

Sub-National Implementation of the Extractive Industries Transparency Initiative (EITI)

Issue Paper

prepared for
EITI Secretariat
Department for International Development

by
Overseas Development Institute

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Acknowledgements and Disclaimer

The Extractive Industries Transparency Initiative (EITI) supports improved governance in resource-rich countries through the full publication and verification of company payments and government revenues from oil, gas and mining. The EITI is a combined DFID–World Bank–IMF initiative and the secretariat is based at the UK Department for International Development (DFID). DFID supports policies, programmes and projects to promote international development, and it provided funds for this study as part of that objective. The views and opinions expressed, however, are those of the authors alone and do not infer policy for DFID or EITI nor do they constitute a set of recommendations.

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Glossary

The following are terms and definitions as applied in this report (logically ordered).

Unitary State	State or country governed constitutionally as a single unit, with one constitutionally created legislature. Governmental power may well be transferred to lower levels, to regionally or locally elected assemblies, governors and mayors ("devolved government"), but in a unitary state the central government has the principal right to recall such delegated power. ⁱ
Federal States	Country governed constitutionally as a cluster of federated states.
Sub-National Governments (SNGs)	Regional, federated state, provincial, municipal, district and community level government authorities with their own jurisdiction.
Fiscal decentralisation	The transfer of greater responsibility for budgets and financial decisions from higher to lower levels of government, and in some cases assuming statutory powers to raise certain taxes and carry out spending activities within specified legal criteria ⁱⁱ .
Internally generated revenue (IGR)	Revenues sourced locally by SNGs within their area of jurisdiction, be that taxes or revenues from levies, licences, fines, etc.
Natural Resource (NR) revenues	Revenues received or transfer by government authorities derived from the activities of oil, gas, mining and mineral companies and consortia, may include revenue from production entitlements (cash in in-kind), corporate income tax (profit tax), royalties (cash or in-kind), dividends, signatory and bonus payments, licence fees, rental fees, entry fees, and IGR (local taxes, local levies and fines, etc).
Fully centralised (FC) NR revenue management	Countries where all major NR revenues accrue to central government and are only assigned to sub-national governments as an integral part of total revenue transfers, i.e. where inter-governmental transfers derive from a 'mix' of revenue sources and are not attributed to any particular portion to NR revenue sources.
Fully decentralised (FD) NR revenue management	Countries where all NR revenues accrue in the first instance to sub-national level governments, and then are shared 'up-wards' with national government (e.g. UAE)
Shared revenue bases (SRB)	Overlapping receipt of revenues between sub-national and national levels (be that royalties, corporate income tax), often using the same tax base as national

government and thus acting as a 'surcharge' on the national tax rate.

NR revenue-sharing (RS)

Where a proportion of NR revenues accruing to one government jurisdiction is transferred (downwards, upwards or horizontally) to other jurisdictions. Transfers are usually downwards from national to sub-national levels, and commonly based on formulas or fixed proportions.

Tax Sharing

Where one level of government shares revenues from a particular tax base with other jurisdictions, typically those where revenues are deemed to originateⁱⁱⁱ.

Intra-governmental assignments

Transfers of revenues from one level of government to another, usually from national to sub-national levels. Transfers from central governments to federal governments are sometime referred to as inter-governmental assignments or transfers.

'Derivation/origin' Principle

Intra-governmental assignments sourced as part of some total of NR revenues, where the amount transferred is some factor of the proportion of total revenues originating (derived) from the recipient jurisdiction. The remaining NR revenues stay with central government for assignment to other purposes.

Benefit-tax principle

The principle that the level of local tax burden (or tax relief) relating to a specified tax base, vis à vis a particular jurisdiction, should take into account the distribution of local economic, social or environmental benefits (and disbenefits) experienced within that jurisdiction related to the activities that are the source of that tax base.

Executive Summary

This report was prepared to provide insight into the possible expansion of the Extractive Industries transparency Initiative (EITI) to the sub-national level, for consideration by the EITI International Advisory Group. The matters and options discussed may have application to other organisations involved in transparency, accountability, and good public sector and corporate governance.

Transfer Mechanisms

Sub-national governments receive non-renewable natural resource (NR) revenues through three principal mechanisms:

- **Intra-governmental (or inter-governmental) revenue assignment** – where NR revenues are collected at national level and then assigned (shared downwards) to sub-national levels in the form of grants, matched funding or soft loans.
- **Internally generated revenue (IGR)** – various forms of ‘proceeds sharing’ by sub-national government authorities, including royalties, surcharges on the national tax base (e.g. corporate income tax), as well as revenue-raising in the form of local business taxes, charges, registration fees, social levies, etc.
- **Transfers between sub-national levels of government** – for example from a federal account or provincial account to district government authorities, or from district levels to community levels.

Relevant Countries

A survey of 56 natural resource-endowed developing countries undertaken for this commission identified 17 countries as having either a formal statutory or explicit policy-driven framework for the assignment of natural resource revenues from national government to sub-national government jurisdictions. All 17 countries are oil or gas producers. Of these, six are also mineral producers to which the same or similar revenue-sharing legislation or policy frameworks apply. A sub-set of 12 of these countries make intra-governmental NR revenue transfers to both 2nd and 3rd tier levels of sub-national government (SNG), i.e. federated states or provinces, and municipalities or districts. The remainder appear to be transferred to 2nd tier only.

A further 16 countries have no discernable arrangements for the explicit assignment of NR revenues from national to sub-national levels. However these might be included in an expanded EITI programme because the sustained high commodity prices in oil, gas and minerals, means that conventional intra-government revenue transfers are likely to incorporate a predominance of NR resourced revenues (defined in this report as >60% of the national income). Please refer to Table ES1.

Table ES 1 Countries and EITI Implementation at the Sub-National Level

A. Countries with statutory or policy frameworks for intra-governmental assignment of attributable NR revenues. 2nd tier transfers only – <i>italics</i> Mineral producing countries – *		B. Countries where conventional intra-government revenue transfers incorporate a predominance of NR resourced revenues (excluding countries in column A)	
Angola	Mexico	Algeria	Azerbaijan
Bolivia	<i>Nigeria</i>	Botswana	Cameroon
Brazil*	Papua New Guinea*	Brunei Darussalam	Ecuador
<i>Chad</i>	Peru*	Republic of Congo	Indonesia
Colombia*	Philippines*	Equatorial Guinea	Iran
Ecuador	Russia	Gabon	Iraq
Indonesia*	<i>Sudan</i>	Kuwait	Kazakhstan
Kazakhstan	Venezuela	Libya	Mexico
<i>Malaysia</i>			

The above classification envisages allocating EITI resources on the basis of either (i) the proportion of national income derived from NR revenues, or (ii) the existence of a legal or policy framework for intra-governmental transfers. An alternative approach is to target resources at specific producing regions regardless of the ratio of NR revenues to national income. The focus would be on those jurisdictions where a continued lack of accountability in intra-governmental revenue transfers (attributable or unattributable) carries high potential for revenue mismanagement, the failure to achieve sub-national sustainable developmental goals, and/or commercial risks for operating companies and investors. This approach would be more inclusionary of the mining sector, which rarely exceeds 10% of a country's total revenue and which to date has received less attention within EITI.

In compiling this report we found little evidence of legal or policy-driven arrangements for transfer between different sub-national government jurisdictions levels of revenues directly attributable to NR-related income.

Internally Generated Revenues by Sub-National Government

Except where SNG authorities and local communities receive a direct share of the proceeds of extractive industry operations (e.g. royalty payments or surcharge on corporate income tax), it can be assumed that, given current commodity prices, the total value of locally raised taxes and charges from NR operations is small relative to transfers of NR revenues from the national level, be these attributable or unattributable. In relative terms, the consequence of mismanagement of these smaller revenue flows is clearly substantially less than the effects of mismanagement of NR revenues accruing at the national level or those transferred from central to sub-national levels.

Links Between Weak NR Revenue Management at the SNG and Corruption, Poverty and Conflict

Applying EITI to the sub-national level would imply that somewhere in the process of transferring NR revenues to (or accruing within) sub-national levels of government, there is mismanagement, and that this mismanagement, as at the national level, can lead to corruption, worsened poverty and, potentially, conflict. At the sub-national level the association of weak NR revenue management with corruption, poverty and conflict works in a number of ways:

- leakage prior to disbursement of NR revenues at the national level
- where intra-governmental transfers are based on the 'derivation principle', inaccuracies in determining the proportion of total NR revenues derived from a particular producing state or province
- the risk of discretionary, patronage-driven, intra-governmental revenue transfers
- lack of a legal framework for lower levels of government to report their financial accounts
- legal challenges and consequent adverse effects on inward investment, as was recently the case in the Philippines where the Foreign Investment Law was challenged in the Supreme Court
- lack of institutional and administrative absorptive capacity in the local public sector, which can render SNGs ill-prepared for the challenge of translating NR transfers into local economic and social development.

Issues for Sub-National EITI Implementation

The issues for EITI to consider in expanding its mandate to include implementation at the sub-national level fall into two broad categories. First, there are the changes that will be needed to broaden the concept of validated and reconciled accounts, i.e. to embrace not just company-to-government revenue transfers, but intra-governmental transfers. Related to this is the complexity

of the task given the many different transfer mechanisms and routes, and the progressively poor quality of fiscal records the lower the level of government.

Second, intra-governmental assignments of NR revenues based on the ‘derivation principle’ can carry deleterious local economic and social risks in their own right, i.e. not only linked to failings in transparency and accountability. These risks include magnified fiscal volatility within SNG authorities; potentially unsustainable recurrent (often consumptive) public expenditure by SNGs; constraints on national government to perform its redistributive and budget stabilisation functions; new claims from non-producing regions for a share of the ‘national’ wealth; and risks to the political stability of the region and country if these trends are resisted by central government.

A decision by EITI to implement programmes of transparency and accountability in the disbursement of NR revenue assignments from national governments to producing (or non-producing) SNG jurisdictions, will need therefore to carefully assess the benefits of effective revenue management for sustainable development, poverty reduction and reduced fiscal mismanagement, against the risks of fuelling these unintended negative consequences. Indeed, EITI resources could be explicitly targeted at reducing these risks (Section 4.2 identifies measures to improve sub-national revenue management and transparency and aid management of risk). A recent survey of mining-related stakeholders concluded that investment analysts rarely consider issues of financial transparency within host governments as an indicator of investment risk^{iv}. Producing regions where the risks might prove to be relatively high include the Niger Delta, Nigeria; Mindanao, Philippines; and the Aceh and Papua provinces in Indonesia.

Management of Sub-National EITI Implementation – Four Models

Four models for EITI implementation at the sub-national level are considered in the report.

Model I – Comprehensive Approach

In this model validation and reconciliation would be undertaken for all material assignments involving NR revenues from national government to state, provincial, district and local levels. The approach would embrace both attributable and unattributable NR revenue transfers, and include disbursements between different sub-national levels, as well as tax and levy payments made by companies to SNGs. To improve both its manageability and defensibility, some arbitrary threshold for the proportion of unattributable NR revenues in transfers (i.e. those mixed with other revenue sources) should be established. The higher the threshold, the lower the total number of reconciliations. Substantial skills and institutional capacity building efforts would need to accompany the model, not least to lower levels of government to prepare relevant and aggregated fiscal accounts.

Because the model embraces unattributed NR revenues it is likely it would overlap considerably with the efforts of other international agencies working on intergovernmental transfers, fiscal decentralisation and fiscal transparency. Alignment with these other initiatives will be critical, for example in establishing the templates for authorities and companies to generate aggregated data. Perhaps the most acute challenge to this model, however, would be in constructing effective oversight mechanisms, both within the systems of local government (elected assemblies and councils) and with regard to civil society participation in the processes by which the reports on disbursements and revenues would be produced and reviewed.

Model II – Attributable Revenues

In light of the constraints facing Model I, a second model for EITI would be to focus only on directly attributable intra-governmental NR revenue assignments. This would avoid the complexities of tracking NR revenues that are ‘mixed’ with other revenue sources. Included in this

model would be material payments made by companies directly to the same levels of sub-national governments that are in receipt of NR revenues transferred from central government.

A variation of Model II would be to exclude any SNGs lower than state level in federated countries, or lower than provincial level in unitary states, i.e. to concentrate only on transfers from central government to 'the next level down'. This would considerably reduce the number of reconciliations required.

A further variant would be to include those producing regions where there is national legislation or a policy framework for companies to share NR proceeds directly with SNG levels without passing through central government. This would include the sharing of royalties with local land owners, or the imposition of surcharges by provincial authorities on the national corporate income tax base.

Model III – Expanded Materiality

To address implementation of EITI at the sub-national level the current definition of 'materiality' could be expanded. Criteria for EITI resource allocation would be broadened to embrace not only the relative dollarised volume of NR attributable (or unattributable) revenues in relation to other intra-governmental transfers, but also include (i) the level of risk associated with these transfers in terms of the potential for mismanagement, corruption, worsened poverty and political insecurity, and (ii) the opportunities such revenue transfers offer for sustainable development, poverty reduction, prevention of community hostilities and political stability. This approach would go some way to addressing the shortcomings of EITI in relation to the mining sector. Here it is arguably sustainable development and not revenue transparency that is the major issue, with transparency of sub-national revenues more significant than national level reconciliations due to the large local footprint of any mining operations^v.

Model IV – Pre-Disbursement

A fourth model could be to avoid involvement in intra-governmental NR revenue transfers at all. Instead, the aim would be to pursue enhanced transparency and accountability in four areas related to sub-national NR revenue transparency and accountability, but each of which takes place 'prior' to actual disbursements from the national level. Key tasks would be to:

- Validate the proportion of total NR revenues derived from a particular producing region, perhaps linked to EITI Physical and Process audits.
- Reconcile payments and receipts within the passage of NR revenues through the various designated accounts that take the proceeds of crude oil, gas or mineral sales, corporate income tax and royalties through to national level disbursement accounts.
- Validate the calculation of the annual cash value of the assigned proportion available for transfer, taking into account cost-recovery allowances, 'cash calls' by joint ventures between National Oil Companies (NOCs) and International Oil Companies (IOCs), the build up of capital stock within National Resource Funds, urgent budget stabilisation and poverty reduction 'calls', rescheduled debt repayment, etc.
- Publicise the anticipated 'timing' of disbursements, taking into account the potential for delays following the start of production due to the above priority calls, and providing clear justifications for these apparent delays in order to reduce misconceptions and a perceived 'benefits gap' for populations within SNG jurisdictions.

Clearly, these four models are not mutually exclusive, not least the proposals in Model IV which could be adopted as part of any the first three models.

1. Introduction

1.1 Purpose

This report provides insight into the possible expansion of EITI to the sub-national level, for consideration by the EITI International Advisory Group. The paper includes:

- a summary of the countries and regions where this issue is most important
- a description of the mechanisms through which revenues currently reach sub-national levels of government in different countries
- a brief summary of the issues that arise for sound revenue management and revenue transparency when significant resource revenues flow to sub-national levels of government
- a brief description of some of the measures that can improve sub-national revenue management and transparency
- a summary of the issues that arise in sub-national implementation of EITI
- suggestions for how sub-national implementation of EITI could best be managed, including outlines of four models of sub-national EITI implementation.

1.2 EITI Rationale

The second meeting of the EITI International Advisory Group (IAG) – 21 October, 2005 – noted that the future of the EITI could comprise a possible expansion of its role to include the aim of ensuring that resources generated by extractive industries are distributed at the sub-national level. The rationale proposed is that if citizens of natural resource-rich developing countries are to understand the volumes of revenues flowing, and where to, then the information provided by such initiatives as EITI should include details of these inter-governmental payments to sub-national levels^{vi}.

1.3 Aligned Initiatives

The IMF, World Bank Group and Global Reporting Initiative (GRI) are each engaged in various initiatives aligned with the proposal to expand EITI implementation to the sub-national level.

1.3.1 *International Monetary Fund (IMF)*

The recent IMF Guide on Resource Revenue Transparency offers recommendations on managing inter-governmental natural resource (NR) assignments between national and sub-national governments (SNGs)^{vii}. The guide also makes explicit the need for taxation powers and expenditure responsibilities at both central and sub-national levels of government to be based on stable principles and agreed formulae, and that these should be legally prescribed, clearly and transparently formulated, and implemented in an open and consistent manner. These recommendations are discussed in Section 4 in relation to possible measures to improve sub-national revenue management and transparency.

1.3.2 *World Bank Group*

As a follow up to the World Bank Extractive Industry Review, a draft set of Development and Poverty Indicators^{viii} have been developed by the International Finance Corporation (IFC). These

are proposed as reporting requirements for investors of extractive industry projects. They include the following indicators of direct relevance to an expansion of transparency in NR revenue management at the sub-national level:

Total Tax/Royalty Revenues paid (US\$m)

- direct to national government (US\$m)
- direct to regional government (US\$m)
- direct to local government (US\$m)
- provisions for Government revenues to flow back to region/local government firm national government (US\$m or percentage)

Also within the World Bank Group, the IFC's new Performance Standards for Social and Environmental Sustainability are to require that from December 2006 onwards all clients involved in IFC-financed extractive industry projects will need to publicly disclose their material payments to the host government(s).^{ix}

1.3.3 Global Reporting Initiative

The Global Reporting Initiative and the International Council for Mining and Metals have jointly launched a Mining and Metals Sector Supplement to the 2002 GRI Sustainability Reporting Guidelines. The supplement contains certain requirements of relevance to a strengthening of reporting and transparency in NR revenue management at the SNG level¹. These requirements fall under the heading of Direct Economic Impacts (public sector) and are as follows:

Monetary flow indicators:

- EC8 – total sum of taxes of all types paid broken down by country.
- EC9 – subsidies received broken down by country or region – This refers to grants, tax relief, and other types of financial benefits that do not represent a transaction of goods and services.
- EC10 – donations to community, civil society, and other groups broken down in terms of cash and in-kind donations per type of group.

¹ The supplement introduces no new reporting requirements on revenue transparency that were not already provided for in the 2002 Guidelines

2. Countries and Regions where Sub-National Implementation of EITI Might be Relevant

2.1 Introduction

A desk-based survey of intra-governmental NR revenue-sharing arrangements was carried out for this commission. The results, including the principal formulae for revenue-sharing and the recipient SNG authorities, are summarised in Annex A. More detail is provided in Annex B.

The exercise gives an indication of where EITI might expand its activities. For example, Table 1 captures those countries for which there is an identifiable statutory or policy-driven NR revenue-sharing arrangements in place, and therefore may lend themselves more readily to the reconciliation of intra-governmental payments and receipts.

Table 1 Countries with Explicit Statutory or Policy-Driven Revenue-Sharing Arrangements: National to Sub-National Levels

Country	EITI status		Main producing regions	Av % Fiscal Revenues from NRs (2000–'03)	
	Im	En		Hydro-Carbon	Minerals
Angola		✓	Province: Cabinda	80.9	
Bolivia		✓	Producing departments: Santa Cruz; Tarija; Cochabamba; Chuquisaca	✓	
Brazil				✓	✓
Chad		✓	Province: Eastern Logone; Petroleum basin: Doba	✓	
Colombia			Departments: Arauca; Casanare	9.0	
Ecuador			Provinces: Napo, Esmeraldas; Sucumbios	26.4	
Indonesia			Special Autonomy Status provinces (since 2001): Aceh; Papua (Irian Jaya)	31.3	✓
Kazakhstan			Fields: Tengiz; Kashagan (offshore); Karachaganak (onshore)	21.0	
Malaysia			States: Terengganu; Sabah; Sarawak	✓	
Mexico			Field: Cantarell	32.2	
Nigeria	✓		States: Ondo; Akwa Ibom; Cross River; Delta; Edo; Abia; Imo; Rivers	77.2	
Papua New Guinea			Provinces: Eastern Highlands; New Island; Central and Oro; Milne; Bougainville	✓	16.1
Peru		✓	Regions (formerly departments): Loreto, Ucayali; Piura; Tumbes	✓	✓
Philippines			Provinces: Mindano; Luzon; Palawan; Mindoro	✓	✓
Russia			Regions: Western Siberia; Eastern Siberia	39.7	
Sudan			Southern Sudan	43.0	
Venezuela			Basins: Maracaibo; Eastern Venezuela	52.7	

The survey considered all countries included in the IMF lists of hydro-carbon rich and mineral rich countries. It also included the following countries with potentially large (relative to total national income) or long-term NR revenues: Bolivia, Chad, Mauritania, São Tomé and Príncipe, and Timor-Leste. The Philippines and Malaysia were also included as although they are not included in the IMF listing, they do have statutory inter-governmental revenue-sharing frameworks in place.

The survey identified 17 middle- to low-income countries as having a statutory or policy-driven framework in place for the explicit assignment of natural resource revenues from national government to sub-national governments (SNGs). All 17 countries are oil or gas producers. Of

these, five – Brazil, Indonesia, Papua New Guinea, Peru and the Philippines – are also mineral producers.

The discussion below focuses predominantly on these 17 countries, since these might be considered particularly relevant to possible EITI implementation. Other hydro-carbon and mineral producers do make intra-governmental revenue transfers to SNGs. The difference is that the portion of these transfers derived from natural resource revenues is unattributable, i.e. mixed with other sources of national revenues. Separating out and tracking the flow of NR revenues within these ‘mixed’ transfers would be highly complicated.

A case for including ‘mixed’ inter-governmental revenue transfers in an expansion of EITI might be where the portion of total national income is heavily dominated by NR revenues. In such cases the majority of any unattributed intra-governmental assignments can be assumed to derive from NR revenues. Attributed and non-attributed intra-governmental NR revenue assignments are discussed below.

There is also a third category of EITI contenders, i.e. those that have neither formal arrangements for NR revenue-sharing from national government to SNGs, nor total fiscal revenues dominated by natural resource rents. This is where local authority revenues (federated state, province, municipality, district, communities proximate to extraction operations) are dependent on the local taxes, levies and other local income-raising arrangements from companies operating in their jurisdiction. The survey, however, was not designed to penetrate to this level of detail. Sub-national ‘internal revenue generation’ (IRG) is discussed separately in Section 3.

2.2 Countries with Attributed Intra-governmental NR Revenue-Sharing Arrangements

Regarding the 17 countries with an explicit framework for intra-governmental assignments derived from NR revenues, most are statutory arrangements, contained within the constitution or laws on natural resource revenue management, fiscal management, tax codes, etc. In a few countries assignments are in part defined by government policy, e.g. Nigeria, Angola and Kazakhstan. Nigeria combines both statutory and (long-standing) policy arrangements. The policy arrangements for revenue-sharing to SNGs in Kazakhstan and Angola do not seem to be regularised.

The hierarchy of government structures within countries varies considerably. Some are federated states, e.g. Russia, Nigeria, where SNGs include semi-autonomous states. Others are unitary states, e.g. Colombia and Peru – with 2nd tier government authorities comprising regional, provincial or departmental assemblies. In both types of country, a variety of 3rd tier government jurisdictions are present: municipalities, districts, local government authorities, elected village councils and other formal community level authorities. In Nigeria, the Niger Delta Development Corporation (NDDC) which has economic planning jurisdiction across a number of the oil producing states, presents an interim level of authority between national and state level and receives a statutory portion of total national revenues.²

Of the 17 countries considered, 12 appear to make explicit, NR revenue-attributed, intra-governmental assignments to both 2nd and 3rd tier SNGs. Indonesia provides an illustration^x:

Indonesian Law on Fiscal Balance (Law 25/99):

- Producing provinces of Aceh and Papua receive 55% and 70% of oil revenues respectively, and 40% and 70% of gas revenues respectively.

² The proportion is ‘not’ directly attributable to oil and gas revenues

- Revenue-sharing for other originating provinces (P), districts (D), and adjacent districts (A) is 15% for oil revenue and 30% for gas revenue, split P3/D6/A6% for oil, and P6/D12/A12% for gas.
- All provinces receive 80% of revenues from mining, forestry, and fishing.

The remaining five countries in the survey – Angola, Chad, Malaysia, Nigeria and Sudan – appear to make transfers only to 2nd tier authorities, although in some countries there are requirements for 3rd tier authorities to be ‘involved’ in disbursements at this level, e.g. Chad. As noted in the illustration above, in Indonesia, districts ‘adjacent’ to producing districts also receive revenue transfers linked to the extent of contribution of the province as a whole. In Bolivia, a ‘National Compensatory Royalty’ of 1% of gross hydrocarbon production at well head is also payable to departments of Beni and Pando. These departments are not current producers, but are allocated the compensation in respect of the accommodation of a national highway, in adherence to the ‘benefits-tax principle’.

Both statutory and policy-driven assignments are based, at least in part, on the ‘derivation principle’ or ‘principle of origin’. This is where the portion of natural resource (NR) revenues transferred by national government to SNGs is large relative to the share of total revenues originating from the jurisdictions of the SNGs as a result of extractive industry operations. In all cases identified, only a ‘portion’ of total NR revenues accruing at national level is re-assigned to the producing regions. The other portion stays with central government for allocation to debt repayments, national long-term savings, annual national budgets or as conventional recurrent transfers to SNGs, producing *and* non-producing alike.

The portion transferred can vary considerably. With reference to the above illustration, in Indonesia up to 80% of mining revenues are transferred to the producing regions. In the Philippines, under the Local Government Mining Code, the figure is 40%. In Nigeria, for oil and gas producers, under the constitution, the figure is 13%.

Most revenue-sharing arrangements are based on relatively simple ‘percentages’, pursuant to the ‘derivation principle’ and drawn against a variety of revenue accounting variables, including, *inter alia*: percentage of gross production at well head (Bolivia), royalty as percentage of gross output of minerals (Philippines), percentage total national oil revenues accruing to Federal Account (Nigeria), royalty as percentage of gross value of petroleum output (Malaysia). Where the variable is linked to production and output figures, identifying the cash value of the assignment should be relatively straightforward, for example, integrated with the current efforts of EITI in Nigeria to undertake ‘physical and process audits’ around production and sales. Where the proportion is linked to total revenues received by national government, consideration will need to be given to the ‘available’ portion of this total.³ This complicates matters considerably.

In Nigeria, for example, the 13% assignment is based on revenues ‘accruing to the Federation Account directly from any natural resources’. Prior to revenues reaching the Federation Account, various priority ‘calls’ are made on these revenues, including: ‘cash calls’ by the Nigerian National Petroleum Company and statutory transfers to the National Judicial Council. In other countries there are frequently further priority calls on these NR revenues in relation to, *inter alia*, national debt, the workings of the state oil or mineral fund (e.g. early stocking of capital to build the endowment, long-term or short-term budget stabilisation, long-term investments), and conventional intra-governmental transfers.

³ Although, even here, calculating the value of revenues accruing from producing regions is not without problems, for example, different well heads for one company or consortium might be located in a number of different sub-national jurisdictions such that at the local level revenue from one well head might actually be derived from a reservoir underneath a different jurisdiction.

A key part of the EITI implementation strategy for NR revenue transfers to SNG will therefore need to not only reconcile payments by national governments of transfers with receipts by SNGs, but also to (i) validate what proportion of total NR revenues is derived from a particular producing region, and (ii) validate the calculation of the cash value of the assigned proportion that is 'available' for transfer.

2.3 Countries with Unattributed Intra-Governmental NR Revenue-Sharing

As already noted, certain countries have no formal arrangements for the attributed transfer of NR revenues to sub-national governments, and yet total national income is dominated by NR revenues. In these cases the majority of these unattributed intra-governmental assignments and transfers can be assumed to derive from NR revenues. This cluster of countries may present a further opportunity for sub-national implementation of EITI. The survey data drew on IMF figures for the period 2000–2003. Based on this survey, applying an arbitrary threshold of 60% of total fiscal revenues derived from NR revenues, suggests the following additional countries for consideration by EITI for expansion to the SNG level:

- Algeria (HC)
- Botswana (M)
- Brunei Darussalam (HC)
- Republic of Congo (HC)
- Equatorial Guinea (HC)
- Gabon (HC)
- Kuwait (HC)
- Libya (HC)

Since 2002, commodity prices for oil, gas and minerals have escalated. If prices remain historically high relative to pre 2002, as seems plausible (but of course by no means certain)^{xi}, is it quite likely that countries with previously lower relative contributions of NR revenues to national accounts should also be considered, since they may well have risen above the 60% threshold. This would mean including:

- Azerbaijan (HC)
- Cameroon (HC)
- Ecuador (HC)
- Indonesia (HC)
- Iran (HC)
- Iraq (HC)
- Kazakhstan (HC)
- Mexico (HC)

The difficulty for EITI with this grouping of countries is that rather than undertaking the types of validations indicated above (i.e. around percentage derivation and percentage availability), effort would need to be focused on reconciling conventional intra-governmental revenue transfers between national government and different levels of SNG. It is questionable whether EITI would wish to enter into this territory, not least because other international agencies already work in this area of fiscal decentralisation and the design of central inter- and intra-governmental transfers (grants, matched funding and loans), including other parts of the World Bank and IMF, as well as UNDP, Asian development Bank, African Development Bank and a number of bilateral agencies.

An anomaly here would be where, within conventional, 'mixed', intra-governmental revenue assignments, the portion derived from NR revenues *is* identifiable, i.e. is made explicit. Mexico appears to conform to this model. Here, although inter-governmental assignments are based on

a 'broad pool' of revenue sources, transfer volumes are calculated using a transparent formula that includes a component derived from NR sources.⁴ It is argued that this type of 'attributable yet mixed' intra-governmental revenue transfer formula, combined with clear and frequent reporting on actual disbursements and receipts, has meant that 'oil revenue sharing in Mexico has been relatively uncontroversial'^{xii}.

The above classification envisages allocating EITI resources on the basis of either the proportion of national income derived from NR revenues, or the existence of a legal or policy framework for intra-governmental transfers. An alternative approach is to target resources at specific producing regions regardless of the ratio of NR revenues to national income. The focus would be on those jurisdictions where a continued lack of accountability in intra-governmental revenue transfers (attributable or unattributable) carry high potential for revenue mismanagement, the failure to achieve sub-national sustainable developmental goals and/or elevate commercial risks for operating companies and investors. This approach would be more inclusionary of the mining sector, which rarely exceeds 10% of a country's total revenue and which to date has received less attention within EITI.

2.4 Limitations of the Survey

Further validation of the survey results is recommended if they are to contribute to decision-taking within EITI to expand activities to the SNG level. Specifically, within the survey: (i) not all on-shore producing regions could be readily identified; and (ii) categorisation of countries by their type of NR revenue arrangement arrangements^{xiii} is based on the default assumption that if no evidence of a statutory or policy framework could be found for intra-governmental NR revenue-sharing, then it is likely that the country is fully centralised, i.e. that no sharing of 'directly attributed' NR revenues is taking place.

⁴ In the other countries from the survey the formula for conventional intra-governmental assignments is separate from the formula (or percentage) applied to NR revenue transfers.

3. Mechanisms Through Which Revenues Reach Sub-National Levels

This section discusses the various mechanisms and routes by which NR revenues reach sub-national levels of government. The focus is on different mechanisms for non-renewable 'natural resource' revenues, not for revenues in general. Figure 1 provides a schematic diagram of the different mechanisms and routes.

Sub-national governments receive payments of NR revenues through three principal mechanisms:

- **Intra-governmental (or inter-governmental) revenue assignment** – where NR revenues are collected at national level and then assigned (shared downwards) to sub-national levels in the form of grants, matched funding or soft loans.
- **Internally generated revenue (IGR)** – including royalties from sub-national ownership of resources, surcharges on the national tax base (e.g. corporate income tax), local business taxes, registration fees and other levies, etc.
- **Intra sub-national level governmental transfers** – for example from a federal account or provincial account to district government authorities, or from district levels to community levels.

There are some rare occurrences of revenues being collected at the sub-national level and then shared upwards with national government, for subsequent redistribution. Only in the United Arab Emirates does there appear to be such a framework, and possibly also with Alaska through the workings of its petroleum fund.

3.1 Intra-Governmental NR Revenue Assignments

The majority of NR revenues accruing at SNG levels are derived from intra-governmental NR revenue-sharing from central government, not from local taxes or levies. In most cases the choice of tax base and tax rate, as well as the choice of percentage or formula for redistribution, are determined by the national authorities.

It is possible to identify at least three mechanisms for intra-governmental revenue-sharing: discretionary assignments, statutory assignments and authorised assignments. These are discussed below.

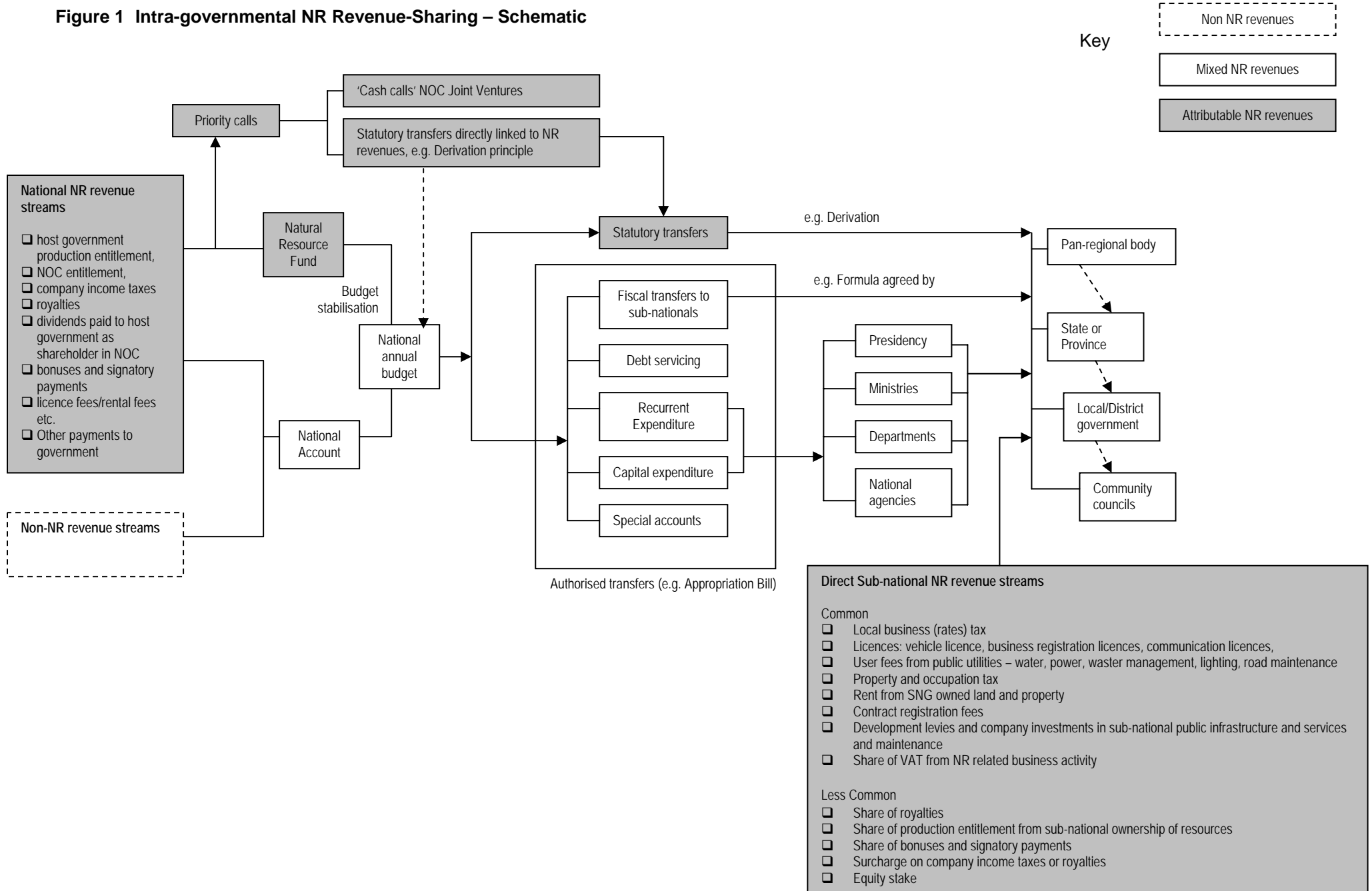
3.1.1 *Discretionary Assignments*

Discretionary assignment (as is possibly the case currently in Kazakhstan, and in Angola for regions other than Cabinda province) are transfers made without transparent or accountable authorisation, often by the Office of the President, or by those who have influence over national accounts or national Natural Resource Funds. Clearly, patronage within the national political system is a potential source of mismanagement with such transactions.

3.1.2 *Statutory Assignments*

Statutory, automatic assignments are those intra-governmental revenue transfers involving attributable or unattributable NR revenues, where the amount of the disbursements are defined by the constitution (e.g. Nigeria, Colombia) or within revenue management, fiscal law, etc. (e.g. Bolivia, Chad, Indonesia).

Figure 1 Intra-governmental NR Revenue-Sharing – Schematic



Such assignments may form part of the priority ‘calls’ on NR revenues, such as the 13% of NR revenues accruing to the Federal Account in Nigeria and transferred to producing regions. Or, they may be assigned ‘following’ these priority calls, i.e. as a secondary concern. Attributable assignments are generally based on some version of the ‘derivation principle’, as is the case in the Philippines and the Sudan, along with 15 other countries (see Table 1). In theory, it is possible for intra-governmental NR revenue transfers to be attributable on some basis other than the ‘derivation principle’, although we found no evidence for this during the survey.

Statutory intra-governmental assignments that are unattributable to NR revenue sources generally form part of conventional national to sub-national transfers. As already noted, in a number of oil, gas and mineral-rich countries, the share of total national revenues (and thus the share of available revenues for intra-governmental transfer) is dominated by NR revenues.

At the sub-national levels of government, receipt of statutory grants (and other automatic grants) from national level are generally preferred because they provide a fixed income and avoid either having to negotiate an annual budget transfer or depending on authorisations by national politicians with uncertain outcomes^{xiv}.

3.1.3 Authorised Assignments

Authorised assignments rely on regular, usually annual, decision-making by national authorities. This includes approvals by the National Assembly or Parliament within, or external, to an Appropriation Bill; and decisions taken in the President’s Office or Cabinet, or by parties authorised to agree disbursements from national Natural Resource Funds.

For example, authorisation is needed for disbursement of developmental and social expenditure from the oil funds in Chad and Azerbaijan. In Nigeria, after ‘first calls’, the National Assembly approves assignments of NR revenues to all sub-national governments based on a long-standing formula (see Box 1). In the latter, as far as can be ascertained, NR revenues are mixed to a limited extent with other revenue sources. In Mexico the formula for calculating NR revenue assignments is defined within law, and includes, in part, a derived portion relating to regions of oil extraction and transportation taxes^{xv}.

Box 1 Nigeria – Formula for Authorised Intra-Governmental Assignment of Revenues^{xvi}

Transfers to states and local governments from the Federation Account are distributed according to a single formula. Nearly half (47.5%) of the allocation is made as a lump sum transfer, primarily comprising funds from the general allocation. The remaining 52.5% is determined by weighted criteria, as follows:

- Lump transfer: 47.5%, comprising:
 - 40% general allocation
 - 7.5% from the revenue equalisation

- Weighted criteria: 52%, comprising:
 - Population (30%)
 - Geographic area (10%)
 - Revenue efforts (2.5%)
 - Social Criteria
 - No. of pupils enrolled in primary schools (2.4%)
 - No. of pupils enrolled in secondary schools (0.8%)
 - No. of hospital beds (3.0%)
 - Index of access to clean water (1.5%)
 - Quantity of rainfall (1.5%) (inverse)

Nigeria has in place both statutory and authorised frameworks for sharing oil revenues between national and sub-national levels. A schematic diagram of these mechanisms is given in Figure 2, and for minerals development in Papua New Guinea in Figure 3.

In both the statutory and authorised version of NR revenue-sharing (attributable and unattributable), the allocation of funds takes place generally as either a 'block grant' (a grant, matched fund or soft loan) delivered as a whole without determining the specific use or the destination project or programme – or as an 'earmarked' grant – where the law (if statutory) or the specific authorisation defines the end use of the revenues^{xvii}. Revenues transferred to SNG authorities via national Ministries tend to be earmarked, e.g. for water or road construction programmes. Revenues transferred directly tend to be 'block grants'. For reasons of policy accountability and political control 'block grants' are generally preferred by SNGs, although not by the central government.

3.2 SNG 'Internal' Revenue Generation

Common local taxes, levies and other more rare internal revenue generation (IRG) by sub-national government authorities from oil, gas and mining activities are given in Box 2.

Box 2 SNG Internal Revenue Generation – Typology
<p>Common</p> <ul style="list-style-type: none"> • Local business (rates) tax • Licences: vehicle licence, business registration licences, communication licences, • Fees for planning, permits and contracts • User fees from public utilities – water, power, waste management, lighting, road maintenance • Property and occupation tax • Rent from SNG-owned land and property • Development levies and company investments in sub-national public infrastructure and services and maintenance • Compensation payments and fines • Share of VAT from NR-related business activity <p>Less Common</p> <ul style="list-style-type: none"> • Share of royalties • Share of production entitlement from sub-national ownership of resources • Share of bonuses and signatory payments • Surcharge on company income taxes • Surcharge on royalties • Equity participation

Essentially there are three categories of internal revenue-raising within SNG jurisdictions:

- *Proceeds sharing at the sub-national level*^{xviii} – where sub-national jurisdictions (government authorities, local land owners, recognised indigenous peoples with collective asset ownership, etc.) have rights to a share of equity, royalties, signatory or bonus payments, or other forms of proceeds sharing, e.g. in the Philippines and Papua New Guinea.
- *Sub-national raising of taxes* – Sub-national tax raising powers where the choice of tax base and tax rate is determined by the national authorities, or where the tax is effectively a

surcharge on national taxes and utilises the tax base defined by national (or state) governments.

- *Charges, fees, levies, fines, etc.* – other non-tax charges raised at the sub-national level, e.g. for environmental permitting, business registration, etc.

Figure 2 Intra-governmental NR Revenue-Sharing – Schematic: Nigeria – 2004 Income, 2005 Budget^{xix xx xxi}

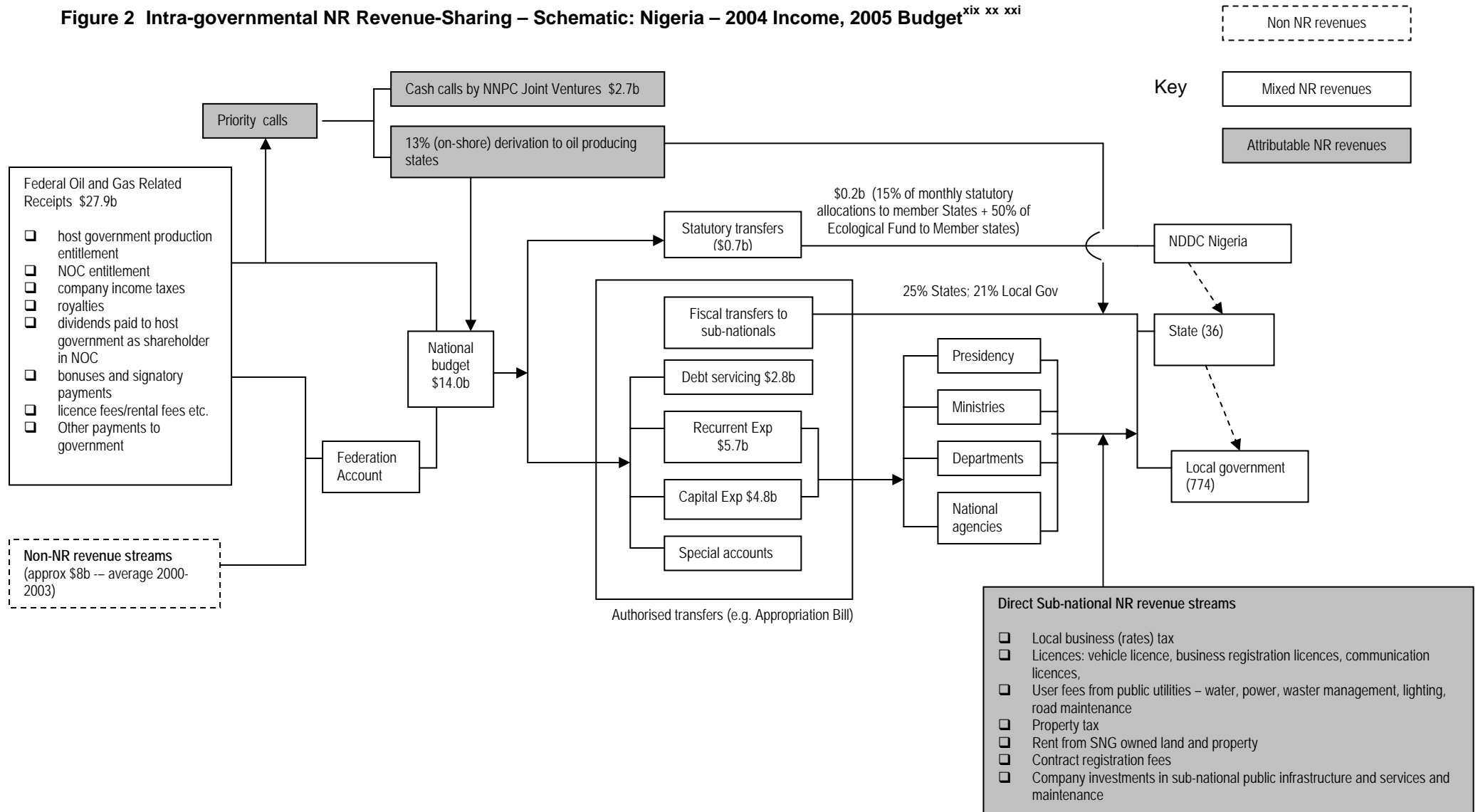
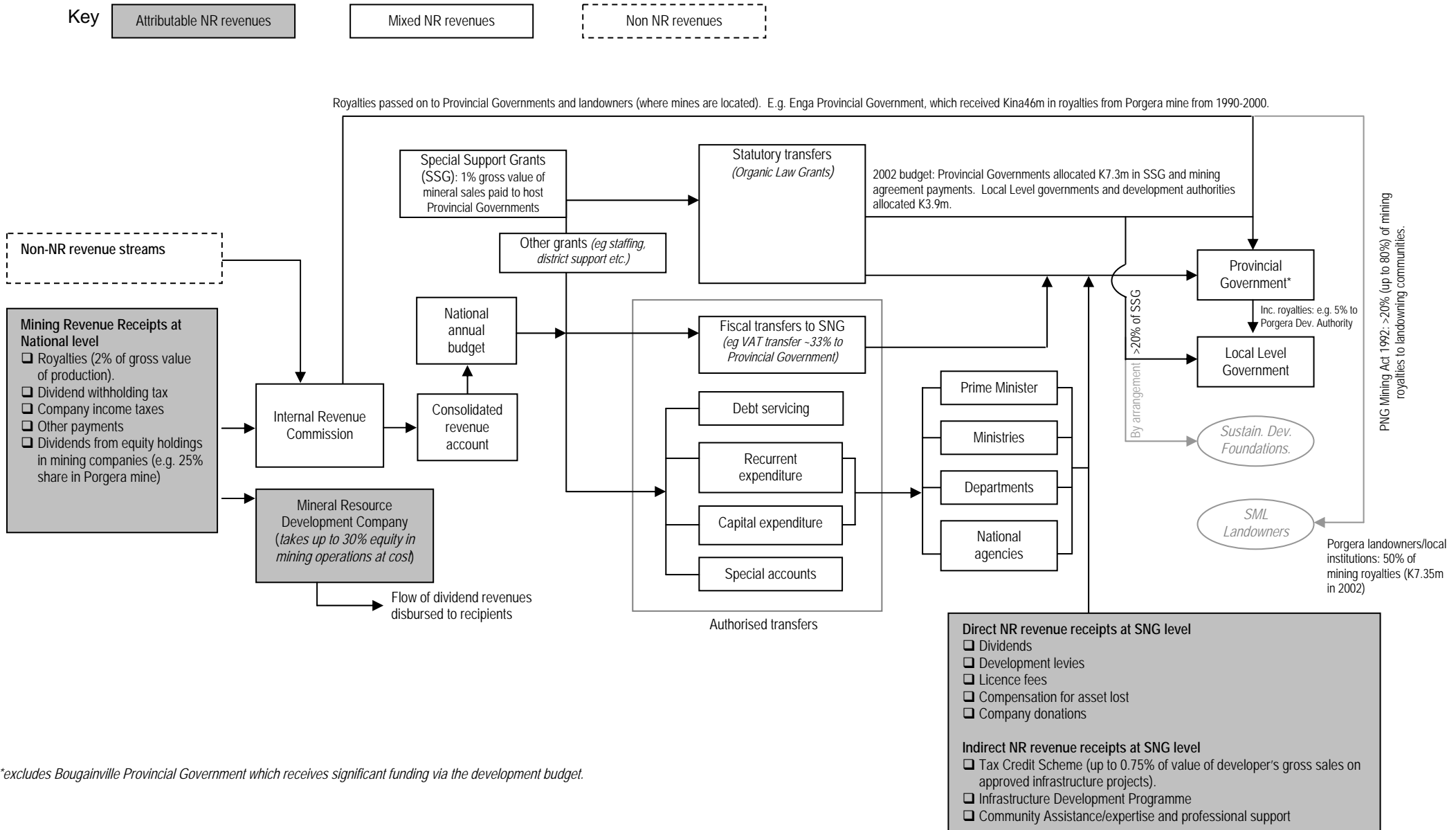


Figure 3 Intra-governmental NR Revenue-Sharing – Schematic: Papua New Guinea



*excludes Bougainville Provincial Government which receives significant funding via the development budget.

3.2.1 *Proceeds Sharing at the Sub-National Level*

Equity

Although it is common for national authorities to hold equity in strategic natural resource companies, it is unusual for this to occur at sub-national government level. Where it does occur, dividend streams may become highly significant, as is the case in Papua New Guinea where in addition to national equity stakes, landowners and provincial government take 5% equity in new mining developments. Currently policy is for this equity to be granted for 'free'^{xxii}.

Royalties

The calculation of royalties is often comparatively straightforward and uncomplicated compared to calculations of production sharing, lending this instrument to application at provincial and community levels. Types of royalties include: royalties on profits, royalties based on unit type and *ad valorem* royalties. Where royalties are collected nationally, sub-national government may also impose a royalty 'surcharge'. In Bolivia, royalty payments to SNG authorities are based on gross hydrocarbon production at the well head. Here, 11% of the value of production is distributed from national government to the departments where production originated^{xxiii}.

Share of bonuses and signatory payments

The rapid desk-based survey undertaken for this report suggests that it is comparatively rare for sub-national governments to either receive directly or be allocated a share of bonus or signatory payments. Where it does occur, political pressure is often a factor. For example, following the extension of the Block Zero concession by Sonangol (the Angolan NOC) in 2004 to Cabinda Gulf Company (a subsidiary of ChevronTexaco), Sonangol received an up-front payment of US\$210 million. In addition, US\$80 million was given for distribution to social and community projects, some of which was to go to the province of Cabinda^{xxiv}.

3.2.2 *Sub-National Raising of Taxes*

Surcharges

Surcharges are usually calculated as a specified percentage of an existing, usually nationally collected, tax base. Since surcharges are paid locally (independent of national agencies) they represent a relatively simple means for sub-national government to raise revenue. Surcharges are also a method whereby national and sub-national government are able to share tax bases^{xxv}. For example, Alaska charges a production tax surcharge for fines paid to national government for hazardous spills^{xxvi}.

Property tax

Often levied by local government, property tax can represent a significant local tax in terms of its contribution to total local authority revenues. The tax is usually calculated annually as a percentage of the book value or assessed value of the property.

Income or profits tax

The complexity of balancing taxable revenues and deductible costs makes the assessment of income/profits tax most suitable at a national level. If applied at provincial or local levels it may take the form of surcharge. However, near-parallel income tax systems do exist at provincial level in several countries, including China and Canada.

Tax credits

Tax credits serve to reduce tax liabilities that would otherwise be due. Tax credits may be an effective method of ensuring that extractive industry operations benefit local populations. For example, in Papua New Guinea, the mine developer may spend up to 0.75% of the value of gross sales on local infrastructure projects. This then becomes a tax credit, offset against the tax the developer would pay to the national government, who foregoes tax revenue. For the local authority it can represent a considerable additional income by freeing internal resources for other priorities.

3.2.3 Charges, Fees, Levees, Fines, etc.

Registration, etc.

Common amongst both national and sub-national government are the nominal charges made for the application, issuing and registration of licences and other documents and approvals. Often the fees charged are relatively small, intended to generate revenue only to cover administrative costs. Relevant examples include: equipment licences, exploration licences, water licences and mining leases.

Subsurface rental or land use fees

Rent, land use fees, occupation fees and surface rental instruments are found across all levels of sub-national government. Often fees are calculated by land area, and then multiplied by a standard rate determined by the type of activity for which the land is being used. The assessment is often constrained by national or provincially imposed limits. In Indonesia, the tax base, rate and administration of the mining land rent is undertaken by central government, but with revenue split as follows: 65% to the centre, 19% to provinces and 16% to local government^{xxvii}.

User fees

User fees are imposed for the usage of local infrastructure such as roads, ports, airports, power lines and water reservoirs. Various names given to these taxes: social infrastructure development tax, road maintenance tax, etc. Normally they are administered by the level of government liable for the maintenance costs.

Development levies

Development levies would include infrastructure development levies, economic development and land use follow-up levies and community and social development levies. In Papua New Guinea, development levies are mandated in the Organic Law on Provincial Governments and Local-level Governments. Here, operators of natural resources must pay levies to provincial or local-level governments of the province in which the operations are situated.

Compensation payments and fines

Fines and compensation charges can be incurred for a variety of reasons. In addition, a number of oil-producing regions have progressively used environmental fines to increase regional revenues. For example, in Kazakhstan environmental fines rose 400% in 2004, compared to 2003), possibly as a result of the right to levy greenhouse emission rights shifting from central authorities to regional authorities^{xxviii}.

3.2.4 Conclusion

Further research is recommended to determine the proportion of total IGRs derived from local NR operations and activity relative to transfers from the national level. Other than, perhaps, for local authorities who receive a direct share of royalty payments and other proceeds, we assume that given the current commodity prices (and if we include the share of VAT proceeds), the total relative value of locally raised taxes and charges is small. Invariably, therefore, there is heavy reliance in oil, gas and mining producing countries by SNGs on intra-governmental NR revenue transfers. This can be seen in part by comparing the range of NR revenues in the Philippines, as follows (converted into US dollars)^{xxix}:

SNG Entitlement of Payments to National Government (40% of total NR revenues accruing to national level)

- Province – 20%
- Municipality – 35%
- Barangay – 45%

Other Payments to SNGs

- Business Tax – varies
- Real property tax – 2% of market value + 1% education levee
- Occupation tax:
 - exploration – US\$0.1/hectare/annum;
 - development area – US\$1/hectare/annum;
 - mineral reservation – US\$2/hectare/annum
- Professional tax (not exceeding US\$6/annum)
- Fixed tax for every delivery truck (US\$10/annum)
- Registration fees
 - US\$1/ha
 - For mineral reservation areas US\$2/ha

The low relative level of receipts of internally generated NR revenues presumably has implications for the EITI in deciding where to target efforts for SNG implementation. For example, in relative terms at least, the consequences of mismanagement in the process of payments and receipts from local taxes and charges is likely to be substantially less than the consequences of mismanagement from intra-governmental disbursements and related SNG receipts. If so, it may be difficult for EITI to justify directing resources to validating, reconciling and publishing local company payments and SNG receipts, when compared to the benefits for transparency and accountability (and their linkage to anti-corruption, poverty reduction and political stability) of working at the intra-governmental interface.

3.3 Transfers between Sub-national Levels of Government

In compiling this report, we found no evidence of legal or policy-driven arrangements for the transfer between different sub-national government jurisdictions levels of revenues attributable to NR related income, neither between provincial levels and district or municipal levels, nor between these levels and community levels. Indeed, we also found no evidence of such arrangements for transfers between individual ministries at the national level and sub-national levels of government.

We would recommend further desk-based research to determine the extent of ‘unattributable’ NR revenue transfers between sub-national levels, i.e. of revenues from ‘mixed’ sources, transferred as grants, matched funds or loans. The literature on intergovernmental transfers and fiscal decentralisation has yet to be fully explored.

3.4 Transparency and Accountability Mechanisms Relevant to the SNG Level

EITI implementation is based on the validation and regular publication of reconciliation in material payments by companies to national government and receipts by national governments. For sub-national EITI implementation, validation and reconciliation of payments and receipts will need to take a different form. It has already been noted that this could include validation of both (i) the proportion of total NR revenues derived from a particular producing region, and (ii) the calculation of the cash value of the assigned proportion that is available for transfer. Other areas of potential scrutiny include each of the three principal mechanisms by which sub-national governments are financed by NR revenues.

3.4.1 Intra-Governmental NR Revenue Assignments

First, there is need for transparency in transfers from the various ‘disbursement’ accounts at national level. This would include: that portion of the national consolidated accounts dedicated for fiscal transfers to sub-national governments (in Nigeria this is the Federation Account); the designated accounts established to manage disbursements of development capital from national Natural Resource Funds; and, possibly, accounts managed by individual ministries that make disbursements to the SNG level. These disbursements would then need to be reconciled with the recorded income of the receiving jurisdictions.

To understand this ‘disbursements transparency’ at the national level, scrutiny may also be needed of the passage of NR revenues through the various designated accounts that take the proceeds of crude oil or mineral sales, corporate income tax and royalties, through to these national level disbursement accounts. To an extent, the existing work of EITI already looks at some of these designated, interim accounts, but the review is around reconciling receipts with payments, not in tracking these receipts through to disbursement accounts. For example, EITI reconciliation in Nigeria looked at designated accounts managed by the Central Bank of Nigeria for crude oil sales (via JP Morgan Chase) and for oil and gas tax receipts, but not, we believe, at the accounts within the national bank of Nigeria used for disbursing NR revenues to sub-national level, either directly, in accordance with the 13% derivation or indirectly as part of a ‘mix’ with other revenue sources, in accordance with the formula for conventional intra-governmental transfers.

3.4.2 Internally Generated Revenue

Reconciliation of internally generated revenues (IGR) at the sub-national level, derived from the presence of oil, gas and mining companies, would be more akin to existing EITI implementation in that they mostly involve payments by companies and receipts by governments. The principal difference is that the amounts involved are likely to be far less, and yet, across a country, the number of individual transactions (payments and receipts) substantially more.

The ‘materiality’ principle of EITI suggests that criteria might be introduced to aid determination of which payments to consider, and between whom. Examples might include: (i) thresholds of company size relative to the jurisdiction, e.g. the proportion of total annual IGR revenues sourced from one company; (ii) a focus on state or province level jurisdictions only; or (iii) categories of IGR above a creation financial level.

3.4.3 Intra Sub-National Level Governmental Transfers

Transfers between federal/provincial accounts and municipal/district accounts, or between district and local community level authorities, present even more of a problem. First of all, they are likely to be unattributable transfers, where the portion of NR revenues is mixed with other revenue

sources. In addition, these lower levels of government may not be required by law to report their income, budgets or financial accounts to higher levels of government. That said, alternative sources of information on payments and receipts *may* be available via national level government authorities, such as the Accountant or Auditor General's office of the national bank. In Nigeria, for example, the Central Bank of Nigeria supports annual surveys that might be modified to assist in scrutinising these types of intra-SNG transfers^{xxx}.

4. Sub-National Revenue Management and Transparency: Issues and Measures

4.1 Issues

The premise of EITI is that in countries highly dependent on revenues from oil, gas and mining, the potential negative impacts of mismanaged revenues on corruption, poverty and conflict can be mitigated, and these revenues can instead become an important engine for long-term economic growth that contributes to sustainable development and poverty reduction^{xxxii}. In applying EITI to the sub-national level the implication is therefore that somewhere in the process of transferring NR revenues to (or when accruing within) sub-national levels of government, there is mismanagement, and that this mismanagement, as at the national level, is associated with corruption, poverty and conflict^{xxxiii}.

At the sub-national level, this association of NR revenues with corruption, poverty and conflict works in a number of ways.

4.1.1 *Mismanagement and Corruption*

The sources of mismanagement and corruption involving NR revenue management at the sub-national level are many.

Leakage prior to disbursement

The first point to make is that the potential for mismanagement of NR revenues arises not only during the process of actual intra-governmental transfers, but also in the passage of revenues through the various designated accounts at national level, on their way to those accounts from which the transfers are actually disbursed. For revenue-sharing directly attributable to the accumulation of NR revenues at national level, this potential 'black-box' extends to the calculation of the portion of revenues available for transfer. As already noted, 'first calls', debt repayment, stabilisation and volatility fund management, statutory and discretionary transfers can all rapidly eat into the available revenues. There is, therefore, a possible role here for EITI in aiding transparency over whether the balance, after these priority deductions, is actually the right amount.

Inaccurate derivation calculations

Further, if intra-governmental transfers are based on the 'derivation principle', then inaccuracies may also arise in determining the proportion of total NR revenues derived from a particular producing state, province, district or affected community. The complexity of such calculations provides an obvious opportunity for mismanagement and misappropriation.

Discretionary transfers

With regard to the transfers themselves, if central government revenue assignments to sub-national levels are not made against statutory rules, or agreed formula or policy, nor made transparent and accountable through the democratic process, the likelihood is towards 'discretionary transfers'. This may then exercise loyalties of sub-national government officials and attract patronage within national political systems^{xxxiii}. The risk of patronage-driven fiscal transfers is potentially worsened the higher the share of sub-national tax revenues not derived from locally sources.

Poor fiscal reporting

In Nigeria, as in some other countries, lower levels of government may not be required by law to report their financial accounts to higher levels of government. This also provides fertile grounds for mismanagement. Other risks arise where sub-national governments are able to impose their own corporate income tax (i.e. as a surcharge on the national tax base). This not only leads to high transaction costs for companies but can also increase the incentive for tax avoidance^{xxxiv}.

Disincentives for investment

Further, an absence of clear rules, regulations and laws (or of language that only trained lawyers can understand) covering intra-governmental NR revenue assignment and the raising of local taxes and fees, also carries potential for fuelling mismanagement. Combined with weak or politicised judicial systems, these weak regulations can lead to legal challenges and subsequent adverse impacts on inward investment, as was recently the case in the Philippines with the Foreign Investment Law challenged in the Supreme Court.

Insufficient absorptive capacity

Intra-governmental redistribution of NR revenues (especially in times of high commodity prices) can reposition recipient SNGs departments as key drivers of local economic growth. However, a lack of institutional and administrative absorptive capacity in the local public sector frequently leaves SNGs ill prepared for the challenge of translating these resource revenues into local economic and social development. The budgeting, disbursement and public sector procurement capabilities of local government may simply not be capable of handling the elevated revenue flows and higher volumes of recurrent and capital works expenditure. These constraints then fuel inefficiencies and mismanagement in the public sector and can lead to excessive spending on social expenditure and public infrastructure, politicised 'white elephant' projects, and growing opportunities for corruption.

4.1.2 Worsened Poverty

There are also many linkages between poor transparency and accountability in NR revenue management at the SNG level and a worsening of poverty, both in the local jurisdiction and nationally. These include the following:

Eroded local tax base

Much of a government's strength comes from its capacity to extract taxes from the population, a capacity often built up over considerable time. SNG authorities that fail to maintain this tax-raising capability during 'resource booms' are likely to be unable to resume the provision of public goods or ameliorate social conflicts once the redistributed revenues from the boom recede^{xxxv}^{xxxvi}. Erosion of the local tax base can in turn challenge local fiscal accountability – the 'social contract' between local tax payers and local democracy – thereby fuelling unresponsive local government.

Perverse incentive

Dependence by SNGs on income derived from the national level can also act as a perverse incentive, encouraging sub-national authorities to intentionally lower locally-raised taxes in order to achieve a domestic competitive advantage and promote inward domestic or foreign investment. This 'race to the bottom' seems more likely in federal systems^{xxxvii}. This effect brings into question the use of 'equalising transfer allocation techniques', which, independent of the derivation principle, may be used to determine the level of intra-governmental assignments. These techniques work on the basis that the amount of assignment needed by a level of SNG is

based on the 'gap' between expenditure commitments and priorities, and the level of taxes raised in the jurisdiction, i.e. on sub-national fiscal capacity and spending needs.

Magnified volatility

Most critically, where the majority of revenues at the sub-national level are derived from NR revenue transfers by central government; this can magnify exposure of the local jurisdiction to fiscal volatility, such that when commodity prices decline (and fewer revenues are available for intra-governmental sharing) local governments cannot address this problem for lack of an alternative revenue base^{xxxviii}. This can then endanger minimum levels of public services or dislodge future plans for delivering poverty reduction targets and the Millennium Development Goals (MDGs). As recently argued: 'most recognise that without predictable transfers from higher levels of government, local governments are often unable to finance basic service delivery or infrastructure investment'^{xxxix}.

The effect of sustained high natural resources commodity prices again only serves to magnify the difficulties for sub-national governments. In this case, when prices do eventually fall, sub-national governments, whose budgets have acclimatised to the high revenue levels and who have borrowed heavily against anticipated future revenue streams, will find they are dramatically overexposed on both their recurrent and capital accounts.

Loss of fiscal flexibility at the national level

Use of the derivation principle can magnify this effect still further, especially if the allocation rate (percentage of total available NR revenues) is relatively high, for example as in Indonesia. Currently the global trend is for more pressure to be exerted on national governments by producing states to increase the rate of NR revenues transfers back to their region. The problem is that this increasingly limits the ability of central government to perform either its redistributive (inter-sub-national 'equalisation') function, or its macro economic function (i.e. its short-term or cyclical budget 'stabilisation' function).

Local dutch-disease effects

The economic dutch disease effects of public expenditure involving high levels of NR revenues are well documented^{xi xli}. The same effects can be exacerbated at the local level where SNGs, who are recipients of substantial NR revenue transfers, engage in consumption rather than productive public expenditure, e.g. on salaries and staffing levels of public bodies, rather than ports, road infrastructure and reliable power and water suppliers.

4.1.3 Conflict Escalation

There is some sound economic justification for applying the 'derivation principle' to the sharing of NR revenues. For example, many regional or local government authorities provide significant services and physical infrastructure of direct benefit to the exploitation of natural resources, and/or absorb additional costs in terms of maintenance and environmental damage. Thus, under the benefit-tax principle, a degree of horizontal 'skewing' of revenue-sharing towards the most affected provinces, districts and communities is understandable^{xlii}.

That said, the main arguments for assigning oil revenues to sub-national jurisdictions are essentially political, often the result of attempts by central governments to appease separatist tendencies in natural resource-producing regions^{xliii}. It follows that failure to distribute NR revenues to SNGs in producing regions in sufficient quantities may create tensions in the federal countries or in regions. This is particularly acute where major ethnic differences prevail or where indigenous peoples have not received significant benefits linked to the presence of the national state^{xliiv}. And yet the opposite is also true, i.e. that application of the 'derivation principle' can lead

to horizontal imbalances between producing regions and non-producing regions, leading to visible economic disparities which fuel political and social tensions on the national stage.

Finally, there is the important issue of ‘timing’. Allowances for companies and consortia to recover the capital costs of their investments, the need to build up a stock of capital within National Resource Funds before beginning major disbursements, urgent budget stabilisation and poverty reduction ‘calls’ on NR revenues, and rescheduled debt repayment, can all act to reduce the availability of revenues for transfer from national to sub-national government in the first few years after the start of production. This can rapidly lead to perceptions of a perceived ‘economic gap’ between the ‘pain’ of hosting extractive industries and the potential ‘gain’ from revenue-sharing. This gap can be a strong source of the social and political tensions described above^{xlv}.

Table 2 shows types of payments made from national government to sub-national government in the Philippines during four phases in the life cycle of mining projects: exploration, development (i.e. the principal construction period), the period of capital cost-recovery, and the period of post cost-recovery operations. As can be seen, optimum intra-governmental NR revenue-sharing arrangements may not take place until perhaps five years after the commencement of production.

Table 2 Chronology of Direct and Indirect NR Revenue Payments to National and Sub-national Governments – the Philippines^{xlvi}

Monetary Payments	Expl/Development	Operating Phase	
		Recovery max 5ys	Post recovery
1a. Payment of Excise and Other Taxes and Fees to National Government (DAO 99-56)			
Excise (Royalty) Tax on Mineral - 2% gross output (market value); 5% if in Mineral Reservation Area (RA 7729)	n/a	no	yes
Excise Tax : - Coal: P10/MT/annum. Copper & metallic minerals: 1-2% market value of gross output/yr (NIRC)	n/a	no	yes
Excise Tax - Gold & Chromite : 2% on the actual market value of the gross output per annum (NIRC)	n/a	no	yes
Corporate Income Tax - 35% income, or 3% sales	no	no	yes
Value Added Tax - 10% value	yes	yes	yes
Capital Gains tax - 5-10% of value (NIRC)	no	yes	yes
Customs Duties - rate set by Tariff & Customs code	yes	yes	yes
Storage charge of imported equipment - P0.25-0.50/Ton (NIRC)	yes	yes	yes
Arrastre charge- P4.50/Ton (NIRC)	yes	yes	yes
Tax on interest payment of foreign loans - 15%	no	no	yes
Tax on foreign stockholder dividends - 15% of dividend	no	no	yes
Documentary stamp duty - transaction variable	yes	yes	yes
Improperly accumulated earnings tax - 10% (NIRC)	no	no	no
Intercompany dividends tax - 15% of value (NIRC)	no	no	yes
1/2 of 1% of the gross selling price or gross value of the shares of stock sold (NIRC)	no	yes	yes
20% Final withholding tax on interest of foreign loans	no	yes	yes
1b. Financial or Technical Assistance Agreement FTAA Options (DAO 96-40)			
Net Mining Revenue Option - 50% of gross output (market value) minus deductible expenses (DAO 99-56)	no	no	yes
Net Cashflow Option - as above but interest payment of loans not deductible (DAO 99-56)	no	no	yes
Profit based Option - 25% of excess profit: (net income after tax minus 40% of gross output)/(1 minus income tax rate)	no	no	yes
2a. LGU Entitlement of Payments to National Government (40% of above)			
Province - 20%	no	?	yes
Municipality - 35%	no	?	yes
Barangay - 45%	no	?	yes
2b. Other Payments to LGUs			
Business Tax - varies	yes	yes	yes
Real property tax - 2% of market value +1% education levy/ee	yes	yes	yes
Occupation tax (to : exploration - P5.00/hectare/annum; MPSA/FTAA - P50.00/hectare/annum; mineral reservation - P	yes	yes	yes
Professional tax (not exceeding P300.00/annum)	yes	yes	yes
Fixed tax for every delivery truck (P500.00/annum)	yes	yes	yes
Registration fees - P50.00/ha. For mineral reservation areas P100.00/ha	yes	yes	yes
3. Other Regional Stakeholders			
Social Investment - 1% of direct mining and milling costs (90% SDMP, 10% mining technology and geo-sciences)			
Semi-annual mine wastes and tailings fees (P0.05/MT of mine wastes/P0.10/MT mine tailings)	n/a	yes	yes
Environmental management - min 10% of capital expenditure during construction	yes	no	no
One time payment to surface/claimowners re change in law	yes	n/a	n/a
Royalties to indigenous cultural communities - 1% of gross output of minerals	n/a	no	yes
CLRF- ETF min P50,000; MRF 10% of EPEP + P50,000/month; MWTRF P0.05/MT mine waste, 0.1/MT tailings	yes	yes	yes
Community Tax - P500.00/annum	yes	yes	yes
Highlighted - Payments to Regional Stakeholders			

4.2 Measures to Improve Sub-National Revenue Management and Transparency

For the combined reasons of magnified fiscal volatility within SNG authorities, potentially unsustainable recurrent (often consumptive) public expenditure by SNGs, constraints on national government to perform either its horizontal redistributive function or macro economic budget stabilisation function, and risks to political stability, many commentators argue that it is best not to share NR revenues with sub-national levels but instead to fully centralise oil, gas and mineral revenues.

If such intra-government transfers *are* to take place, the following measures can be recommended to help manage the risks.^{.xlvii xlviii xlix}

- Complete and timely statistical information on fiscal performance made available.
- The amounts of revenue involved should be kept relatively small, i.e. relative to total revenues within the SNG jurisdiction.
- Depending on the scale of the potential fiscal volatility, appropriate safeguards and transparency to protect levels of critical recurrent expenditure.
- Sub-national government jurisdictions assigned other more regularised sources of revenues, e.g., production excises and local surcharges on corporate income taxes.
- Overlap of NR revenues with other sources (as with Mexico).
- Assignment of taxation powers and expenditure responsibilities to central and sub-national governments based on stable principles, rules and agreed formulae, clearly and transparently formulated, and implemented as legally prescribed, in an open and consistent manner.
- Rules and procedures for modifying these revenue-sharing arrangements established.
- Revenue transfer systems should address vertical imbalances between the central and local governments, and horizontal imbalances across local governments, e.g. in producing and non-producing states.
- The formulae for revenue-sharing to take into account macroeconomic considerations and national fiscal policy objectives, and entail setting fiscal deficit targets and expenditure ceilings for sub-national governments to curtail demand in periods when large natural resource revenue spikes occur, thereby avoid unsustainable levels of recurrent expenditure.
- An intra-governmental regime established to operationalise the above, executed through fiscal responsibility laws, internal stability pacts or other institutional arrangements that seek to coordinate fiscal management between central and sub-national governments.

The IMF Guide on Resource Revenue Transparency (2005) is directed mostly at the national, not sub-national, level. Much of this guidance is, however, very relevant to the reconciliation of payments and receipts for attributable (and non-attributable) NR transfers between sub-national layers of government. With adaptation, this includes¹, *inter alia*:

- clarity in the roles and responsibilities of different layers of SNG authorities
- clear mechanisms for the management of budgetary and extra budgetary activity
- expenditure of public funds governed by budget law and open administrative rules
- taxes duties, fees and charges to have an explicit legal basis
- government involvement with the private sector to be conducted in an open manner
- publishing of budget documentation and final accounts on a regular basis

- a legal obligation to publish fiscal information
- budget information presented in a way that promotes accountability
- budget execution internally audited, and the procedures open to review.

More specifically, for SNG authorities whose total revenues are dominated by attributable intra-governmental NR revenues (or by ‘mixed’ transfers containing a high proportion of NR revenues) there is a need to build on existing fiscal decentralisation programmes so that they also embrace the specific needs of local authorities to manage the volatility, savings and expenditure aspects of NR revenues. This includes⁵:

1. The design of medium-term budget or expenditure frameworks (MTEFs) within SNG authorities that take account of the potential for high volatility within the period of the budget.
2. Development of resource allocation criteria that are ‘downwardly accountable’, especially to those local populations that are most adversely affected by extractive industry operations, or where attributable NR revenues are in the form of ‘earmarked’ grants.
3. Improved local level industrial, competitiveness and investment policies that achieves the right balance between maximising productive investment, avoiding localised dutch-disease effects (crowding out and spending effects) and delivering public infrastructure and other development goals.⁵
4. Preparation and dissemination of communication materials on revenue receipts and public expenditure that take account of items 1, 2 and 3 above.
5. Improved public expenditure transparency and accountability mechanisms through local multi-stakeholder fora mandated to ensure consideration of items 1, 2 and 3.

Finally, a key feature in creating linkage between NR revenue transfers and local economic development is for the recipient SNG authority to use part of these revenues to develop vertical and horizontal business linkages with the resource production sector. This includes employment promotion, skills enhancement, enterprise development and infrastructure alignment. This could include, for example, public–private partnerships on infrastructure projects between the SNG authorities and the operating companies.

⁵ Locally calibrated, General Equilibrium Models and other forms of economic options analysis can play an important role here.

5. Sub-National EITI Implementation: Models and Issues

5.1 Issues

The issues for EITI to consider in expanding its mandate to include implementation at the sub-national level can be divided into two categories. The first has to do with the need to broaden the concept of validated and reconciled accounts to embrace not just company-to-government revenue transfers, but intra-governmental transfers; and related to this, the sheer complexity of the task given the many different transfer mechanisms and routes, and the progressively poor quality of fiscal records, the lower the level of government. The second is the danger that the benefits of reduced mismanagement from EITI implementation at the sub-national level may be off-set by the potential for such expansion of the initiative to inadvertently fuel a trend towards greater decentralised NR revenue management.

5.1.1 A Complex Task

The difference between EITI implementation at the national level and at sub-national levels is in the sheer number of validations and reconciliations that may need to be carried out. Regarding payments by companies direct to SNG jurisdictions, whilst the number of companies involved is likely to say around the same, there are many more recipients. Take for example the eight main producing states in Nigeria. Not considering sub-provincial government authorities or benefits-sharing local communities, the number of reconciliations needed of 'disbursements made' versus 'payments received' would need to increase by this factor of eight. Reconciliation of disbursements made by national government would need to be added to this against the 13% derivation of NR revenues for the same eight states.

And this covers only the 'attributable' revenue transfers, i.e. those directly linked to the accumulation of NR revenues at the national level. An argument was made earlier about cases where national revenues are assigned on an unattributable basis, i.e. mixed with other sources of revenue, but with the majority of these derived from NR production and activities. If these transfers are to be included under a new EITI initiative, then, again taking the Nigeria example, reconciliation would be needed of the national disbursements and SNG receipts that result from the annual authorisation of intra-governmental assignments for all x states and y local government authorities.

Also, with respect to unattributable transfers, in order to fully track the flow of NR revenues, reconciliation may also be needed between the disbursements from the designated accounts of individual ministries to SNGs (e.g. for road building programmes).

Overall, for unattributable intra-governmental NR revenue assignments, the process of strengthening transparency and accountability would bring the new EITI proposals far closer to the IMF Code of Conduct than the existing initiative.

Finally, whether for attributable or unattributable NR revenue transfers, not only is the task of validating and reconciling NR revenue transfers to sub-national levels complex, it is also likely to be severely hampered by the progressively poor quality of fiscal records the lower the level of government.

5.2.1 Risks

As already noted, intra-governmental assignments of NR revenues based on the 'derivation principle' can have deleterious local economic and social effects in their own right, i.e. not only linked to failings in transparency and accountability, namely: magnified fiscal volatility, constraints on national government to perform its redistributive and budget stabilisation functions, and risks to the political instability of the region and country if these trends are resisted by central government.

At present, rather than responding to these risks and moving towards centralised oil, gas and mineral revenue management, the movement seems to be in the opposite directionⁱⁱⁱ. For example, although there is a trend in African countries to shift from discretionary methods to formula-based systems of revenue allocation,ⁱⁱⁱ there is also the trend (in African and other resource-rich nations) towards an intensified use of sub-national NR revenue and a consequential reduction in the central government's share and room for fiscal flexibility. Some examples of this trend towards greater intra-governmental NR revenue transfers are as follows:

- Indonesia – changed from a centralised model to a decentralised revenue-sharing model in 2001^{iv}.
- Bolivia – the central government's share diminished from 77% in 1998 to 68% in 2002.
- Colombia – where central government's share diminished from 43% in 1997 to 30% in 2000.
- Peru – where the central government's share has remained stagnant around 59%, a figure that will diminish in the next years even as gas production increases.^{iv}
- Nigeria – legal challenge by federal governments to secure revenues from off-shore production (and not only on-shore).

Another aspect of the trend is the effect this is having on the demands of non-producing levels of SNG. For example, in Bolivia, there is strong pressure to change the existing hydrocarbon revenue allocation system in favour of a higher revenue allocation to provinces that do not produce oil and gas. In Indonesia allowances are already built into the transfer system for districts 'adjacent' to the producing districts. And in Mexico, allocations of NR revenues to municipalities take into account whether oil is transported through the jurisdiction.

These trends serve to exacerbate the problems of local fiscal volatility, constraints on national government redistributive and stabilisation functions, and risks of political instability. Any decision by EITI to implement programmes of transparency and accountability in the disbursement of NR revenue assignments from national governments to producing (or non-producing) SNG jurisdictions will need to be taken with great care. The benefits for reduced mismanagement and corruption in the process of these transfers, and for meeting poverty reduction targets due to greater autonomy for localised targeting of expenditures, will need to be carefully weighed against the potential for such programmes to further fuel the trend towards decentralised revenue management, and so contribute to local fiscal volatility, constraints on national government fiscal flexibility, and an elevated risk of political instability.

5.2 Management of Sub-National EITI Implementation – Four Models

Four models of how EITI might be implemented at the sub-national level are briefly described below.

5.2.1 Model I – Comprehensive Approach

The first model might be called a comprehensive model, and would include all three ways in which SNGs receive NR revenues:

- intra-governmental revenue assignment from national level to sub-national levels
- internally generated revenue (IGR), including royalties, surcharges, local business taxes, registration fees, fines, etc.
- intra sub-national level governmental transfers from a federal account or provincial account to district government authorities, and from district levels to community levels.

In this model, validation and reconciliation would be undertaken for 'material' disbursements (probably judged in financial terms) from all levels of national government (Ministry of Finance, and other Ministries) to state, provincial, district and local levels. It would also include disbursements between different sub-national levels, and tax and levies payments by companies to SNGs. To improve both manageability and defensibility, some arbitrary threshold for unattributable NR revenue transfers would need to be set. The higher the threshold, the lower the total number of reconciliations. As far as is practical, reconciliations would need to adhere to the EITI principle of aggregated accounts, i.e. where the government parties involved provide the auditor with consolidated accounts of all relevant disbursements and all relevant receipts.

Substantial skills and institutional capacity-building efforts would need to accompany this model, not least to lower levels of government, not only in preparing relevant and aggregated fiscal accounts, but also quite possibly in the establishment of budgets, and in budget allocation and execution. Because the model embraces unattributed NR revenues, it is likely it would overlap considerably with the efforts of the many international agencies working on fiscal decentralisation and fiscal transparency. Alignment with these other initiatives will be critical, for example, in establishing the templates for authorities and companies to generate aggregated data.

Perhaps the most acute challenge to Model 1 is how to build effective oversight mechanisms, both within the systems of local government (official auditors, elected assemblies and councils, etc.) and with regard to civil society participation in the process by which the reports on disbursements and revenues are produced and reviewed. Under the existing EITI model, internal oversight is a function of the national civil service, and civil society participation a reasonably cohesive series of multi-stakeholder events. Implementation of EITI at the sub-national level is likely to involve a more politicised process of scrutiny and a highly complex web of civil society interests, with potentially less capacity to actively participate or to comprehend the true financial implications of the published results.

These observations on the need for elevated levels of institutional support in the preparation of aggregated accounts, and on the challenges of internal and external oversight, also apply to the three models below, although to differing extents.

5.2.2 Model II – Attributable Revenues

The EITI reconciliation and validation process needs to be credible, but it also needs to avoid being too complex and bureaucratic. As noted in the *EITI Sourcebook*, the process should 'focus on basic steps: how to get transparency in revenue, how much the government receives, how citizens can get access to this information. Standards for validation of accounts and reconciliations should be kept to a minimum, allowing flexibility for country implementation while respecting contract confidentiality'.

In light of this, a second model for EITI would be to focus only on directly attributable intra-governmental NR revenue assignments. This would avoid the complexities of tracking NR revenues mixed up with other revenue sources. As noted in Bolivia,

'oil rents transferred to prefectures and municipalities get mixed with other sources of departmental and municipal resources. Therefore, it is not possible to establish a correspondence between sources and uses of oil rents. It is not possible either to determine the effectiveness and efficiency in the use of resources generated by the upstream activities in the hydrocarbon industry, except that they are managed in the same manner as resources from any other sources.'^{lvi}

Model II (a)

Assuming that for the most part that attributable NR revenue assignments are transferred between the Ministry of Finance and various sub-national levels of government, the parameters of this model would largely be limited to the 17 countries identified in the above survey as having a statutory or policy-driven framework in place for the explicit assignment of intra-governmental natural resource revenues sharing.

Staying with the Nigerian example, the model would require validation of accounts and of reconciliations for eight (annual aggregated) transfers associated with the allocation of 13% of NR revenues accruing to the Federation Account. It would, however, exclude the disbursements made to these and other states based on the formula for inter-governmental transfers and authorised by the National Assembly, as well as disbursements to the Niger Delta Development Commission. The former disbursements include other sources of revenue (albeit minor in relation to the portion derived from NR revenues). The latter disbursements are based not on the principle of derivation, but against (15%) of total statutory monthly allocations from the Consolidated Revenue Fund^{lvii}. In other words, in both of these cases the sources of revenues are mixed.

Nigeria is atypical in that the 13% applies only to transfers to state level governments. For 12 of the 17 countries with revenue-sharing frameworks in place (including Colombia and Bolivia) the model would need to also embrace attributable transfers to municipal levels, and possibly affected communities as well.

Model II(b)

A variation on this model would be to exclude any SNGs lower than state (in federated countries) or provincial level (in unitary states), i.e. to concentrate only on transfers from central government to 'the next level down'. This would considerably reduce the number of reconciliations required.

Model III(c)

A further variant would be to include (or perhaps even focus explicitly on) those producing regions, provinces and districts where there is national legislation or a policy framework for companies to share NR proceeds directly with SNGs, without passing revenues through central government. This might include the sharing of royalties with local land owners, or surcharges imposed by provincial authorities on the national corporate income tax base. Further research is needed to clarify which countries have such operative frameworks in place and whether the number is sufficiently large to support this variant.

5.2.3 Model III – Expanded Materiality

A third model is to extend the existing 'materiality' criterion used by EITI to allocate resources, i.e. to target validation and reconciliation efforts that, in dollar terms, are high relative to national income. Applying the existing monetary definition of 'materiality' to frame EITI implementation at the sub-national level presents some problems. It could, for example, result in exclusion of those producing sub-national jurisdictions where, although there is urgent need to improve transparency and accountability in intra-governmental revenue transfers (in order to reduce revenue mismanagement or the perceptions of mismanagement), the contributions of the sector as a

whole might not be considered 'material' to national income. Many mining regions are likely to be disadvantaged in this way.

To address this, implementation of EITI at the sub-national level would need to expand the definition of 'materiality'. Criteria for EITI resource allocation could be designed to embrace not only the relative, dollarised, volume of NR attributable or unattributable revenues in relation to other intra-governmental transfers, but to also include:

- the level of risk associated with NR revenue transfers that are not transparent and accountable in terms of the potential for mismanagement, corruption, worsened poverty and political insecurity
- the development opportunities that NR revenue transfers offer for furthering poverty reduction goals, reducing and preventing community hostility and improving political stability.

Under this model, the commitment of effort to reconciliation, oversight and capacity-building would focus not only on the large NR revenue transfers from national government to oil or mineral producing states, but also the royalty payments and other proceeds-sharing made to affected communities or the business taxes paid by companies to district authorities.

It is not for this report to determine the full suite of criteria for this expanded 'materiality' model, but some of the factors for allocating EITI resources might include the following:

- the volume of NR revenues transferred
- whether the transfers are 'earmarked' for explicit public expenditures (and thus EITI might be involved in tracking the revenues to determine whether the monies were subsequently disbursed to their intended purposes)
- within the receiving SNG jurisdiction, the ratio of resulting NR revenues to other revenue sources (i.e. an indication of volatility risks faced by the recipient authorities)
- the institutional absorptive capacity of the recipient authorities to be able to translate the revenues into sustainable economic and social development
- the level of latent risk within the recipient jurisdiction of political instability, i.e. that might be triggered or fuelled by the EITI implementation at the sub-national level
- the extent of the social, economic and environmental costs being born by the jurisdiction as a result of the presence of oil, gas, mining or processing operations.

This last criterion is derived from the 'benefit-tax principle'^{lviii}. This principle is important since it offers a means for EITI to target its efforts at jurisdictions where there is the greatest social justification for NR revenue transfers, therefore lessening the likelihood of EITI interventions inadvertently fuelling jealousy between regions.

5.2.4 Model IV – Pre-Disbursements

A fourth model could be designed to accommodate the joint constraints of weak fiscal accounting at sub-national levels, and the risks posed by a sub-national EITI programme contributing to increased NR revenue-sharing. In essence, the approach would avoid involvement in intra-governmental NR revenue transfers. Instead, it would seek to enhance transparency and accountability in four areas related to sub-national NR revenue transparency and accountability,

but each of which takes place 'prior' to actual disbursements from the national level. These would be to:

- Validate the proportion of total NR revenues derived from a particular producing region, perhaps linked to EITI physical and process audits.
- Reconcile payments and receipts within the passage of NR revenues through the various designated accounts that take the proceeds of crude oil, gas or mineral sales, corporate income tax and royalties through to these national level disbursement accounts.
- Validate the calculation of the cash value of the assigned proportion available for transfer, taking into account: cost-recovery allowances, 'cash calls' by NOC/IOC joint ventures, the build up of capital stock within National Resource Funds, urgent budget stabilisation and poverty reduction 'calls', rescheduled debt repayment, etc.
- Publicise the anticipated 'timing' of disbursements, taking into account the potential for delays following the start of production due to the above priority calls, and providing clear justifications for these apparent delays in order to reduce misconceptions and a perceived 'benefits gap' for populations within SNG jurisdictions.

Clearly, these four models are not mutually exclusive not least the proposal in Model IV could be adopted as part of any of the first three models.

The two tables below, provide a commentary on how an expansion of EITI to the sub-national level might relate to, or require a broadening of, the core EITI principles and criteria; where no change is anticipated this is labelled 'same'. Comparisons are given for the two principal mechanisms: attributable intra-governmental NR assignments from national to SNGs, and direct payments from locally operating companies to SNG authorities.

Table 3 Broadening the EITI Principles to Enable Sub-National Implementation

EITI Principles (Company–National Government)	Attributable NR assignments from National to SNGs	Direct Payments from local companies to SNGs
1. We share a belief that the prudent use of natural resource wealth should an important engine for sustainable economic growth that contributes to sustainable development and poverty reduction, but if not managed properly, can create negative economic and social impacts.	Same	Unlikely, due to low level of payments except for royalties and some business taxes for very resource poor authorities.
2. We affirm that management of natural resource wealth for the benefit of a country's citizens is in the domain of sovereign governments to be exercised in the interests of their national development.	Same	Same
3. We recognise that the benefits of resource extraction occur as revenue streams over many years and can be highly price dependent.	Same	Depending on type of payment, these could be far less volatile, e.g. occupation tax, registration fees, flat businesses taxes (e.g. per vehicle movement), sub-national public infrastructure maintenance)
4. We recognise that a public understanding of government revenues and expenditure over time could help public debate and inform choice of appropriate and realistic options for sustainable development.	Risk – publicity of gap between derivation of national revenues from producing regions, and actual assignments to sub-national government, could fuel calls for greater levels of transfer, which in turn could (i) increase inter sub-national jealousies, (ii) fuel calls for	same

EITI Principles (Company–National Government)	Attributable NR assignments from National to SNGs	Direct Payments from local companies to SNGs
	political succession, (iii) constrain national government's capacity to perform its redistributive and budget stabilisation functions (iv) act as a perverse incentive eroding the local tax base	
5. We underline the importance of transparency by governments and companies in the extractive industries and the need to enhance public financial management and accountability.	Same	Same
6. We recognise that achievement of greater transparency must be set in the context of respect for contracts and laws.	Same, although 'contracts' not applicable language for intra-governmental transfers.	same
7. We recognise the enhanced environment for domestic and foreign direct investment that financial transparency may bring.	Risk – as above, with consequence that investment risk is also raised	
8. We believe in the principle and practice of accountability by government to all citizens for the stewardship of revenue streams and public expenditure.	Same	same
9. We are committed to encouraging high standards of transparency and accountability in public life, government operations and in business.	Same	Same
10. We believe that a broadly consistent and workable approach to the disclosure of payments and revenues which is simple to undertake and to use is required.	Same	Same
11. We believe that payments' disclosure in a given country should involve all extractive industry companies operating in that country.	n/a	Same
12. In seeking solutions, we believe that all stakeholders have important and relevant contributions to make – including governments and their agencies, extractive industry companies, service companies, multilateral organisations, financial organisations, investors and non-governmental organisations.	Risk – if NGOs are politicised, then this may further fuel the above risks.	Same

Table 4 Broadening the EITI Criteria to Enable Sub-National Implementation

EITI Criteria	Attributable NR assignment from National to SNGs	Direct Payments from companies to SNGs
1. Regular publication of all material oil, gas and mining payments by companies to governments ('payments') and all material revenues received by governments from oil, gas and mining companies ('revenues') to a wide audience in a publicly accessible, comprehensive and comprehensible manner.	Regular publication of all material attributable NR revenue disbursements by national governments ('disbursements') and all material NR revenues received by sub-national governments from national governments ('revenues') to a wide audience in a publicly accessible, comprehensive and comprehensible manner.	same – note audience primarily from the relevant sub-national region
2. Where such audits do not already exist, payments and revenues are the subject of a credible, independent audit, applying international auditing standards.	Same – but many countries may need to enact legislation to allow scrutiny of fiscal transfers to and from sub-national levels	Same – but may be prohibitively expensive if auditing a number (or all) sub-national jurisdictions
3. Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the	As above	As above

administrator's opinion regarding that reconciliation including discrepancies, should any be identified.		
4. This approach is extended to all companies including state-owned enterprises.	n/a	same
5. Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contributes towards public debate.	Same – but many countries may need to enact legislation to allow public scrutiny of fiscal transfers to and from sub-national levels	Same – but many countries may need to enact legislation to allow public scrutiny of fiscal transfers to and from sub-national levels
6. A public, financially sustainable work plan for all the above is developed by the host government, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints.	As above	As above

ANNEX A

Summary of Intra-Governmental NR Revenue-Sharing Arrangements in Developing Countries

Key

I = countries implementing EITI
E = countries endorsing EITI

HC = Hydro-carbon-rich countries
M = Mineral-rich countries

FD = Full Decentralisation
FC = Full Centralisation
SRB = Shared Revenue Bases
RS = Revenue-Sharing

Country ^{ix}	EITI status ^x		Main producing regions	Av % Fiscal Revenues from NRs (2000–03) ^{ixi}		NR revenue assignments and accumulations ^{ixii}					Legal Framework (National constitution, appropriation bills, dedicated acts, fiscal laws, subordinate legislation etc.)	Policy Framework (Non-judiciary)	Comments
	I	E		HC	M	FD	FC	SRB	RS				
Algeria				69.9			✓						Sonatrach (NOC) pays oil and gas royalties and income tax to the Treasury, both for itself and for the foreign enterprises that must partner with it to operate in Algeria. ^{ixiii}
Angola		✓	Province: Cabinda	80.9									Cabinda province receives 10% of taxes paid by ChevronTexaco and its partners. ^{ixiv} Assumed that this share is assigned from central government.
Azerbaijan	✓			47.0			✓						State Oil Fund for the Azerbaijan receives revenues related to the new, post- Soviet fields (those currently being developed by international oil companies), leaving revenue from fields originally developed during Soviet times to support state budget ^{ixv} .
Bahrain				71.2			✓						Small unitary state.
Bolivia		✓	Producing departments: Santa Cruz Tarija Cochabamba Chuquisaca ^{ixvi}	✓						✓	Hydrocarbons Law 1689 (1998), Art. 50: <ul style="list-style-type: none"> Royalty equal to 11% of gross hydrocarbon production at well head payable to department where production originated. National Compensatory Royalty of 1% of gross hydrocarbon production at well head payable to departments of Beni and Pando for national road.^{ixvii} In 2002, oil rents from upstream operations were US\$201m. 36.2% of this was directly allocated across all regions: 33.8% to departmental prefectures; 1.9% to local municipalities.^{ixviii} 		

Country ^{lix}	EITI status ^x		Main producing regions	Av % Fiscal Revenues from NRs (2000–03) ^{lxi}		NR revenue assignments and accumulations ^{liii}					Legal Framework (National constitution, appropriation bills, dedicated acts, fiscal laws, subordinate legislation etc.)	Policy Framework (Non-judiciary)	Comments
	I	E		HC	M	FD	FC	SRB	RS				
Botswana					56.2		✓						
Brazil				✓	✓					✓		Distribution based on origin: <ul style="list-style-type: none"> • States: 45% tax on minerals • Locals: 70% tax on gold, 2.3% of revenues from crude oil production, 50% tax on minerals. ^{lxix} 	
Brunei Darussalam				85.8			✓						
Cameroon		✓	Petroleum basins: Logone Birni, Douala, Rio del Rey ^{lxix}	26.6			✓						National oil production forecast to decline. Receives revenue from Chad–Cameroon pipeline. ^{lxxi}
Chad		✓	Province: Eastern Logone ^{lxxii} Petroleum basin: Doba ^{lxxiii}	✓						✓	Petroleum Revenue Management Law (1999): <ul style="list-style-type: none"> • 5% royalties to Doha oil-producing region (to be spent by local authorities). ^{lxxiv} 		To date, none of the revenues earmarked for the oil-producing region have been disbursed, 'largely because there is no one to administer them.' ^{lxxv}
Chile			Antofagasta ^{lxxvi}		3.9		✓						No RS evidence found. Assume FC.
Colombia			Departments: Arauca, Casanare ^{lxxvii}	9.0						✓	Constitution (1991) Art. 360: right to participate in royalties and compensations of NR revenues: <ul style="list-style-type: none"> • Departments and municipalities where NRs are exploited, • Sea and river ports through which NRs are transported. ^{lxxviii} Law 756 (2002): 20% of royalties distributed as follows: <ul style="list-style-type: none"> • 47.5% to oil-producing departments, • 12.5% to municipalities, • 8% to ports • 32% to National Royalties Fund^{lxxix} 		2002: intergovernmental transfers to SNG predicted to reach 46.5% of central government's current revenues. ^{lxxx} Clear regulations regarding how royalties received by SNG agencies must be used. ^{lxxxi}
Congo, Republic of	✓			70.6			✓						
Dem. Republic of Congo		✓	Region: Kasai		✓		✓						Government institutions defined as 'centralised system' ^{lxxxii} .

Country ^{lix}	EITI status ^x		Main producing regions	Av % Fiscal Revenues from NRs (2000–03) ^{lxi}		NR revenue assignments and accumulations ^{lxii}					Legal Framework (National constitution, appropriation bills, dedicated acts, fiscal laws, subordinate legislation etc.)	Policy Framework (Non-judiciary)	Comments	
	I	E		HC	M	FD	FC	SRB	RS					
Ecuador			Provinces: Napo, Esmeraldas, Sucumbios	26.4							✓	<p>Law 040 (1989): Substitutive Rents for Napo, Esmeraldas and Sucumbios, (subsequently Orellana and Pastaza). Law 122: Funds for the Development of the Eastern Provinces (Sucumbios, Napo, Morona Santiago, and Zamora Chinchipe).</p> <ul style="list-style-type: none"> Funds distributed to: provincial councils, municipalities of provincial capital cities and then other municipalities.^{lxxxiii} 		In 2002, US\$71m distributed to decentralised government (small % of total oil rent). US\$3.6m distributed according to Law 040 and US\$6.1m according to Law 122. ^{lxxxiv} Oil Stabilisation Fund established in 1999.
Equatorial Guinea		✓		84.0						✓				
Gabon		✓		60.5						✓				
Ghana	✓				✓					✓				
Guinea		✓			18.3					✓				
Indonesia			Special Autonomy Status provinces (since 2001): Aceh, Papua (Irian Jaya) ^{lxxxv}	31.3	✓						✓	<p>Law on Fiscal Balance (Law 25/99):</p> <ul style="list-style-type: none"> Aceh and Papua receive 55% and 70% of oil revenues respectively, and 40% and 70% of gas revenues respectively. RS for other originating provinces (P), districts (D), and adjacent districts (A) is 15% for oil revenue and 30% for gas revenue (split P3/D6/A6% for oil, P6/D12/A12% for gas). All provinces receive 80% of revenues from mining, forestry, and fishing.^{lxxxvi} 		Until 2000, oil and gas revenue was fully centralised, and no revenue-sharing took place. Law 29/99: approved in 1999, in force in 2001. Money flows from Central Government to regions.
Iran				59.3						✓				
Iraq			Fields: Rumaila, Kirkuk ^{lxxxvii}	58.4 ^{lxxxviii}						✓				Considerable debate regarding if (and how) oil revenues should be shared.
Jordan					1.6					✓				Jordanian municipal governments have no independent source revenues. The rates and bases for all revenue sources – the property tax, fees, charges, intergovernmental grants, and borrowed revenues – are delineated by the central government. ^{lxxxix}

Country ^{lix}	EITI status ^x		Main producing regions	Av % Fiscal Revenues from NRs (2000–03) ^{lxi}		NR revenue assignments and accumulations ^{lxii}					Legal Framework (National constitution, appropriation bills, dedicated acts, fiscal laws, subordinate legislation etc.)	Policy Framework (Non-judiciary)	Comments
	I	E		HC	M	FD	FC	SRB	RS				
Kazakhstan		✓	Fields: Tengiz, Kashagan (offshore), Karachagana k (onshore) ^{xc}	21.0			✓					Regional authorities in oil-producing regions increasingly use fines and quasi-fiscal policy as means to secure revenues.	Lack of clarity regarding distribution mechanism criteria. Revenue-sharing implementation varies across regions. ^{xci} National Fund is allocated a large share of oil revenues.
Kuwait				68.4			✓						
Kyrgyz Republic	✓				4.1		✓						
Liberia					✓								
Libya				72.5			✓						
Malaysia			States: Terengganu, Sabah, Sarawak	✓						✓	1974 Petroleum Development Act: <ul style="list-style-type: none"> • 5% royalty on gross value of petroleum output to government of producing state. • 5% royalty on gross value of petroleum output to Federal Government.^{xcii} 	Import and excise duties on oil (30% to states). ^{xciii}	
Mauritania		✓		✓	10.6								
Mexico			Field: Cantarell	32.2						✓	Formula-based system enshrined in law [possibly: Law on Fiscal Coordination]: <ul style="list-style-type: none"> • 3.17% of 'additional' oil extraction rights earmarked for municipalities where oil is extracted or transported.^{xciv} 		Large majority of oil revenue to central government.
Mongolia		✓			6.1								
Namibia					10.0 ^{xcv}								
Nigeria	✓		• Ondo • Akwa Ibom • Cross River • Delta • Edo • Abia • Imo • Rivers ^{xcvi}	77.2						✓	1999 Constitution: 162.(2): based on principle of derivation, not less than 13% of revenues accruing to the Federation Account directly from natural resources, to producing states.	After 'first charges' (including the 13%) oil and gas revenue shared between the federal government and the state and local governments, according to a formula decided by the National Assembly every five years.	
Oman				78.3			✓						

Country ^{ix}	EITI status ^x		Main producing regions	Av % Fiscal Revenues from NRs (2000–03) ^{ixi}		NR revenue assignments and accumulations ^{xiii}				Legal Framework (National constitution, appropriation bills, dedicated acts, fiscal laws, subordinate legislation etc.)	Policy Framework (Non-judiciary)	Comments	
	I	E		HC	M	FD	FC	SRB	RS				
Papua New Guinea			Provinces: Western Highlands; New Ireland; Central and Oro; Milne Bay; Enga	✓	16.1 ^{xcvii}					✓	<p>Organic Law on Provincial Governments and Local-Governments (1995), Section 98:</p> <ul style="list-style-type: none"> • Developers pay landowners royalties, land owner premiums, compensation and other assistance. • Special Support Grants: 1% of gross value of mineral sales paid by national government to the provincial governments that host mines. Developers pay development levies to provincial and local governments. <p>PNG Mining Act (1992):</p> <ul style="list-style-type: none"> • Memorandum of Agreement (MOA) sets out responsibilities and allocation of benefits between the various stakeholders • Minimum of 20% (up to 80%) of mining royalties received paid to the landowning communities of the mining lease area. <p>Minerals Resources Development Company Pty Ltd Privatisation Act (1996):</p> <ul style="list-style-type: none"> • Covers the state's right to acquire a 30% interest in mining development projects 	Landowners and provincial government to share 5% free equity in new mining developments	
Peru		✓	Regions (formerly departments:) Loreto, Ucayali, Piura, Tumbes, ^{xcviii}	✓	✓					✓	<p>Distribution of Canon and Sobrecanon is set by law, one law for each producing region. E.g., Loreto (Decree Law No 21678):</p> <p>52% regional government 5% Universidad Nacional de la Amazonia 3% Peruvian Institute for Amazonia 40% municipal councils^{xcix}</p>	Perupetrol distributes revenues on behalf of the Ministry of Economy and Finance ^{ci}	Producing regions receive Canon, normally equivalent to approximately of 44% of the royalties paid by oil companies. ^{ci}
Philippines			Mindano, Luzon, Palawan, Mindoro		✓					✓	<p>Local Government Code of 1991: LGUs receive 40% of the gross collection derived by national government resulting from activity in LGU territory. Where NRs are located in the province:</p> <ul style="list-style-type: none"> • 20% to province • 45% to component city/municipality • 35% to barangay 		LGUs receive NR revenues based on the gross collection of the previous year.
Qatar				71.3					✓			Population less than 200,000.	

ANNEX B

Intra-Governmental NR Revenue-Sharing Arrangements in Developing Countries: Additional Notes

Algeria^{cxii}

- Sonatrach (NOC) pays oil and gas royalties and income tax to the Treasury, both for itself and for the foreign enterprises that must partner with it to operate in Algeria.
- Oil revenue recorded in excess of budget law projections is allocated to a special account for earmarked funds, the Revenue Regulation Fund. This is consolidated within the single Treasury account at the central bank.

Angola^{cxiii cxiv cxv}

- In May 2004, Sonangol (NOC) extended the concession for Block Zero (off Cabinda province) to the Cabinda Gulf Company (a subsidiary of ChevronTexaco) from 2010 until 2030. Sonangol made public the up-front payment of US\$210 million by ChevronTexaco in return for the extension. In addition US\$80 million was given for distribution to social and community projects, of which some will go to the province of Cabinda.
- International oil companies make payments on a monthly basis in respect of production, income, and transaction taxes, generally with a delay of a month, directly to the National Bank of Angola.
- The Angolan tax and royalty regime provides revenue to the government through three taxes: the production tax (commonly known as royalty), the income tax (commonly referred to as Petroleum Income Tax), and the transaction tax (commonly referred to as Petroleum Transaction Tax).
- There is no public information about whether centralisation of oil revenues through the central bank has been achieved, nor has any audit of the central bank been published, both key recommendations of a study of the upstream oil sector published in 2003, which revealed an overall picture of severe fiscal laxity.
- Cabinda receives 10% of taxes paid by Chevron Texaco and its partners operating offshore in Cabinda.

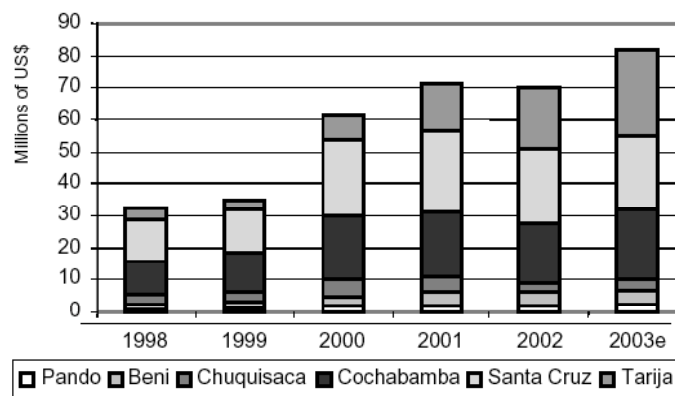
Azerbaijan^{cxvi}

- The State Oil Fund for the Azerbaijan Republic should receive all revenue related to the new, post-Soviet fields. Revenue from fields originally developed during Soviet times accrues to the state budget.

Bolivia^{cxvii}

- Hydrocarbons Law 1689 (1996):
 - Art. 50: 1. A departmental participation called royalty, equal to 11% of the gross hydrocarbon production at the well head, payable to the department where production is originated. 2. A national compensatory royalty of 1% of the gross hydrocarbon production at the well head, payable to the departments of Beni and Pando, according to the provisions of Law 981 dated March 7, 1988.
 - Law No 981 (1988): the compensatory royalty is intended to fund costs associated with construction of the portion of the Trinidad–Guayanameri'n-Cobija highway that crosses the departments of Beni and Pando.
 - Art. 51: A National Complementary Royalty is established on the Production of Existing Hydrocarbons equal to 13% of the value of the supervised production of existing hydrocarbons, which shall be computed and paid every month directly to the National Treasury by the producers.
- In 2002 oil rents from upstream operations were US\$201m. Of this, 36.2% was directly allocated to the regions:
 - 33.8% to departmental prefectures
 - 1.9% to local municipalities
 - 0.5% to local public universities.
- Royalties to producing departments consists of 11% plus National Compensatory Royalty.

- Not possible to establish direct correspondence between sources and uses of resources generated by upstream activities in the hydrocarbons sector since they are mixed with other sources of departmental and municipal resources.
- Regulations do not provide specific requirements on the distribution of oil rents within a department or among ethnic groups or any other possible distribution criteria.
- Royalty percentages not based on a technical study of the needs of the departments; instead they are a consequence of the historic conditions of the sector laws and/or the negotiation of agreements.
- Transfer of royalties can be considered a specific and automatic transfer.
- Hydrocarbons Law may be revised following election of Evo Morales as President (sworn in January 2006).
- Distribution of royalties by department:



Brazil ^{cxviii}

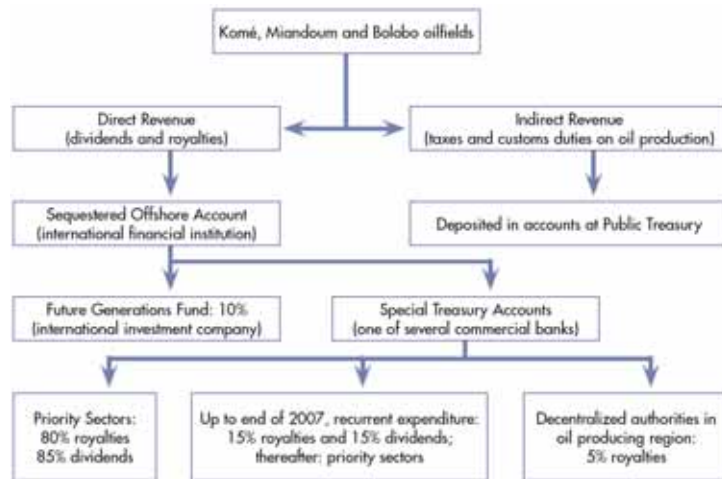
- Distribution based on origin:
 - States: 45% tax on minerals.
 - Locals: 70% tax on gold, 2.3% of revenues from crude oil production, 50% tax on minerals.

Cameroon ^{cxix}

- Oil fields becoming exhausted; oil production forecast to drop in the future.
- Cameroon's refinery capacity and its strategic location ensure that the country will continue to play a large role in oil transportation for many of its African neighbours, especially through the Chad–Cameroon pipeline.

Chad ^{cxx}

- Petroleum Revenue Management Law (1999): 5% royalties to Doha oil-producing region (to be spent by local authorities). The Law also establishes a Collège de Contrôle et de Surveillance des Ressources Pétrolières (CCSRP) or a Petroleum Revenue Oversight and Control Committee, a joint government–civil society body whose task is to 'verify,' 'authorise' and 'oversee' expenditure of oil revenues.
- Revenues earmarked for the oil-producing region have not yet been disbursed, in part because of a lack of administrative capacity.
- Summary of Petroleum Revenue Management Law:



Chile ^{cxxi}

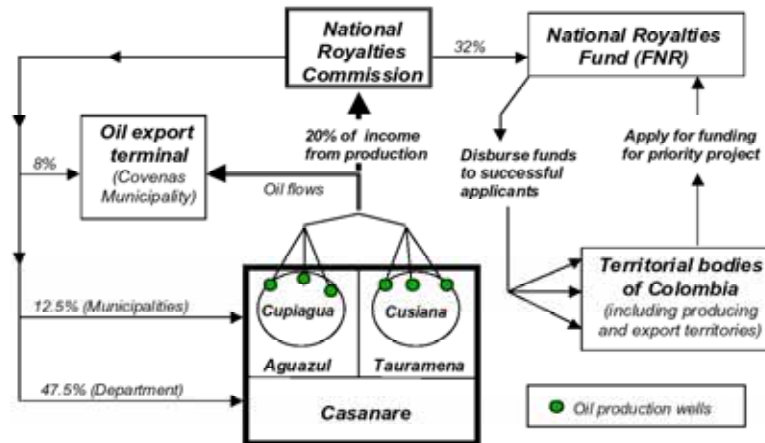
- All taxes are legislated, collected, and overseen by the central government.

Colombia ^{cxxii cxxiii cxxiv}

- Colombia is a unitary republic but has significant subnational governments.
- Constitution (1991) Article 360 establishes the right to 'participate in royalties and compensations' from NNRs for:
 - Departments and municipalities where NNRs are exploited.
 - Sea and river ports through which NNRs are transported.
- Oil rents directly distributed in a decentralised manner amounted to US\$661 million in 2002.
- ECOPETROL (NOC) is a collecting agency, and directly distributes royalties among the producing departments, municipalities, and ports. The remaining portion is given to the National Royalties Fund, which distributes the rents according to law.
- Royalties are distributed in steps as a function of gradual criteria based on the average quantity of daily barrels produced by each municipality or district. The rationale for such distribution criteria is to avoid a situation where large deposits and thus a great quantity of money, are concentrated in a few territorial agencies. In those places where the average oil production is in the range of 0 to 100,000 barrels per day, royalties are distributed as follows (Law 756 (2002)):
 - 47.5% producing departments
 - 12.5% producing municipalities or districts
 - 8% port municipalities or districts
 - 32% National Royalties Fund
- The law on oil-revenue sharing was established to prevent political considerations influencing use of revenue: regulations are clear concerning how royalties received by SNG agencies must be invested.
- In some instances, oil revenue shares (together with guaranteed transfers) have had a deleterious effect on macroeconomic stability by inducing some territorial governments to contract debt beyond their repayment capacity.
- Evidence of lack of transparency in managing funds by some municipalities.
- Colombia is the only country that has enacted laws on rent distribution aimed at making it possible that such rents directly reach indigenous communities. Indigenous communities can have access to oil rent resources:
 - Directly: Law 756 (2002), Article 11:
 - Whenever non-renewable natural resources are exploited in an indigenous resguardo (territories) or at a point located not further than five kilometres around the indigenous resguardo zone, 5% of the value of the royalties to be paid to the department due to such exploitation, and 20% of the royalties to be paid to the municipality shall be allocated to investment in the zones where such indigenous

communities are settled and shall be used in terms provided in Article 15 of Law 141 of 1994; and

- Indirectly. Through the use made by the National Royalties Fund of the resources allotted to environment preservation that can be aimed at the sustainable development of indigenous resguardos.
- Royalty distribution:



Ecuador ^{cxxv}

- Law 040 (1989): Substitutive Rents for Napo, Esmeraldas and Sucombios, (subsequently Orellana and Pastaza).
 - Funded by Trans-Ecuadorian Oil Pipeline (companies pay US\$0.05 per barrel transported).
 - Money flows to Central Bank, responsible for distribution to provinces.
- Law 122: Funds for the Development of the Eastern Provinces (Sucumbios, Napo, Morona Santiago, and Zamora Chinchipe).
 - Funded by tax on the total amount invoiced to PETROECUADOR or its affiliate companies by service companies within the jurisdiction of each Amazon province.
 - Central Bank must deliver money to provinces within first ten days of each month.
 - Funds distributed to: provincial councils, municipalities of provincial capital cities and other municipalities.
- Law 010 (1992), then Law 020: establishment of Institute for the Ecological Development of the Amazon Region (ECORAE).
 - ECORAE receives fixed revenues per barrel of oil (US\$0.10, increasing from 1998 by US\$0.05 per year until maximum of US\$0.50).
- In 2002, US\$71m distributed to decentralised government (small percentage of total oil rent):
 - US\$3.6m distributed according to Law 040
 - 11% or US\$6.1m distributed according to Law 122
 - 80% allocated to ECORAE.
- Oil Stabilisation Fund established in 1999.
- Ecuador: 'The distribution of oil rents has become increasingly complicated with time, due to the high level of earmarking for each segment of revenues, namely, royalties, production ex-consortium, service contracts, pipeline fees, and so forth.' ^{cxxvi}

Indonesia ^{cxxvii cxxviii}

- Law on Fiscal Balance (Law 25/99), approved in 1999, in force in 2001 (until 2000 oil and gas revenue was fully centralised). Money flows from central government to regions as follows:
 - Aceh and Papua receive: 55% and 70% of oil revenues respectively, and 40% and 70% of gas revenues respectively.
 - Other originating provinces (P), districts (D), and adjacent districts (A) is 15% for oil revenue and 30% for gas revenue (split P3/D6/A6% for oil, P6/D12/A12% for gas).
 - All provinces receive 80% of revenues from mining, forestry, and fishing.

- Revenue of sub-national governments (as percentage of total sub-national government revenue) in 2002: 15.4%.
- Sources of oil and gas revenue are concentrated in a small number of provinces and districts. It is estimated that districts in five provinces would likely receive over four-fifths of the total local share, while those in the remaining 25 provinces would receive zero or near zero oil and gas-revenue shares.
- Between 1997 and 2000 oil and gas revenues represented 33% of total revenue of the central government (5.6% of GDP).

Jordan ^{cxxix}

- Municipal governments have no independent source revenues. The rates and bases for all revenue sources – the property tax, fees, charges, intergovernmental grants, and borrowed revenues – are delineated by the central government.

Kazakhstan ^{cxxx}

- Regional authorities in oil-producing regions have increasingly used fines and quasi-fiscal policy as a means to increase regional revenues. Previously, central authorities levied greenhouse emission rights, but this has become the mandate of regional authorities and, probably as a result, environmental fines increased by 400% in 2004 compared to the previous year.
- National Fund allocated a large share of oil revenues.
- According to PSA agreements consortia are requested to invest in social infrastructure projects (SIP). Regional authorities propose local development projects, which should reflect the real needs of local communities. AgipKCO's investments represent 1.25% of the revenues of Mangghystaou and Atyraou regions and Karachaganak Petroleum Operating (KPO) 6.5% of the revenues of West Kazakhstan region. AgipKCO has mainly financed the building of schools, hospitals, gas pipelines to villages and other infrastructure. Annually, this consortium spends \$US5 million (or 0,15% of regional GDP) in Mangghystaou and Atyraou regions. KPO invests annually US\$10 million in West Kazakhstan (or 0,8% of regional GDP).
- 'One of the two largest oil-producing regions remains, on average, the poorest region of the country.' ^{cxxxi}
- Oil production is dominated by two regions: Mangghystaou and Atyraou, which represented 98% of Kazakhstan's production in 1970 and now accounts for three-quarters of national production.
- 'Kazakhstan remains a centralised State [...] local fiscal autonomy in Kazakhstan appears limited. Fiscal federalism with revenue-sharing arrangements was tentatively developed but the implementation seems to vary across regions. Undeniably, certain redistribution mechanisms seem to occur but criteria to identify benefiting regions are obscure.' ^{cxxxii}

Kenya

- 'Has a highly centralised system. No decentralisation process is on the Agenda.' ^{cxxxiii}

Malaysia ^{cxxxiv cxxxv}

- Petroleum Development Act (1974):
 - 5% royalty on gross value of petroleum output to government of producing state
 - 5% royalty on gross value of petroleum output to Federal Government
 - 20% royalty for cost recovery
 - 21% for profits to the producer company
 - 49% to Petronas.
- Financial Procedures Act (1957): channels petroleum revenues into programmes such as: Programme Mesra Rakyat (Befriend the People) and Natural Disaster Fund as well as educational, rural development and entrepreneurial programmes.

Mexico ^{cxxxvi}

- 3.17% of 'additional' oil extraction rights earmarked for municipalities where oil is extracted or transported.
- 20% of 'ordinary' extraction rights to lower level governments (incorporated into a general fund, distributed to the states based on a fixed formula).
- Majority of oil revenue accrues to central government.

Nigeria ^{cxxxvii}

- 1999 Constitution: 'The principle of derivation shall be constantly reflected in any approved formula as being not less than thirteen per cent of the revenue accruing to the Federation Account directly from any natural resources.'
- After so-called first charges (mainly the government share of the production cost of oil and priority projects of the national oil company, the external debt service, and the 13% allocated to oil producing states) are withheld, oil revenue is shared between the federal government and the state and local governments according to an arrangement whereby the remainder (over 75% of gross oil revenue) is divided between the central government and subnational governments. More specifically, the 1999 constitution assigns control and collection of oil revenue to the federal government, but attributes at least 13% of the net oil revenue to the oil-producing states. In addition, about half of the net proceeds (after deduction of first charges) are redistributed to state and local governments according to a formula decided by parliament every five years. Excess proceeds over the budgeted revenue are also redistributed in the same way, after assigning 13% to oil-producing states. States and local governments are highly dependent on revenue-sharing arrangements with the federal government. In 1999, 75% of state revenue came from redistributed revenue from the federal government. Federation revenue released to subnational governments rose from 7.4% of GDP in 1999 to about 15.3% of GDP in 2001.
- Oil accounted for 82% of the total revenue of the general government, or 40% of GDP in 2000.
- 'Several oil-producing states call for a total regional control over oil revenues.'^{cxxxviii}
- High oil prices have led to a large increase in the distribution of financial resources to sub-national governments, particularly to oil-producing states. Often transfers are immediately spent, fuelling inflation.
- 'Lower levels of government in Nigeria are not required to report their budgets or their final accounts to higher levels of government. [...] no source of comprehensive and reliable data on general government or on its different tiers.'^{cxxxix}

Papua New Guinea ^{cxli cxlii cxliii cxliv}

- Section 98 of the 1995 Organic Law: developers shall pay 'landowners' benefits in respect of natural resources obtained.' Subsequently referred to as 'royalties, land owner premiums, compensation and other assistance,' but without the rate or nature of these payments being specified.
- PNG Mining Act 1992: a minimum of 20% (up to 80%) of mining royalties received must be paid to the landowning communities of the mining lease area. The balance is currently being paid to provincial governments. Royalties are paid directly by the Company to the Agreed Beneficiaries and then reconciled to central government for Audit.
- Minerals Resources Development Company Pty Ltd Privatisation Act (1996) covers the state's right, through MRDC or Orogen Minerals, to acquire a 30% interest (at sunk cost of exploration) in mining development projects in Papua New Guinea.
- Mining companies pay royalties of 2% of gross value of production to the State. The state, since 1974, has passed these on to the landowners and provincial governments that host each of the mines. In the Porgera case, after initially receiving 23% of mine royalties, Porgera landowners and local institutions negotiated an increase in 1995 to 50%. [...] Royalties for landowners and these institutions were worth a total of Kina 7.35 million in 2000.
- 'Taxes and royalties are remitted to the Government: Sometimes (but not universally) mechanisms exist to share this wealth with lower levels of regional or local government, and in some jurisdictions even directly with impacted communities'^{cxliv}.

- Special Support Grants: a form of derivation grant established under a constitutional organic law which determines that a value equivalent to 1% of the gross value of sales (effectively equivalent to a 1% royalty) is paid to the provincial government as a grant from the National Government in the National Budget. By agreement a portion of this grant may be channelled to the local-level government in the mine area (up to 20%). By agreement a portion may also be channelled to sustainable development foundations established by the mine Developer.
- Infrastructure Tax Credit Scheme established in recognition of limited capacity of local level governments to implement infrastructure projects. Enables the mine developer to spend up to 0.75% of the value of gross sales on approved infrastructure projects and receive a tax credit when paying company income tax, i.e. the amount expended is considered as tax paid.
- Landowners have the right to take up 5% of project equity free carried to point of development on special mining leases.
- Prescribed Infrastructure: each mining development contract specifies what type of community facilities and infrastructure is to be constructed by the developer.
- Receipt of benefit funds by provincial governments hard to track ‘...likely that there has been substantial under-reporting of mineral revenues and that substantial gaps in the adequacy of public financial management systems at the sub-national level have allowed these funds to be diverted into private hands without any significant risk of detection’^{cxlvi}.
- Company tax payments are not published by the Internal Revenue Commission (IRC).
- Dividends generated by public equity holdings in mining and petroleum companies are received and then disbursed to the ultimate beneficiaries by the Mineral Resource Development Company (MRDC). They do not appear in the national budget.
- Taxes from mineral and petroleum companies due to GOPNG are paid to the IRC and thereafter deposited in the consolidated revenue account of GOPNG and thereafter fully accounted for in GOPNG’s budget.
- Funding arrangements for Bougainville are different: Bougainville Provincial Government receives significant funding through the development budget. As part of the Bougainville peace package, new financing arrangements have been agreed to, leading eventually to financial autonomy. Note: In May 1989, Bougainville mine stopped all operations.
- In the 2002 budget, provincial governments which host mining and oil projects are allocated Kina7.3 million in Special Support grant (SSG) and mining agreement payments, while local-level governments and development authorities will receive K3.9 million.
- The Enga provincial government has received over K46 million in royalties from the Porgera mine from 1990–2000.
- Compensation is a requirement of the Mining Act 1992.
- Current policy is for landowners and provincial government to share 5% free equity in new mining developments. Both the Enga provincial government and the Porgera landowners hold 2.5% equity in the Porgera mine. Dividends generated by this equity stake can take some time to become significant but when they do start being paid they can be substantial, and may even dwarf the amounts paid in royalties. The structure of the companies by which landowners’ equity is held varies, and hence the geographic spread of dividend payments also varies: at Porgera only SML landowners receive these.
- Since, by the end of 1999, total mine production values had been US\$3.7bn in Porgera’s case and US\$5.7bn in Ok Tedi’s, then these mean that the national government had been easily the biggest PNG beneficiary from both ventures.
- Excluding Special Support Grants from national government, provincial governments involved with Ok Tedi, Porgera and Misima (FRPG, EPG and MBPG) have received respectively and approximately US\$100m, US\$150m and US\$15m from project revenues up to the end of 1999.
- A quasi-LLG, the Porgera Development Authority, was granted a 5% share of all royalties. Other projects have been negotiated since the provincial and local government reforms of 1995/6. And in all cases LLGs have been taken note of in such negotiations. At Lihir the Nimamar LLG receives 30% of royalties.

Peru^{cxlvii cxlviii}

- Distribution of Canon and Sobrecanon is set by law, one law for each producing region. E.g., Loreto (Decree Law No 21678):

- 52% regional government
- 5% Universidad Nacional de la Amazonia
- 3% Peruvian Institute for Amazonia
- 40% municipal councils
- Perupetrol distributes revenues on behalf of the Ministry of Economy and Finance.
- Producing regions receive Canon, normally equivalent to approximately of 44% of the royalties paid by oil companies.
- Royalties are variable and negotiated in each agreement. The Canon received by the oil-producing regions represents a fixed percentage of the gross value of oil production in the region, as defined by law. In the case of the hydrocarbon production in the north-western, north-eastern and central-eastern deposit, 10% (Canon) goes to the producing regions and 2.5% (SobreCanon) goes to neighbouring regions, but only to those stipulated in a law passed by the Congress.
- In producing regions Canon and SobreCanon are subdivided in shares for the regional governments, the municipalities, and the universities.
- The share (Canon) received by regions and municipalities is not based on a technical study of their need but is the result of the contracting conditions.
- Local and regional governments in areas where mineral resources (metals and industrial minerals) are exploited will receive 50% of the taxes collected to be invested in education and in social programmes (health, housing, and others) in conformance to the Canon Minero (Resolución Ministerial No. 266-2002-EF/15).

Philippines ^{cxlix}

- 2002 estimated own-source revenue of sub-national government (as percentage of total sub-national government revenue): 31.1%.
- *Local Government Code of 1991*:
 - SECTION 289. Share in the Proceeds from the Development and Utilisation of the National Wealth. Local government units shall have an equitable share in the proceeds derived from the utilisation and development of the national wealth within their respective areas, including sharing the same with the inhabitants by way of direct benefits.
 - SECTION 290. Amount of Share of Local Government Units. Local government units shall, in addition to the internal revenue allotment, have a share of forty percent (40%) of the gross collection derived by the national government from the preceding fiscal year from mining taxes, royalties, forestry and fishery charges, and such other taxes, fees, or charges, including related surcharges, interests, or fines, and from its share in any co-production, joint venture or production sharing agreement in the utilisation and development of the national wealth within their territorial jurisdiction.
 - SECTION 291. Share of the Local Governments from any Government Agency or Owned and Controlled Corporation. Local government units shall have a share based on the preceding fiscal year from the proceeds derived by any government agency- or government- owned or controlled corporation engaged in the utilisation and development of the national wealth based on the following formula whichever will produce a higher share for the local government unit: (a) One percent (1%) of the gross sales or receipts of the preceding calendar year; or (b) Forty percent (40%) of the mining taxes, royalties, forestry and fishery charges and such other taxes, fees or charges, including related surcharges, interests, or fines the government agency- or government- owned or controlled corporation would have paid if it were not otherwise exempt.
 - SECTION 292. Allocation of Shares. The share in the preceding Section shall be distributed in the following manner:
 - (a) Where the natural resources are located in the province:
 - (1) province – Twenty percent (20%)
 - (2) Component city/municipality – Forty-five percent (45%)
 - (3) Barangay – Thirty-five percent (35%)
 - Provided, however, That where the natural resources are located in two (2) or more provinces, or in two (2) or more component cities or municipalities or in two (2) or more Barangays, their respective shares shall be computed on the basis of:
 - (1) Population – Seventy percent (70%); and
 - (2) Land area – Thirty percent (30%).

- (b) Where the natural resources are located in a highly urbanised or independent component city:
- City – Sixty-five percent (65%); and
 - Barangay – Thirty-five percent (35%)
- Provided, however, that where the natural resources are located in such two (2) or more cities, the allocation of shares shall be based on the formula on population and land area as specified in paragraph (a) of this Section.

Russia^{cl}

- Natural resource taxes are generally collected by SNGs, and represent significant sources of own revenue in oil-producing regions. Rates and bases of these revenues are frequently constrained or set by federal law.
- In 1997: five wealthiest regions, Khanty-Mansi, Yamalo-Nenets, Tyumen, Tatarstan, and Yakutia (Sakha) collected 52.7% of all regional revenues from taxes, fees and charges on NRs, but only account for 5.5% of the population.

Saudi Arabia

- 'No clear set formula for allocation of oil revenue can be distilled in Saudi Arabia.'^{cli}

Sudan^{clii cliii}

- Agreement on Wealth Sharing during the Pre-Interim and Interim Period: after payment into a national oil stabilisation account at least 2% of oil revenue allocated to oil producing states/regions in proportion to output. Of the remainder: 50% to Government of Southern Sudan, 50% to national government and states in northern Sudan.
- Distribution of revenue overseen by National Petroleum Commission (NPC).
- The NPC is comprised of the President of Sudan and the President of the GOSS as permanent co-chairs and eight permanent members, four each from the national government and the GOSS. A maximum of three representatives of an oil-producing region in which oil production is being considered are also admitted as non-permanent members.

Syria

- Proven oil reserves anticipated to last only about 10 more years.^{cliv}

Tanzania

- LGU revenue sources: 'property, business, fuel and other minor taxes.'^{clv}

Timor-Leste

- Petroleum revenues flow into the Petroleum Fund before they are then transferred to finance the central government's budget deficit.

Turkmenistan

- 'Turkmenistan's economic statistics are state secrets, and GDP and other figures are subject to wide margins of error.'^{clvi}

United Arab Emirates^{clvii}

- The approach the United Arab Emirates utilises allows each emirate to collect its oil revenue and maintain control over its allocation. Nonetheless, each emirate is required to devote a

certain percentage of its oil revenue to the UAE central government. The UAE is the only country that fully decentralises allocation of oil revenue and has an upward revenue-sharing arrangement. Regional allocation of oil revenue with a contribution to the central government seems to work well for the UAE, without noticeable tensions among the seven emirates.

Venezuela ^{clviii}

- The Law of Special Assignations for States derived from Mines and Hydrocarbons: approved on November 26, 1996. It was established therein that of the total amount of revenue collected by the nation as payment of the taxes established in the hydrocarbons law and the mining law (having reduced the amount correspondent to the Constitutional assignation in 1998), 20% would be earmarked for the states. Additionally, it was established that by 2000 the proportion earmarked would reach 30%. The law provided that the municipalities' share would reach 20% of the amount to be distributed in the year 2000. It also determined the transfer of revenue to the states that did not participate in mining or drilling for oil. The coordination of this new legal document would be the responsibility of the MRI.

Vietnam ^{clix clx}

- 2002 State Budget Law, Art. 30: Revenue assignments to central level: 100% of taxes and other revenues from the petroleum industry in accordance with government regulation.
- All tax collections are centralised. The General Taxation Department collects all domestic taxes with offices that extend through the provinces and the districts, and the Customs Department collects all taxes falling on imports.

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