickel and zinc mine into major difficulty. In addition to severe economic consequences, this has had a major human impact. As one of the biggest shareholders, Ambassador Hukka described how the government is working to address the problems to continue mining operations and provide much-needed employment in north-east Finland, but while still ensuring sustainable and economical use of natural resources and minimization of adverse environmental impacts.

Ambassador Hukka described how in 2013 Finland's government set out a formal plan and timeline through to 2019 to become a global leader in sustainable extractive industries centered on a government-led multistakeholder working group with broad public sector (ministries and local government), business (including mining and tourism) and civil society involvement. Among the top priorities and objectives of Finland‘s development policy programme is a move towards an inclusive green economy and sustainable use of natural resources. One important initiative to support these objectives is the Extractive Industries Transparency Initiative (EITI), to which Finland signed-up in 2008 and is currently serving a 2-year period on the Board of the EITI-initiative and representing a group of supporting nations. A recent government resolution on corporate social responsibility asked the relevant authorities to study the possibilities of Finland implementing the EITI-standard and "accepting and to start using EITI-standards by 2015" was a recommendation of a broad-based working group tasked with planning how the country would become the world leader on sustainable mining. The ministries of Economy and Employment and Foreign Affairs are each working towards clarifying and assessing the potential impacts of full EITI implementation with relevant stakeholders and international EITI-secretariat. In Finland's case, EITI has been a development cooperation instrument mainly facilitated through the World Bank Trust Fund and through support to the EITI secretariat, but also via some country level operations, for example, working with Tanzania to include a forestry component in its EITI-program. In a related activity that is linked with geological resources, the Geological Survey of Finland has also been involved in activities such as mapping, surveying and capacity enhancement.

Ambassador Hukka went on to suggest that the global "resource boom" – even though cooling off in the short-term – is providing many developing countries with a great opportunity to promote their own development processes. The challenge, Ambassador Hukka contended, lies in converting temporary windfall from the use of natural resources – non-renewables for only one-time use - to a sustainable economic and human development that will penetrate throughout the population. While the track-record of developing countries that are rich in natural resources could be much better, there has nevertheless been progress in the political and economic environments through initiatives such as the African Mining Vision and increasing awareness of the importance of transparency and accountability in order to access a better share of the value chain.

Ambassador Hukka briefly summarized developments in the EITI initiative, an international standard that started 10 years ago in order to improve transparency and accountability around oil, gas and mineral resources and is developed and overseen by a coalition of governments, companies, civil society, investors and international organizations. The EITI-process is mostly about transparency on the use and management of natural resources, those resources that contribute to the mobilization of domestic resources and how these are allocated. It's function depends on two basic parameters - transparency increases when the oil, gas and mining companies disclose their payments to the government, and when the government discloses its receipts. Figures are independently reconciled and published in annual EITI reports along with contextual information about the extractive sector. All parties stand to benefit from participating in the EITI process. Governments benefit from following an internationally recognized transparency standard that demonstrates commitment to reform which can lead to improvements in taxation and enhanced trust and stability in a volatile sector. Companies benefit from a level playing field in which all companies are required to disclose the same information, and from an improved and more stable investment climate. Citizens and civil society benefit from receiving reliable information about the sector and a multi-stakeholder platform where they can better hold the government and companies to account. The latest revision, agreed by the EITI Board in 2013, broadens transparency and accountability to the full extractive value-chain, from licenses and contracts, production, tax collection, revenue distribution and expenditure management. The standard produces more relevant and reliable data for decision making. The EITI-process has important links and contributes to the ongoing reforms of public finance management reforms, including taxation, local government reforms, and better linkage to wider reforms, such as valuing natural resource wealth, taxation and macroeconomic management.

In the nearly ten years that EITI has been in operation, it has made great progress and has some 50 countries have now implemented the EITI Standard. However, as with other global initiatives, however, Ambassador Hukka observed that there are no "quick fixes" in implementing EITI and it requires much effort, improvements in public financial management and improved enforcement at country level. Moreover, while EITI supports reforms, it is not an end itself, but rather a tool and while implementation is tasked to a country specific multistakeholder group, government must show leadership in executing the reforms. Ambassador Hukka went on to recommend that more is must be done to integrate EITI into government systems, make reporting more timely and useful, present data in a more accessible forms and ensure consistent validation – upholding the standard – to a higher quality assurance mechanism. As he put it, EITI is not something that a country graduates from but rather requires persistent effort to maintain the standard. Issues like corruption, and openness and respect for civil liberties remain an enormous challenge and EITI compliance does not necessarily mean that a country is free of corruption.

Ambassador Hukka described the success stories of the Republic of Congo (the Congo) and the Democratic Republic of Congo (DRC) which have made significant strides in implementing EITI. Congo Brazzaville reports quarterly on the significant flows of money that result when the national oil company SNPC sells oil. In the DRC, the EITI report lists the natural persons who own or control of 40 privately held companies, information on some controversial barter deals between international companies and the state-owned companies, and increasing information on artisanal mining and smuggling. However, while these are important achievements, both countries still face significant challenges.

Ambassador Hukka next outlined his thoughts on the role that MPs can play in the EITI process and, more broadly, on management of natural resources. Firstly, MPs should become better informed and more effective overseers of the EITI process within and across party lines, and work towards internal parliament coherence between committees and with their peers in other EITI countries. Secondly, legislators are in a position to build public awareness about EITI since citizens do care about whether the proceeds of natural resource extraction in their country are benefitting them, but tend to know little about what the government receives, or how it spends extractive industries revenues. Finally, legislatures, through their lawmaking capacity, can ensure that their governments sign-up to and participate meaningfully in the EITI process. Ambassador Hukka observed how several countries have run into legal obstacles to EITI implementation, and a revision to the laws has been required.

Concluding his presentation, Ambassador Hukka suggested that the EITI is in many cases a reflection of a commitment to reform. The task of the international community and MPs should be to continue efforts to make the EITI a better instrument for those wishing to use it for reforming the extractives sector. The EITI is a system based on the conviction that lasting change will only be achieved if it comes from within. Outsiders cannot force or buy such a reform. Development experience shows that when the reform agenda is locally owned, long lasting results follow.

5. The Role of the Finnish Parliament in Revenue Management

The spending limits system used in Finland is an effective operational instrument for planning and implementing fiscal policy.

After opening remarks, Matti Saarinen, Member of Finance Comitee from the Parliament of Finland provided an overview of the powers of the Parliament in Finland, spending limits and the budget process.

Although decision-making powers under the Finnish constitution are extensive (with no limitations) in relation to amending the budget, in practise they tend to be used restrictively with, for example, the spending limits (approved by the Government) being the ceiling for expenditure. In the 1990s, Parliament's budget power changed so that today the budget is less specific and net budgeting means that income and expenditure are no longer budgeted for separately. A sizable part of state economy has been shifted outside the budget economy, with many state agencies having been turned into business enterprises. The annual budget is to a large degree based on the spending limits proposed by the new government after elections, and valid for the whole electoral period. At the same time as the budget powers of Parliament have been diluted, the powers and capacity of the monitoring authority have increased.

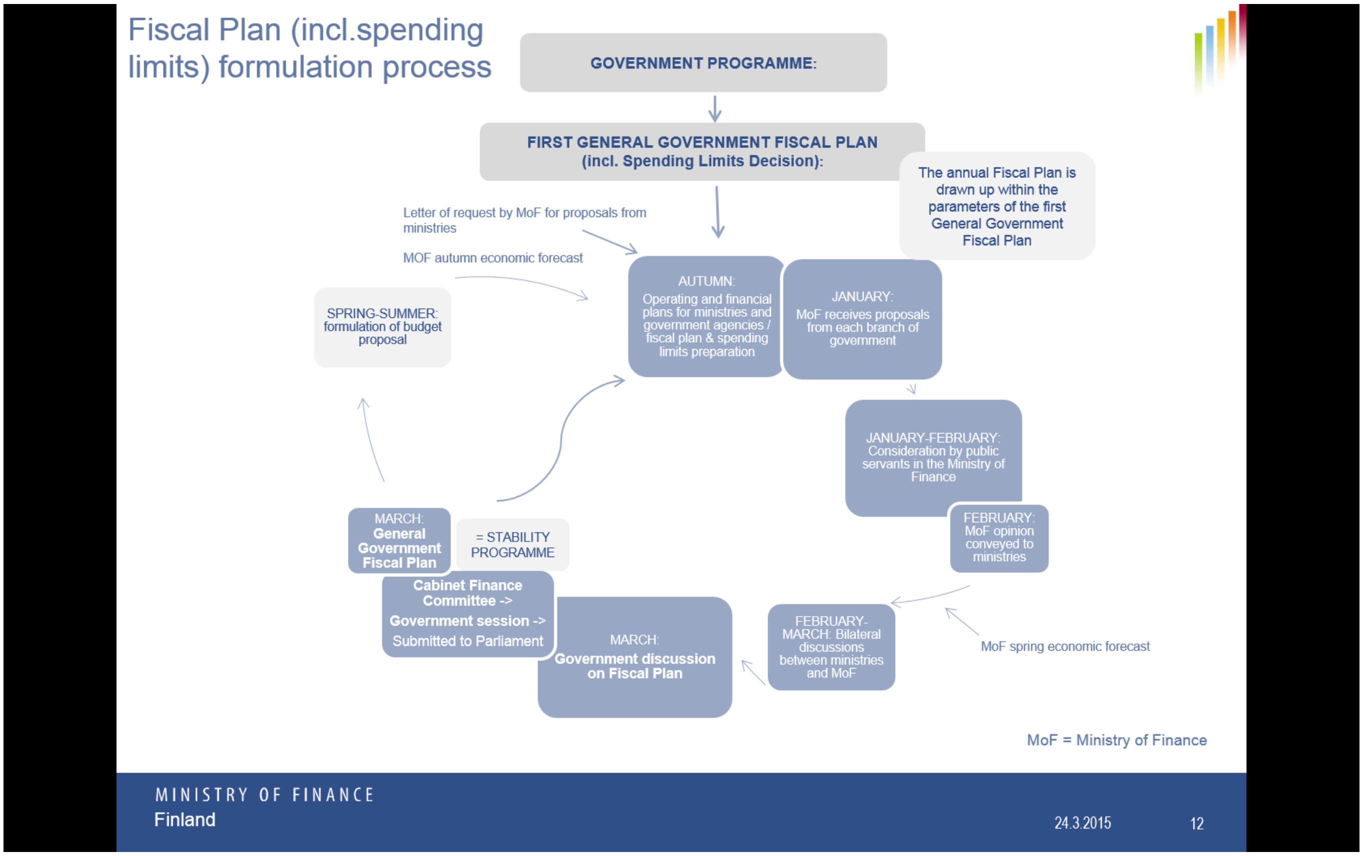
The budget actors in the Finnish Parliament are the Finance Committee (the lead role), 16 sectoral committees that can make recommendations to the Finance Committee plus the Audit Committee that oversees the management of government finances and compliance of the budget. After the government submits its budget proposal to Parliament in mid- September, a preliminary debate in plenary session takes place, lasting at least three days. The Minister of Finance presents the main points of the budget and at the end of the preliminary debate, the proposal is referred to the Finance Committee. Members are able to submit budgetary initiatives (e.g. that an appropriation be increased or reduced, or that a new appropriation be added for a specific purpose) within ten days of the goverment submitting its budget proposal. Such amendments are presented for Parliament to vote on when the plenary session next discusses the budget in December after the committee stage. In recent years as many as 500 to 1,000 such initiatives have been submitted but few of them have been approved. The Finance Committee's report serves as the basis for discussion in the December plenerary where the budget is debated in a single reading which includes debate on each sector and voting on individual MP initiatives. Handling the budget in plenary session takes several days and includes many votes, but more often than not the plenary session approves the Finance Committee's report without changes. The budget is ready for implementation once it has been approved by Parliament and published as law in the Collection of Statutes of Finland.

The Finance Committee has 21 members and 19 deputy members.

For the purposes of its practical work the committee is divided into eight subcommittees – each subcommittee has 11 members:

1. Subcommittee for Administration and Security
2. Subcommittee for Education and Science
3. Agriculture Subcommittee
4. Communication Subcommittee
5. Subcommittee for Employment and the Economy
6. Subcommittee for Municipal and Health Affairs
7. Housing and Environment Subcommittee
8. Tax Subcommittee

Risto Hakoila, Director of Finance Ministry for Foreign Affairs described in more detail how the government's general fiscal plan covering all general government finances, is developed. Medium-term budgetary targets are set - independent of the macroeconomic forecasts of the Ministry of Finance - for general government finances and each subsector. The fiscal plan includes central government spending limits that includes all on-budget expenditures. While not legally binding and based on political commitment, the spending ceiling has not once been exceeded, even during the recession periods. The system, which has been in place since 2003, is seen as a key operational instrument that has increased the predictability of fiscal policy and limited expenditure growth with the government having committed to follow the spending limit rule and expenditure ceiling throughout its 4-year term. Hakoila explained how that although formal spending limits are set for each administrative branch and allocation between different appropriations is set out in the annual budgets, in reality limits are negotiated and decided at appropriations level. Budgeting is based on the concept of performance-informed planning in which performance is linked to the appropriation in the explanatory statements of the budget and each ministry is obliged to issue an annual statement covering all performance reports in its domain. Guidance and management of government activities in Finland use a 'management by results' system which leaves considerable autonomy and discretion to the directors of the government agencies to adopt those measures that will deliver optimum performance.



6. Revenue from non-taxable resources: Sovereign Wealth Funds

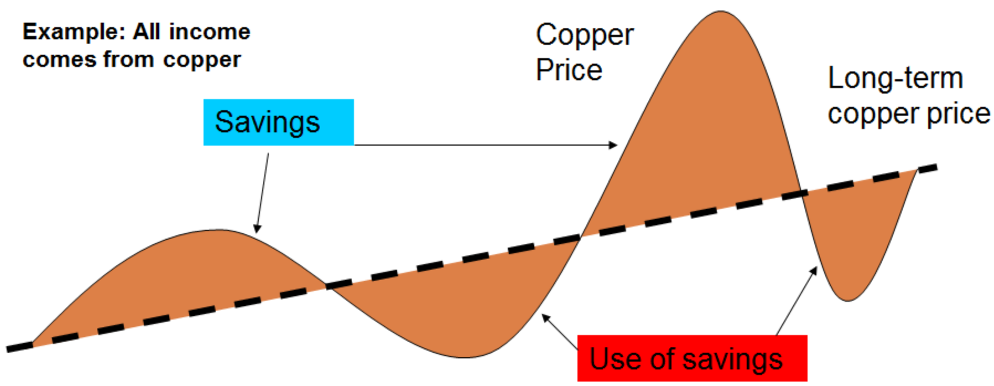
In discussions with politicians and parliamentarians, international development organizations need to adopt particular caution when discussing SWFs in relation to revenue management models.

As self-insurance mechanisms for attaining/retaining fiscal discipline in a volatile world economy, SWFs should not be political fads. They should only be established after full, collaborative discussions with both parliament and government on the specific business circumstances of the country. For example, the model should not be proposed in countries which run a deficit each year.

Victoria Barbary from the Sovereign Wealth Center, an institution that provides actionable intelligence on Sovereign Wealth Funds (SWFs), introduced SWFs as popular vehicles for revenue management in resource-rich economies. She outlined what she sees as the 3 central tenets for setting up and managing SWFs, viz. (1) there must be clear deposit and withdrawal rules (stated in the legislation); (2) SWF must have clear objectives; and (3) SWF must be transparent and offer full disclosure for stakeholders. Referencing SWFs in Abu Dhabi, Kuwait, Norway, Ghana, and Azerbaijan, Ms. Barbary put forward a clear "one instrument, one rule message" for a successful SWF, that is a simple and singular objective is preferable to attempting to accomplish multiple objectives, a theme that was picked up in subsequent discussions. Barbary proposed that a SWF's founding legislation should clearly state its purpose, whether that be intergenerational savings, stabilization or economic development, and the return expectations should be calculated in advance of the fund's establishment.

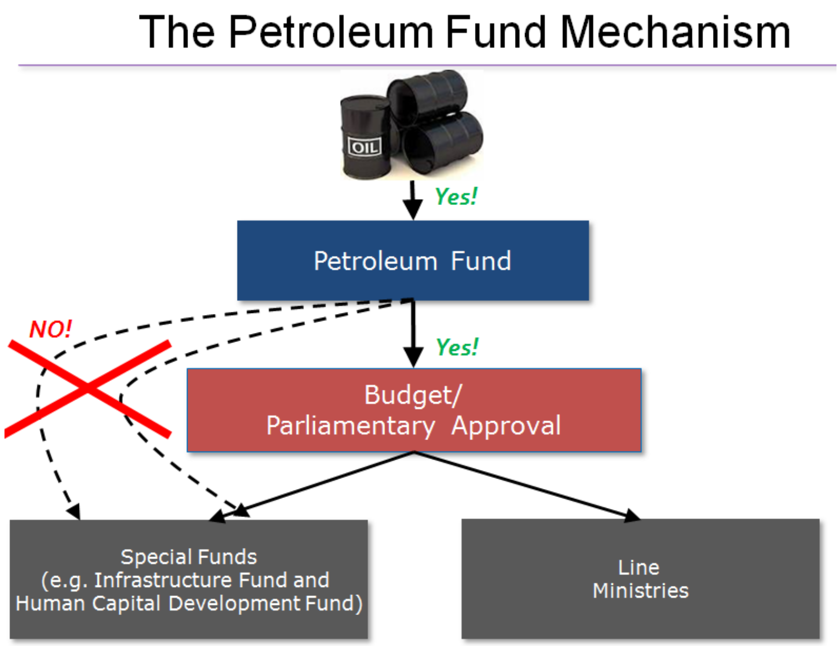
Eric Parrado, Superintendent of Financial Institutions in Chile, shared his experiences as International Financial Coordinator and adviser to the Minister of Finance of Chile (2007-2010). Drawing upon the successful Chilean experience, Mr. Parrado's advice to countries with major volatilities in revenues was to think in terms of permanent income and revenues, and to manage spending to a similar trajectory. In light of increasing interest in SWFs, Mr. Parrado proposed that the first and most important consideration should be setting fiscal rules in terms of flows and not stocks. He advised that surpluses are required for having a SWF and that in situations where fiscal deficits are run each year, a SWF is not appropriate. Parrado cited the case of Brazil which has had to issue debt to fund the SWF, which is counter-intuitive to the mandate of a SWF. The links between good economics and being prudent were emphasized, and the necessity for having a complete and comprehensive fiscal policy framework, which will ultimately achieve the political dividends. He pointed to the case of Chile, where the government saved during high revenues in order to be in a position to spend during the economic downturn, and was subsequently re-elected. The Chilean example of copper (see diagram) shows how macroeconomic risk can be reduced by saving money during periods of high revenues which has a counter-cyclical effect on the business cycle as shown. This approach ensures financial sustainability of government policies, allows for long-term planning, reduces spending volatility, and secures financing of ambitious social agendas. This will in turn protect export competitiveness during copper price booms by avoiding unsustainable fiscal spending increases and the resulting transitory exchange rate appreciations, and will also boost public saving, reducing the need for historically volatile external financing in times of crisis or recession.

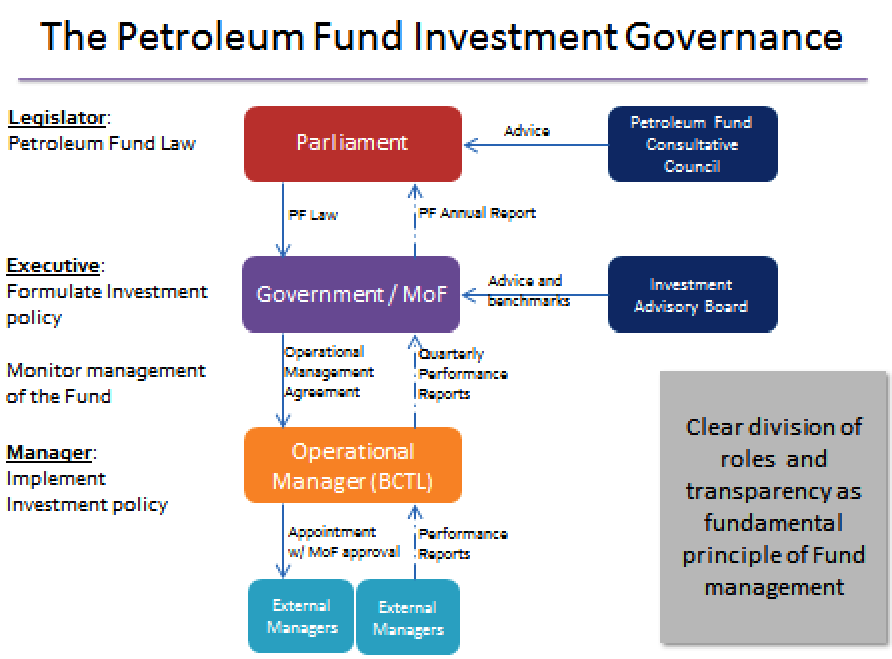
Fiscal stabilization: the fiscal structural surplus rule



- The long-term copper price defines permanent income, contributing to have a countercyclical policy

Filipe Bernardo, Acting Coordinator of the Petroleum Fund Administration Unit in the Ministry of Finance in Timor Leste, stressed the importance of keeping the SWF legitimate. The main risk of running any fiscal discipline device is that it is used for politically illegitimate purposes. All expenditures should be accounted for through the budget - not off budget - and therefore subject to full parliamentary scrutiny and sign off. His case study was the TL Intergenerational Fund which from 2005 to 2014 received $20bn in revenues in circumstances where petroleum revenues supported approximately 85% of government expenditures allocated in the 2015 Budget. Timor Leste is an example of a small economy ($1bn GDP) where the need to save revenues is particularly critical as spending them would most likely result in wasted funds and an overheated economy. In fact, as Bernardo observed, Timor Leste, had learnt this the hard way in 2012 when $1.5bn withdrawals resulted in inflation jumping to 70% forcing realignment of its public expenditure-driven economy. Underlining Parliament's vital role in the SWF governance structure, he showed how the only way to withdraw money from the Fund is via transfer to the state budget, which requires parliamentary approval (see diagram below). The ESI (estimated sustainable income) is a benchmark indicating the level of annual withdrawals that is sustainable over the long term and each year estimated sustainable income ESI is 3% of Petroleum Wealth. The Government may transfer more than ESI as seen fit, provided that justification and certification reports are provided to Parliament. The essential component of a SWF success is to have a clear governance structure so everyone knows his/her responsibilities and everyone shares the same vision. For instance, (as per diagram 2) operational investment comes under the Central Bank but on an annual basis it must report to Parliament. As Mr. Bernardo concluded, Timor Leste has recognized that its oil supply will not last forever and the need to establish a long-term fiscal framework. It is, therefore, in the process of diversifying its economy to prepare for the future, focusing primarily on two sectors - agriculture and tourism.





7. The Revenue Debate: How much to Spend?

The need for effective revenue management frameworks

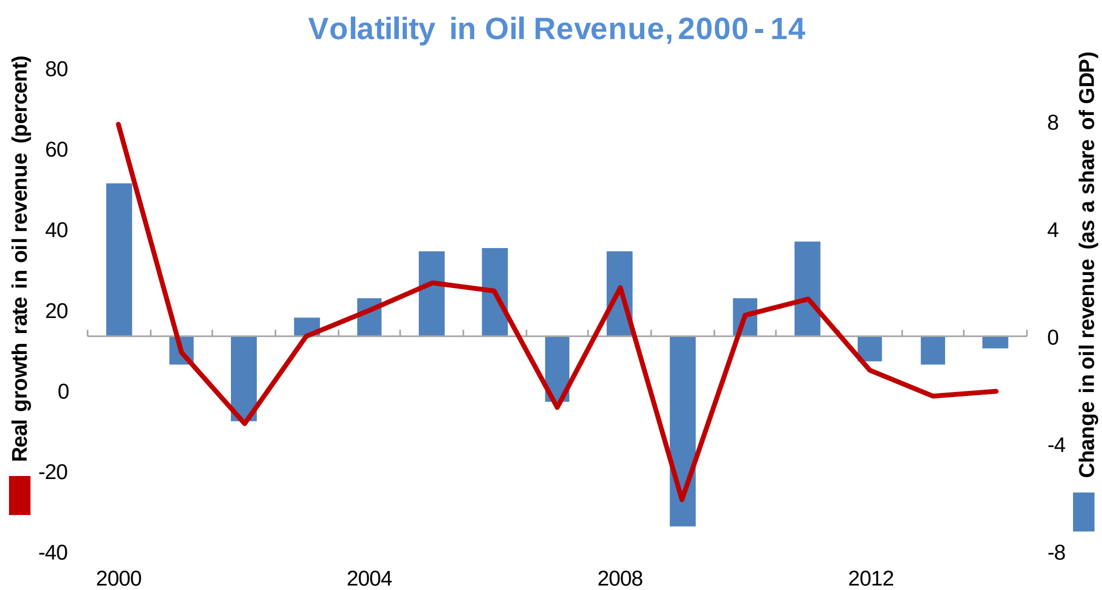
Depending on which stage of the extractive process a country has reached, it is important to implement and oversee a framework of revenue management that strikes an appropriate balance between: (1) providing sufficient revenue for the state-provision of services to communities; and (2) sustaining future investment in the sector. Delegates emphasized the importance of reaching the right revenue balance at the outset as well as the need to build capacity in existing institutions and strength appropriate fiscal regimes.

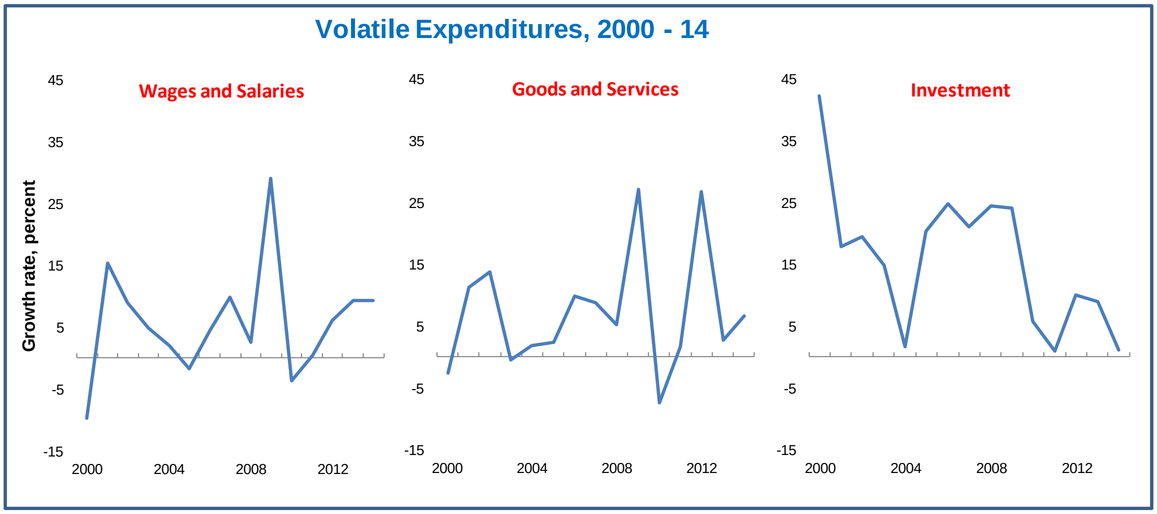
Strong consideration of broad macro-fiscal policy objectives is needed when approaching the equity debate in relation to E.I. windfall revenues.

Priorities will differ from one country to another, but arriving at the right balance between how much to save and how much to spend should take into consideration broad macro-fiscal policy objectives.

In this session two global financial experts presented the opposing arguments in this well-established policy debate and elucidated the different macroeconomic policy decisions involved. Paulo Medas, International Monetary Fund, advocated the benefits of a more prudent "saving" approach, while Mark Henstridge, Chief Economist at Oxford Policy Management, represented the spending side.

The results from many cases of resource windfalls have been disappointing and, on average, resource-rich countries tend to experience less growth than non-resource countries. This has caused economists to question whether resources constitute a blessing or curse and further to explore the enigma of what has prevented some countries from taking advantage of their newly-discovered assets. While development of natural resources can generate a large revenue windfall with potential to address infrastructure and social needs, Paulo Medas discussed the difficulties of translating these revenues into economic sustainable development. He pointed out that revenues tend to be volatile and are in foreign currencies which can place pressure on the domestic economy and exchange rates, introduce inflation and make other exports less competitive. Fiscal and public policy are significant, but the fiscal institutions in many countries have not been strong enough to manage windfalls and resist corruption. Boom-bust cycles cause volatility in commodity prices and in many cases, countries have been unable to protect economies from the instability being transmitted to the national budget and disrupting expenditures (see graphs). For example, the large falls in the oil price and in the prices of metals and minerals seen in recent years – e.g. in the second half of 2008 oil prices fell by 70% - have been deeply subverting to long term expenditure and key aspects of the budget in many producing nations. Medas proposed, therefore, that it is necessary to de-link expenditures from revenues in order to avoid large fluctuation in social provisions, which would cause much discontent and resentment. He suggested a profound need for an appropriate fiscal anchor to ensure a smoothing of public spending to obviate the need for major readjustment when resource wealth is depleted. Fiscal anchors could, for example, take the forms of a Non-Resource Primary Balance (NRPB) to stabilize a non-resource balance (non-resource revenue minus expenditures), or a Structural Primary Balance (SPB) to stabilize balance over the cycle (no concerns with resource depletion for long period) or even expenditure growth rules to supplement the NRPB and SPB. Possible benchmarks for determining exactly how much to save might vary from a "bird-in-hand consumption" model where spending is limited to the returns on wealth – a model which tends to be more relevant for high-income countries - to a Permanent Income Hypothesis (PIH) which looks to smooth consumption and can be combined with a scaling-up investment, which is advisable for countries with large infrastructure needs.





Representing the "savings" approach, Mark Henstridge proposed that while revenues from extractive industries have the important potential to positively impact human development indicators and help overcome acute deficiencies in education and health provisions in developing countries (see diagram below), when making broad spending policy decisions there needs to be consideration given to which channels are most appropriate to invest. For example, should the priority be (1) recurrent spending on health and education, (2) capital spending on infrastructure and O&M or (3) industry spending on construction and operations. Decisions on the most appropriate investments for achieving the best results - such as in direct human capital, public capital (indirect: supports GDP growth and jobs), infrastructure, training and jobs and other supply chain development (direct impacts) – all need to be considered. Moreover, when facing the challenge of unlocking the opportunities for translating new resource discoveries/sub-soil assets into human capital, Henstridge pointed out that countries need to identify the links between the natural resource and human development. It is likely that most of the people to benefit from these revenues do not actually work in the sector and the policies that are decided will need to address the vibrancy and economy of the non-resource sectors. Of particular relevance to parliamentarians is the length of time between discovery and production and their role in managing realistic expectations in the population, an aspect that was of particular interest to the Kenyan delegation. While managing the expectations of constituents is politically challenging, on the one hand, the longer the time between discovery and exploitation, the better it is for putting in place effective legislative frameworks and institutional strengthening.

Open and transparent dialogue between parliamentarians and their constituents is required to manage realistic expectations in new resource discoveries.

New discoveries are expected to generate high revenues and a substantial development dividend. In reality, a project typically takes 5 years of construction before any revenues are captured by the state.

8. Revenue from Taxable sources

Tax systems can generate higher state income than royalties

Royalties are often seen as the easiest and most effective way to capture income from E.I. However, a taxation system where government revenue increases as rents increase has the potential to produce substantially higher state revenues. Formalization of tax architecture can also be applied to small-scale and artisanal mining in order to raise state income.

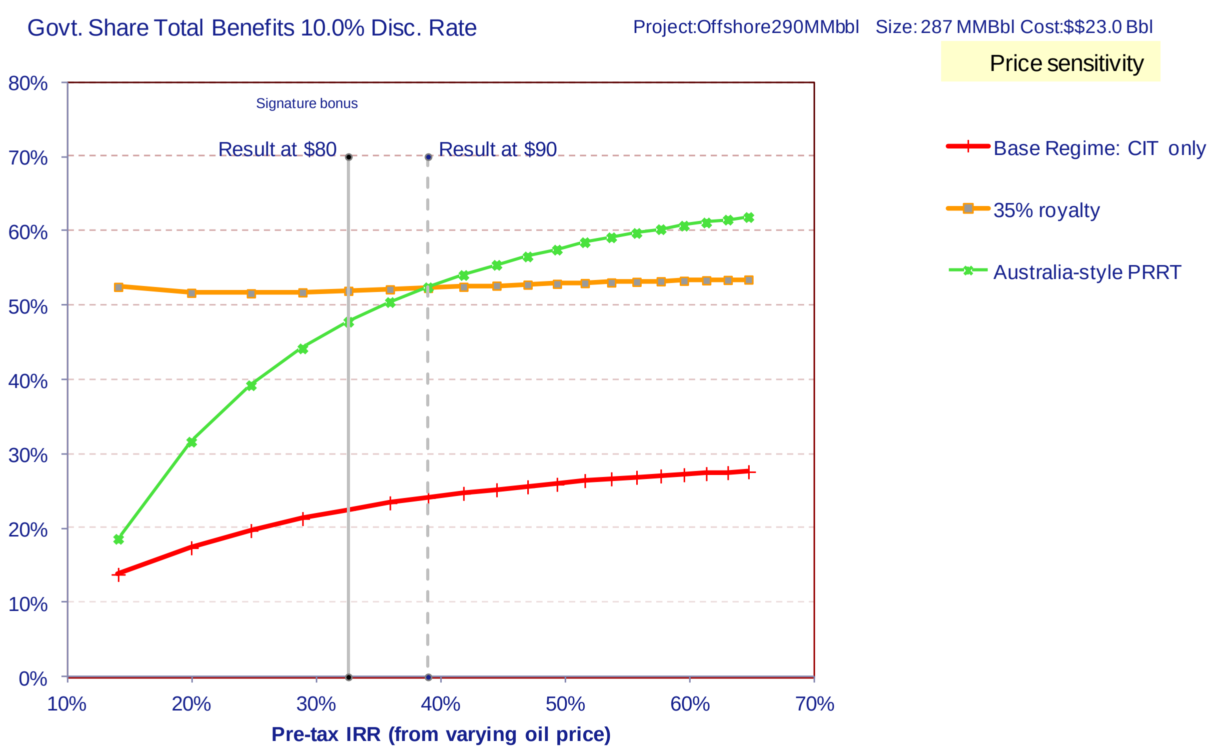
In this session, Paulo Medas from the IMF advocated the need for robust fiscal regimes that are tailored to the specific needs of extractive economies, which tend to be characterized by high rents, asymmetric information and uncertainty of revenues due to price and cost fluctuations. Extractive sectors tend to have high sunk costs, long production lead-times and can be complex, involving multinationals and state-owned enterprises. However, while having a secure and transparent fiscal regime in place that can yield sustainability and maximize present value of revenues, countries must also remain competitive and attractive to investors. The challenge is to provide stability and credibility while ensuring industries are compliant.

Tax administration has been done poorly in the past and there is a widely-held view that rent-based tax is complicated, however Medas suggested that this is not necessarily a correct perception. He maintained that principles of effective modern tax administration are equally relevant to the extractives sector and that more should be done to strengthen the institutions that calculate and collect tax. Above all, transparency is critical and should include measures such as ensuring adequate information for fiscal policy formulation and risk management, enhancing investor perception/credibility and reducing corruption and the siphoning-off of funds for illegitimate purposes.

Medas went on to present an overview of Pillar IV of the Fiscal Transparency Code dedicated to Natural Resource Management which was recently launched by the IMF. It outlines 12 principles which can be evaluated according to “Basic”, “Good” and “Advanced Practices” and the code is complemented by a guide to Resource Revenue Transparency and Accountability with a Natural Resource Revenue statistics reporting template.

While rent taxes tend to reduce pressures to renegotiate or unilaterally change the rules, Medas also points out that the fiscal regime should be flexible enough to allow review as revisions may need to be made at different stages of the extractive process.

Three main fiscal systems exist: (1) contractual, which includes production sharing/service contracts; (2) tax and royalty, with licensing of areas and (3) state ownership or participation. Even though royalties tend to be the most common way of taxing companies and are perceived to be the easiest to administer, explicit rent taxes are less distorting and take into account the exploration stage. Each mining project is unique and tax rate will depend on the jurisdiction's fiscal regime, the project production profile and the project economics (i.e. mineral price and cost curves). Therefore, significant evaluation and modelling should take place before settling on a specific fiscal regime. However, Medas showed by reference to the graph below how a Petroleum Resource Rent Tax can yield benefits progressively and gives time for companies to pay off their initial fixed costs early when production is low. While fiscal regimes must be developed on a country-by-country basis to ensure a good fit, Medas proposes a framework that incorporates a mix of royalty on gross revenue, tax targeted on rents (results-based), corporate income tax and perhaps bonus-bidding. This approach should reconcile receiving revenue incomes from the outset while allowing for increased revenue in years to come as production increases.



Gavin Hilson, Professor of Sustainable Business at University of Surrey, UK, discussed formalization of tax regimes in small-scale and artisanal mining operations around the world, an area in which he has considerable expertise and research experience. He began his presentation by suggesting that the perceptions of small-scale mining are generally negative with the informal sector often described as illicit and unsavoury. Such viewpoints, Hilson claimed, have tended to influence official policy mind-set when it comes to government involvement with the sector, which he pointed out employs vast numbers of people and, in particular, provides youth employment in regions where there are few other opportunities. In Ghana's gold mining industry, for example although most of the country's artisanal and small-scale miners are unlicensed and operating illegally, the government nevertheless has in place a system of buyers that purchase gold from the operators, regardless of whether or not they are in possession of the required permits. Small-scale/artisanal mining is not going away, Hilson maintained, but better governance of the sector can actually provide hard-pressed governments with the breathing-space to rethink the development issues that plague one-sector economies. By formalizing the small-scale mining sector, there is an opportunity to derive greater revenue from mining assets through taxation, a policy that Ghana, Tanzania and other African countries are looking at implementing. Hilson claimed that the small miners actually want to be taxed as being in possession of official permits both provides security of tenure and can reduce outgoings by eliminating the bribery that occurs in illegal operations.

The second half of Hilson's presentation outlined the precise mechanisms by which the formalization of the sector can be achieved, for example by simplifying the license process and making land available for small-scale miners to operate legitimately. Furthermore, decentralization frameworks will make it straightforward to implement simplified tax regimes that can take the form of, for example, taxing royalties on sales or using provision of services such as land reclamation as a form of taxation. Hilson, however, advised caution on overall levels of taxation as when the difference between the market price of the commodity and the amount of tax being paid in local currency exceeds 5%, experience has shown that smuggling and cross-border leakage occurs. This makes it important for harmonized taxation policies between neighboring countries to be achieved. Hilson concluded his presentation by proposing that through redesigning policies that embrace small-scale mining operations as part of the licensed mainstream, there is enormous potential for governments to generate significant additional revenues and ensure that income and benefits from the extractives industries are fully harnessed to achieving the development dividend.

9. Extractive Related Revenue and Expenditure Information Parliaments can Access

International community needs to help create an enabling environment that allows parliamentarians and support staff to perform PFM oversight more effectively.

It was agreed that this needs to be achieved by improving data accuracy, access and transparency, and availability in a form that ensures that information is relevant and useful. The importance of knowledge exchange and dissemination of best practice through consistent and regular engagement at regional and global levels was also

Rob Floyd, Director at World Bank LLI, moderated the session on how parliamentarians can gain access to the data that informs the work they do. What are the sources of data and how can parliamentarians ensure that the information is made available?

Michael Jarvis, Senior Private Sector Development Specialist works extensively on issues relating to governance and the extractive industries. Starting his presentation, he first confirmed a central theme of the conference - that is that natural resource wealth does not automatically translate into development. He put this down to a number of factors including high stakes, power disparities, long horizons and concentrated geographic impacts that place strain on domestic institutions. Jarvis saw transparency and availability of information as constituting the keys for unlocking the translation of resource wealth into beneficial development and, while observing that there is no single model for addressing this, identified three areas of focus. Firstly, information can highlight gaps in **policy making (**access to information helps guide policy formulation and implementation). Secondly, **enforcement** provides information on compliance requirements, enforcement protocols and the roles of regulatory or oversight agencies. Lastly, **institutional design** makes information available for appropriate design of governance structures and institutional arrangements, and defines roles of stakeholders. Historical governance problems in the extractives industries have led to increased scrutiny of the sector, and new open government and CSR initiatives, with a spate of open data initiatives now enabling collaboration across all stakeholders including civil society, industry and government. Such initiatives include, for example:

- Dodd-Frank (USA)
- EU Accounting and Transparency Directives
- Canada Extractive Industry Transparency Measures Act
- IFC and other lender disclosure requirements
- Individual stock exchange requirements e.g. Hong Kong

Jarvis extolled the virtues of open and truly accessible data that is properly "joined-up", standardized and presented in intuitive ways that will empower and resonate with citizens. He described how by combining data from a variety of sources, it is possible to detect patterns that cannot be seen in individual datasets or smaller samples.

Mr. Jarvis pointed to a number of ways that the World Bank has been contributing to more and better dissemination of information, including, for example, pushing for open contracting to promote disclosure of all public contracts and creation of a data standard that allows for easier comparison. He observed that although information on revenue capture (EITI) and spending (Boost) is more readily available and that while information on concessions, populations and revenues are necessary, it is also critical to be able to understand and quantify how the benefits and negative impacts are changing the societal equilibrium or affecting vulnerable groups and environmental impacts.

Jarvis went on to describe different ways for mobilizing data for legislative and oversight roles, observing that governments collect high volumes of data - most of which is public by law - and which could relatively easily be made open and available for use more generally. This could range from informing decision making (e.g. linking revenue data into budgeting processes,) to aiding and improving general oversight of the sector. Providing parliamentary information in open formats, which are machine-readable, reusable and re-publishable, will make parliamentary information more accessible to citizens. There is an important role for "infomediaries" – think tanks, media, NGOs etc. - in contextualizing data and developing tools that make the data into "starting points" of useful conversations to engage people. Technology solutions such as applications, databases and visualizations can all contribute to make data on the extractives sector more accessible and useful. Data hackathons and mashups can also be arranged to develop new applications and to demonstrate how extractives data can be used. For example, emerging technologies such as mobile apps and interactive web-mapping can be used to mobilize data from EITI and other sources, to make it easier to understand, more intuitive and dynamic, and so lowering barriers to participation by citizens. In Jarvis's view, information should be generated and utilized in a *participatory* way that engages both citizens and institutions in ways that they can act upon. He concluded with the message that information alone is not the solution – there are limitations. Access to relevant and accurate information has to be combined with the *capacity* to understand and act upon it e.g. to enforce compliance with rules. Lessons to be learned were summarized as follows:

- **Lesson 1:** *availability of information is not an objective in itself but a means to an end (materiality matters)*
- **Lesson 2:** *data should be of high quality, openly available, and in an accessible, widely used format*
- **Lesson 3:** *data should serve a purpose e.g. in a transparency initiative to help provide ability to track progress against clear indicators of success*
- **Lesson 4:** *meaningful consultation and participation around disclosed information are key*

- **Lesson 5:** *data can be leveraged to fulfil institutional roles, but not automatic – needs capacity and systems in place.*

Jonas Moberg, Head of EITI International Secretariat, emphasized two key messages in his presentation. He first reiterated Michael Jarvis's observation that campaigning for greater transparency in the extractive industries has seen success in making available a large amount of data that was not previously accessible, but, he added, the challenge is now around effective use of the data. He suggested that transparency should not be seen as an end in itself, but rather transparency leading to accountability should be the priority. In his second key point, Moberg pointed to lack of initiatives by the international community in regard to supporting legislators to enforce accountability. He was critical that emphasis in the development debate has been focused on NGOs/CSOs to the detriment of more established ways of holding government to account, e.g. through parliamentary oversight. Moberg went on to describe EITI as a global standard that represents a quasi-multi-lateral coalition response to problems in the sector. So far 240 EITI reports have been published, resulting in $1.6trillion of payments being made transparent for the first time. He went on to recommend that EITI should be locally-owned with each country taking ownership of the initiative instead of outsourced internationally.

The second half of Jonas Moberg's presentation concerned parliament's role in EITI and the parliamentary functions of lawmaking, oversight and representation. He drew on the following examples to demonstrate different ways that parliaments have engaged with and embraced EITI.

- In the **Republic of Congo**, parliamentarians have established the practice of reviewing EITI Reports before approving the government budget
- In the **DRC**, both chambers of parliament have EITI committees. As a result of this, EITI is deeply embedded in most oversight institutions and government agencies. Parliamentarians call relevant Ministers in the multi-stakeholder group (MSG) and National Coordinator to explain progress on reporting, follow-ups from previous reports, etc. Following the publication of the latest EITI Report in December, the DRC Parliament instructed the Chair of the MSG to produce 2 EITI reports this year. The first report covering 2013 is to include artisanal mining for the first time, and needs to be published by the end of June. The second report covering 2014 data will include forestry for the first time and be published by 31 December 2015.
- In **Nigeria**, the NEITI works closely together with MPs. Remedial issues identified in the NEITI Audits, such as physical, financial and process lapses, require legislative interventions. This is in addition to the use of information and data in the report as tools for debate.
- In **Yemen,** contracts are shared with Parliament but not made publicly available. The MSG is, however, looking at how a parliamentarian that sits on the MSG can to use his access to the contracts to make them public.
- In **Niger**, EITI transparency is built into the constitution; **Nigeria** and **Liberia** have passed EITI Laws; a draft Law is under debate in **Mongolia**. **Norway** has amended the Petroleum

Law and the **Kyrgyz Republic** revised the Law on Subsoil to enable EITI reporting/disclosure.

Moberg concluded his presentation by highlighting the following success stories:

- **Nigeria.** A new calculation model for royalty payments from oil is being developed after NEITI identified a US$2bn underassessment. US$410m of missing education taxes have been collected from oil and gas companies. An inter- ministerial team is working to ensure that gas from oil fields is captured and generates revenue for the state.
- **Ghana.** The EITI Reports identified misuse and underpayments of royalties intended for local development. Subsequently, the government developed guidelines for the utilization of mineral royalties at the subnational level. Separate bank accounts were opened to enable following of funds.
- **Liberia.** Liberia EITI conducted an audit, which revealed that most of the 68 contracts and licenses that were examined had not been awarded in line with applicable legislation. The audit provoked public debate on license awarding procedures.

Mohammed Adam, Executive Director of African Energy Policy in Accra discussed the supply/demand of disclosure of data. He described the difficulties that legislatures encounter in trying to make sense of the data needed to perform their roles, and that the importance of relevant and fully disclosed data to support MPs should not be undermined. As MPs cannot be expected to be specialists in all areas, independent analysis at MPs disposal is of vital importance. He outlined the different types of data available in Ghana, the sources that this data can be accessed from and what the Ghanaian Parliament is able do with the data in order to demand accountability.

Not only is disclosure of revenue streams vital, Adam contended, but also disclosure of the parameters used in arriving at the data is needed. In some countries revenue data is accessible by law or by voluntary initiatives but often the parameters that lead to that data are not made available, usually because they are found in contracts or project documents which are not readily accessible. In particular, parliamentarians need access to extractives revenue and expenditure data through standards such as:

– Mandatory contract disclosure

– Mandatory and voluntary payments disclosure (EITI)

– Open budget requirements

– Companies listed on SEC or European stock markets

– Companies having corporate governance principles that facilitate public reporting on their activities and finances

Adam pointed out that in the case of Ghana's oil resource, parliamentarians have needed to realize that there can be divergence between price estimates and realized price and it was important, therefore, to have a policy on price forecasting and to have access to sources for cross-checking and ensuring data integrity. Crude oil prices in Ghana are benchmarked to the Dated Brent price using a moving average price model (usually provided by IEA) whereas realized crude oil price is the actual jubilee price - provided (by law) in the quarterly reporting of oil revenues by the Ministry of Finance and Economic Planning (MOFEP). Therefore, aside from difficulties in assessing actual production figures, there can be significant differences in the prices used by the state and those used by oil companies; a divergence which needs to be examined separately for tax purposes. Ghana's Revenue Agency is supposed to conduct independent analysis of production quantities (i.e. how much is taken out of the ground by oil companies) and initially used electronic seal/s on wells. However, these were removed when companies protested that they were interfering with electronic systems and so currently, Ghana has no way of independently assessing this information. Adam also discussed the assessment of project profitability through project rate of return (although this is difficult to access without the plan of development which Parliament should demand access to) in determining government revenues and also the relationship between data and legal frameworks.

Finally in his presentation, Adam stressed the importance of the Finance and Budget Committee's use of these data sources to carry out independent assessment of government estimates of resource revenues in the budget and to determine how realistic such estimates are, and the accuracy of data captured. The Public Accounts Committee too has a crucial role in ex-post assessment of realized resource revenues and their allocations to determine the extent of compliance with rules on revenue management, where there are leakages in the resource flow chain and to question violations of rules and mismanagement of resources to be put to the executive.

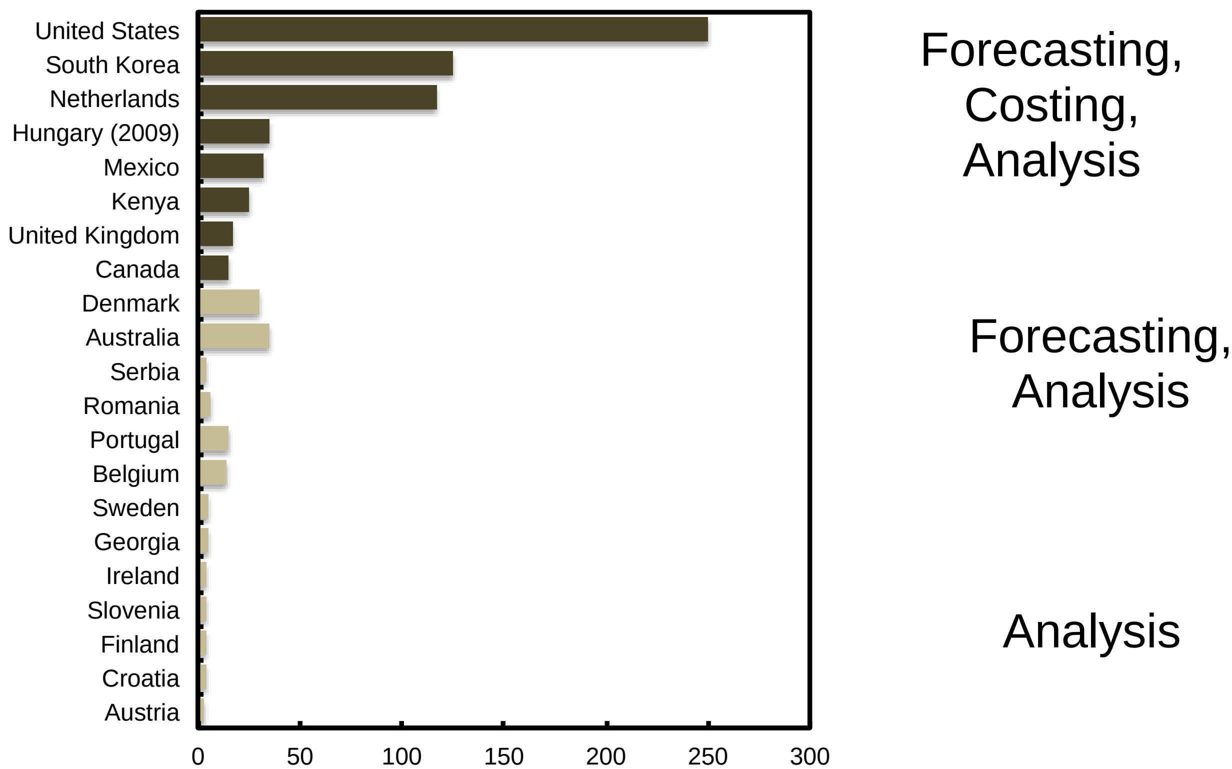
10. Parliamentary Revenue Forecasting and Budget Analysis

Support needs to be provided not just for MPs, but also for their staff

This is especially important as these will serve as the institutional memory of the future.

To follow-up to the previous session on data, this part of the seminar, looked at how data should be used to for budget analysis and forecasting.

First, Jason Jacques, Director of Fiscal Analysis at the Parliamentary Budget Office in Canada, focused on the issue of budget analysis using his experience of working with MPs and committees on budget issues in the Canadian Parliament. Using the mantra that"transparency is a necessary condition but not a sufficient condition", Jacques stated that the legislator's most important role is to hold government to account for both the amount of money received and for how it gets spent. Alongside elected officials, parliamentary support staff personnel are employed to assist parliament in its challenging of the government by meticulous understanding of the data and the capacity to perform budget analysis. Jacques presented a chart of IMF data (see below) that compared the parliamentary support capacities of countries around the world and segmented these into 3 broad categories of budget analysis capacity.



Source: IMF Fiscal Council Data Set.

He observed that countries towards the lower end of the chart are generally only able to perform minimum/basic budget *analysis* and so tend to accept financial information provided by the government, their primary focus being to make the information more comprehensible for the legislators. Countries in the middle ranking category perform *forecasting and analysis*, having the additional capacity to undertake their own independent forecasting and report on discrepancies in government figures that can then provide the basis of challenge to the executive. Examples of countries with the highest historic capacities for analysis are the US and the Netherlands and more recently, Kenya, which all have large budget offices that can perform detailed, independent analysis on costings and are able to drill-down into the finer details of the budget.

Clarify which parliamentary institutions and processes are best equipped to ensuring good governance of the sector at different points of engagement along the value chain.

There was general agreement that the Budget, Finance and Estimates Committees working with Parliamentary Budget Offices are best placed to oversee the inflow and outflow of E.I. revenue streams. Consensus among client countries was, however, that instead of focusing on specific procedures for extractives, international support would be better directed to build technical capacity in the parliamentary institutions and processes that provide oversight across all national revenue streams.

Budget analysis, Jacques maintained, can be especially challenging when the elected party fails to disclose its forecast methodology, observing that there is usually little incentive for governments to share this information with the legislators. Moreover, since legislators generally do not have the time or expertise to decipher or analyze data themselves, it is imperative that MPs can rely on capacities of the regulatory agencies and other accountability institutions in order to be able to ask the right questions of the executive. Jacques made the point that as financial issues tend to be broadly similar across all jurisdictions and the same types of financial analysis are needed around the world, there is a big untapped opportunity for sharing PBO expertise and technical capacity internationally and for utilizing international organizations to testify, clarify and elucidate issues. Jacques also pointed to PBOs, like other public entities, being stretched financially and often having to manage without the resources needed to replicate the executive's methodology and so being unable to adequately test its assumptions and figures. However, he suggested that there are ways by which PBOs can compensate for internal resource limitations, for example, by teasing out the cyclical variation in commodity prices and studying the economic cycle to see how much should be spent – permanent, ongoing, real revenues - versus how much to be expected. Commodity production, and in particular energy exports, Jacques pointed out, is a key part of the Canadian economy, and price fluctuation can be highly disruptive to policy planning, a reality that requires adoption of a medium term planning horizon when budgeting for the public sector. Accordingly, the Canadian PBO uses techniques such as tracking the underlying market fundamentals and creating average estimates for commodity prices over the next period of time. It also performs scenario analyses to model a range of potential outcomes. While the point estimate is usually wrong, it nevertheless provides parliamentarians with a planning environment and initiates discussion on what might happen if figures do not materialize in the way anticipated. Such sensitivity analysis is relatively straightforward for the PBO to carry out and provides a range of values that legislators can use when framing discussions with the Ministry of Finance in order to test contingency plans for when revenues fluctuate due to temporarily higher/lower prices.

Next, Gareth Jones of Merrill Lynch Commodities presented the view from the private sector, in particular, introducing market price-based techniques that can be used for performing budget analysis in countries with significant commodity revenues. Jones began by identifying 3 key messages that had so far arisen during the conference. Firstly, the difficulty in executing parliamentary scrutiny given opaque information and resource constraint. Secondly, the benefits of using a counter-cyclical fiscal policy in a resource-rich economy, and lastly, the challenges posed for getting price transparency as part of forecasting and revenues. Jones proposed that financial markets and instruments can assist in all 3 of the following:

1) Execution of revenue forecasts
2) Assessment and analysis of the sitting government's budgets
3) Tax revenue stabilization

Jones used oil as an example of a commodity which, because price is dependent on the location of extraction and on the hydrocarbons composition, is not a fungible product. He explained how the recent and dramatic decrease in price has been influenced by 3 supply-driven factors - the future of OPEC, US shale production and the prospects for an Iran-US deal. Even though historic-based forecasts may be of interest, it is more relevant to look at future outcomes using market assessments of the price forecast – the futures price. It is not necessary or useful, Jones proposed, to imitate the Ministry of Finance forecasting techniques, but instead it is better to use a futures curve – looking at WTI, Data Brent market etc. to provide a more accurate and dynamic estimate of future prices. The futures curve is the most dynamic and accurate forecast of commodity prices available for arriving at an estimate of tax revenues to be derived from extractive industries. Futures markets allow dynamic adaption of the forecast to changes in the market and therefore are far superior to macroeconomic forecasts. That said, futures can also be volatile, and so a moving average calculation should be used to leverage the collective wisdom of the markets in order to generate a revenue forecast.

Parliaments should use the PBO and independent consultants for budget analysis/revenue forecasting with asymmetric information and finite resources
The options market can also be used to generate probability-weighted upside/downside scenarios

The next step, according to Jones, is the ability to generate a range of outcomes using the options market. The benefit of financial market derivatives – specifically options (call and put) – is that they provide a pricing signal of implied volatility. The implied volatility of exchange listed options can be used to generate probability-weighted price scenarios and budgetary revenue forecasts. Again, through leveraging the collective wisdom of markets by using options prices, it is possible to generate probabilities of where the oil prices will move in the future.

In concluding, Jones spoke of how the intelligent use of derivatives can be leveraged to increase resource revenue stability. Hedging is not as uncommon as is typically thought. An example is the national oil company of Mexico, where oil makes up one third of revenues of the Mexican budget, and which frequently uses options to hedge and stabilize revenue sources through "put" options. Similarly, Morocco - a gasoline-importing country – to avoid volatility in gasoline and diesel prices bought a call option. Derivative strategies can therefore help to stabilize government revenues and benefit a counter-cyclical policy. However, Jones cautioned that there are risks in hedging through market liquidity or political considerations, and as highly technical and volatile tools they should be used with great care. He concluded that sovereign risk management of commodity exposure with derivatives requires considerable experience and technical expertise and there are many ways to get it wrong!

Following lunch Participants divided into two groups with Gareth Jones and Jason Jacques each leading a group through a case study that was designed to apply the content of the morning session to a typical scenario to illustrate the kind of data legislators should be aware of, how/where to obtain it and what kind of questions they need to ask to perform rigorous scrutiny of the government's medium-term forecast.

11. Conclusions and Wrap-Up from Helsinki 2015

In the closing session MPs were divided into smaller groups to facilitate discussion and distillation of the main lessons for taking away from the event including ideas for implementation on return to their parliaments. The group discussions identified the following as the key lessons learned from the seminar:

- The need for revenue management frameworks that balance income (for public benefit) and investment in the sector in an appropriate way.

- For effective revenue management and allocation (Stage 4 in value chain), a combination of Budget, Finance and Estimates Committees and PBO are best placed to provide oversight of E.I. revenue streams.

- Parliaments need to consider extractive industry revenue streams in the context of the whole budget rather than developing special oversight procedures for the sector alone.

- More emphasis is needed on strengthening parliamentary institutions and the processes around taxation, budget formulation and supply procedures.

- Parliaments should make use of PBO and independent consultants for budget analysis/revenue forecasting technical support

- Macro-fiscal policy objectives should be factored into the "spend versus save" equity debate when considering E.I. windfall revenues.

- The international community has an important role to assist in creating the enabling environment that permits parliamentarians and support staff to perform PFM oversight of E.I revenues effectively. For example, there should be greater emphasis placed on integrating E.I. data into national estimates and parliamentary supply processes.

- Parliamentarians should engage in open and transparent dialogue with their constituents when it comes to managing realistic expectations in relation to new resource discoveries.

- International development organizations need to adopt an individual case-by-case approach when entering into discussions about SWFs with politicians/parliamentarians in relation to revenue management models.

- Progressive tax systems have potential to generate higher state income than royalties.

- Parliamentarians, parliamentary staff and practitioners should be encouraged to get together at regional and/or global levels in order to share knowledge and experience.

- Support programs must be designed with both MPs *and* parliamentary staff in mind.

When summarizing their key findings, delegates expressed appreciation for the content of the seminar and complimented Finnish hospitality, the country’s unequivocal support for parliamentarians across the world and its impressive budget system. While most of the countries represented lack the level of support and resources available in Finland, delegates were nonetheless enthusiastic about the practical value of the learning delivered and the extent to which they would be able to implement significant improvements in their respective parliaments and governments as a result of participating in the seminar.