



The Extractive Industry Transparency Initiative in Mozambique

by

Per-Åke Andersson, Arne Bigsten, Aurélio Bucuane and Luis Matsinhe



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The intent of the discussion paper series is to stimulate and exchange ideas on issues pertinent to the economic and social development of Mozambique. A multiplicity of views exists on how to best foment economic and social development. The discussion paper series aims to reflect this diversity.

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Contact:

Jonas Tembe
DNEAP/MPD
Av. Ahmed Sekou Touré, 21, 7º andar
Telefone: +258-21-492711
Fax: + 258-21-497663
email: jtembe@mpd.gov.mz
Maputo Mozambique

The Extractive Industry Transparency Initiative in Mozambique

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1. Introduction

The purpose of this study is to investigate whether it would be useful for Mozambique to implement the Extractive Industry Transparency Initiative (EITI) to guarantee an effective and transparent handling of oil and mineral revenues in the future. Although the analysis of this issue is in itself potentially very important (if significant amounts of natural resources are found), the study will also discuss more generally what is required to improve surveillance and scrutiny of the use of revenues in the public sector. Can there be a shift from external agents of restraint such as the IMF, the World Bank and donors to domestic agents of restraint such as the civil society and citizens in general?

The focus here is on the handling of resources generated from the oil and mineral sectors. It is an established fact that developing countries that have exploited natural resources on a large scale have since the 1960s done worse in terms of growth than countries without natural resources. This paradox is known as the natural resource curse, and is generally explained by the rent-seeking made possible by a weak institutional environment. Natural resource rich countries with good institutions such as Norway do not suffer from this problem. The EITI is set up to address exactly this problem.

This high dependence on natural resource income and its dramatic fluctuations mean that the management of the associated price and income swings is a key element in economic policy making in African economies. We will in this study also analyse the problems of handling large resource rents in an economically rational as well as honest and transparent way.

The paper is structured as follows. The next section looks into the determinants of African growth, and thereafter we link African growth to natural resource incomes. In Sections 4 and 5 we briefly present the EITI and the EITI implementation in Nigeria and Ghana. We proceed by discussing the natural resource situation and the present institutional system for handling resource rents in Mozambique in Sections 6 and 7. Section 8 concludes the paper.

2. Determinants of African growth

The world economy is rapidly integrating, and growth has accelerated very significantly in most regions. The determinants of economic growth have been analysed extensively, and Africa has been very much in focus in this research since the continent stands out as the worst performer. A decade ago Easterly and Levine (1997) even referred to it as 'the African growth tragedy'. To put the analysis of the potential role of the EITI initiative in Mozambique in perspective, we start by reviewing some relevant aspects of research done on African growth.

In the early cross-country regressions on growth, analysts typically inserted a dummy to pick up 'the Africa effect', which was consistently found to be significantly negative. Since then, however, researchers have chipped away at this measure of our ignorance, making it possible to replace the dummy by relevant explanatory variables. According to recent studies, African growth seems to be based on the same variables as growth elsewhere, but is nevertheless slower due to the continent rating badly on many of those variables (Hoeffler, 2002). Factors that explain Africa's poor growth are for example 'expensive investment goods, low levels of education, poor health, adverse geography, closed economies, too much public expenditure and too many military conflicts' (Artadi and Sala-i-Martin, 2003; Tsangarides, 2005). It is features like these that have to be changed for Africa to take off.

One interesting recent analytical approach focuses on growth accelerations and the extent to which these can be sustained, rather than focusing directly on long-run growth patterns (see e.g. Hausmann et al., 2004). Pattillo et al. (2006) apply this approach and find that growth tends to accelerate particularly when policies and institutions improve. There are clearly strong links among institutional quality, policy stance and growth accelerations. For growth episodes to last for a decade or more, countries require growth in trade and investment, low debt and democratic institutions. Pattillo et al. (2006) find that growth in sub-Saharan Africa (SSA) would increase by 1.7 percentage points annually if only the continent could achieve the average world quality of institutions. They do not find any consistent association between resource availability and growth episodes, though. Hausmann et al. find economic liberalisation and democratisation to be associated with sustained accelerations, although the effect was not sustained. This suggests that while the current resource boom in Africa, or a discovery of new resources, may lead to growth spurts, they may be hard to sustain. We will return to this issue later.

The most ambitious study so far trying to explain variations in African economic growth was undertaken by the African Economic Research Consortium (Ndulo et al., 2007)). It attempted to identify the growth opportunities and constraints, and to explain the success or failure of countries in seizing these opportunities. The study characterises growth opportunities along two dimensions. The first divides countries into three geographical categories, namely coastal countries, landlocked countries and resource-rich countries (irrespective of location). The second dimension is the degree of polarisation in the society, from not polarised to moderately polarised and highly polarised countries. It should be noted here that resource-rich countries, such as Mozambique, are placed in a category of their own irrespective of being coastal or landlocked. This is due to the finding that resource-rich countries in Africa have different development challenges and growth patterns than countries without resource abundance. After having defined the opportunities,

the study goes on to investigate how domestic governments have shaped the growth environment in the various countries covered. Four different types of anti-growth syndromes are identified in the case studies. First, there is the regulatory syndrome, which refers to excessive government interventions in markets. Second, there is the redistributive syndrome, where efficiency-reducing resource transfers play a dominant role in government policy. Third, there is the inter-temporal syndrome, which redistributes resources from the future to the present via for example looting by the elite or unsustainable government spending booms generally followed by sharp adjustments. Fourth, there is the state breakdown syndrome, i.e. civil wars or severe political instability. Then there are some countries that are characterised as syndrome-free. The empirical analysis shows that an absence of syndromes increases the growth rate by almost 2% per year.

Collier and O'Connell (2007) also notes that growth accelerations in Africa have tended to evaporate. One reason is that growth in the early stages of an acceleration is not real. For example, most of the government component of GDP is measured at cost, and thus increases with the growth of government wages. Since government wages often exceed the opportunity cost of government workers, the resulting increase in measured real GDP is partly illusory. If the government expansion proves unsustainable, it is generally hard for the government to lay off workers, and instead other types of expenditures are cut with negative supply-side effects. This is thus one reason why overspending during booms is often followed by economic decline. This is certainly something that can happen in case there is a major resource discovery or if there is a commodity price boom that boosts export revenues dramatically.

The main conclusion of the AERC study is that African growth has faltered due to dysfunctional political-economic configurations or syndromes. Africa's poor growth performance is not the product of a uniform phenomenon but is rather due to interaction among different syndromes with different effects in different countries with different opportunities.

An alternative characterisation of the African growth problem is offered by Sachs et al. (2004), who argue that Africa is caught in a poverty trap and that therefore small changes are not enough. The authors do not believe that the poor African performance is due to poor governance. Instead they argue that it is an effect of poverty, and that poor countries are poorly governed due to a lack of resources and skills. Furthermore, they argue that African countries are not more badly governed than other poor countries, but that there is a poverty trap. Savings is needed to cover replacement investments, investments to compensate for population growth, and finally investments to increase the capital stock. Since savings in Africa is low, the continent tends to get stuck in a low level of equilibrium. What is needed is a big push of investment to get the economy to a point where it can converge to a high level equilibrium. Sachs et al. identify three reasons for the poverty trap: First, savings are too low, since people are too poor to save enough. Second, people have many children. Third, capital has a threshold level below which it is not productive. Investments are lumpy. Savings are therefore not enough to increase the capital stock. However, if financial resources were the binding constraint, African countries that have enjoyed commodity booms should have leveraged them into an exit from the trap. They have so far failed to do so, which suggests that economic resources by themselves are not enough. The case of resource booms is discussed in Section 3.

While the innovation of the Sachs et al. paper is that it advocates a massive and externally funded scaling up of country public-service delivery, the central thrust of the recent literature on African development including the AERC growth study has been to dismiss capital fundamentalism as a viable interpretation of Africa's way forward. Pritchett and Woolcock (2004) point out that many of the Millennium Development Goals (MDG) services are both transaction intensive and discretionary. Unlike many macroeconomic reforms, the delivery of many health and education services requires the collaboration of multiple individuals who make highly discretionary choices in an environment where many key actions are unobservable. Such services are subject to deep incentive problems and cannot be delivered by a few politically protected technocrats. The empirical link between spending on health and education and outcomes is notoriously weak (World Bank, 2004). So again there is a concern about the efficiency of resource management. It is not enough that a country gains access to resources in one way or another – it must also ensure that they are reliably and wisely used.

African economies face a whole range of development challenges, which means that the demand on policy makers in Africa is larger than in other regions. At the same time, there is a governance problem. In recent years African economies have changed many of their policies in a sensible direction, but the problem of revamping the administrative machinery is a task of a much larger order. Implementation is a key problem in Africa. The main question concerning large aid injections is how the new or expanded programmes are to be managed. (Rapidly increasing revenues from natural resources have a similar character as aid, and is thus beset with similar problems.) How can one reach a situation where governments have incentives and possibilities to deliver efficient administration? Tight foreign control by donors in the form of policy conditionality has generally not worked well. Domestic systems of control must therefore be tried, and the EITI is one example of such a system that can contribute to more effective public sector resource management.

3. Resource incomes and African growth

3.1. The evolution of commodity prices

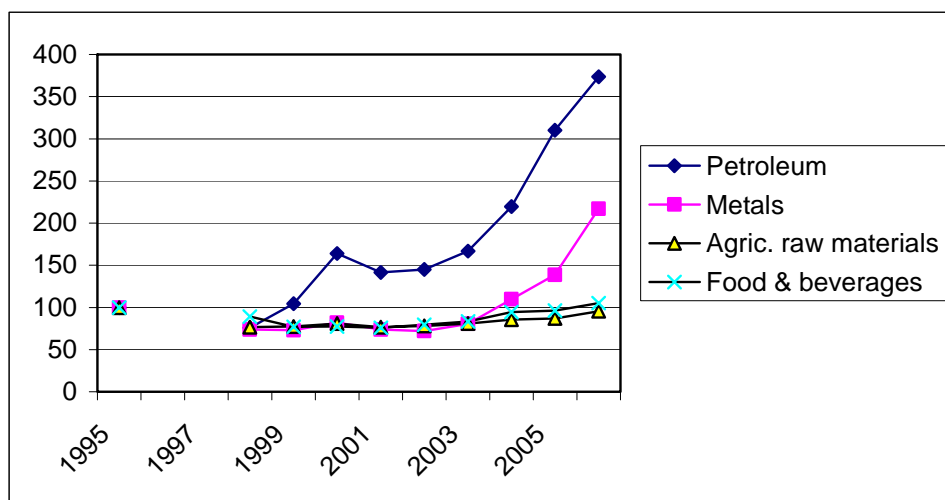
Many African economies are highly dependent on natural resource incomes, which represent a large share of all production, export and tax revenues. The degree of dependence has fluctuated over time, but the natural resource boom in recent years has meant that the importance of the incomes has increased significantly. While this is mainly due to dramatic increases in commodity prices, it is also a result of new discoveries and increased investments in existing ones.

A key characteristic of the markets for these commodities is that prices are volatile and unpredictable, and do not follow a smooth development path. The typical pattern is instead a rapid price increase when there is a stockout of the commodity (i.e. when stocks fall below some level that is considered acceptable) (Collier, 2007). This abrupt increase in the commodity price is generally followed by a slow long-term decline. Hence, the long-term pattern is characterised by short periods of very high prices (Africa is currently in such a period) with slowly falling prices in between.

Figure 3.1 shows that there have been dramatic price increases in petroleum and metal prices in the last few years, while very little has happened with regard to agricultural products in the form of industrial inputs and edibles. The figure shows nominal prices, but even after correcting for inflation the price increase for non-agricultural commodities is very high. It is not easy to predict future prices, but by the middle of 2007 there had not been any significant declines in prices. Again, if experience is any guide, we would expect prices to come down gradually. However, some observers believe we may be in a new situation with some kind of super-boom, driven by the rapidly growing Asian economies.

Figure 3.1. Indices of Primary Commodity Prices, 1995-2006

(1995=100, current US dollars)



Source: IMF Primary Commodity Prices.

3.2. The natural resource curse

From an African perspective the price increases described above may seem like good news. However, looking back a few decades it can be noted that countries with an abundance of natural resources have actually grown very poorly. There is a huge literature on what has come to be known as the natural resource curse, which suggests that resource-abundant developing countries tend to grow slower than resource-scarce countries.¹ However, at the same time as there is extensive evidence that there is indeed a long-term negative growth effect of resource abundance, there is also recent evidence that recent commodity booms, even in Africa, have significantly increased the rate of growth (Raddatz, 2005). Hence, we seem to be faced with a combination of positive short-term and negative long-term effects.

Let us first consider the three main possible explanations of the negative long-term effects featured in the literature. The first and most classical explanation is the Dutch Disease, which describes the situation where an export boom leads to a currency appreciation that makes other exports uncompetitive. Numerous studies have identified this effect. A recent study by Rajan and Subramanian (2005) finds that an appreciating exchange rate reduces growth of labour-intensive industries. This is certainly a concern for African countries, since labour-intensive production is an area where they may be expected to have comparative advantages that they need to exploit in order to generate long-term growth and employment.²

The second explanation focuses on the negative effects of the volatility of incomes due to price swings. It has clearly been hard for African economies to manage the booms to avoid boom-and-bust cycles.³ Volatility can have negative effects on growth by making private sector investments more risky, which makes investors less willing to invest (Sala-i-Martin and Subramanian, 2003). It also tends to have negative effects on the efficiency of government spending. Governments often initiate large extra spending programmes during booms, which have to be followed by dramatic cuts of expenditure programmes during busts.

Thirdly, there are a series of explanations that focus on the impact of resource incomes on governance. It has been suggested that lobbying and rent-seeking is more likely in situations where there are large resource rents (Torvik, 2002). Mehlum et al. (2006) argue that this mainly occurs in countries with grabber-friendly institutions, and not in countries with producer-friendly institutions. Many countries in Africa fall into the former category, while countries such as Norway fall into the latter. A key policy challenge is thus to find ways and means to reform grabber-friendly environments. A related explanation is offered by Robinson et al. (2006), who argue that resource rents provide strong incentives to the politicians in power to pursue inefficient redistributive policies to build political support that can guarantee their power position. Examples are provision of public employment, subsidies to farmers, and protectionist measures for certain domestic industries. Both these governance-related explanations thus suggest that large resource rents tend to undermine economic governance, which leads to lower economic growth. The handling of the (often

¹ The classical reference is Sachs and Warner (1995). A recent survey of the literature can be found in van der Ploeg (2006).

² Large inflows of aid are also associated with the Dutch Disease effects. This may be a concern in the case of Mozambique, where foreign aid is currently above 15% of GDP.

³ See e.g. Addison (2007) about the oil boom impact on the volatility of Nigeria.

substantial) revenues is therefore crucial to economic policy making in resource-rich countries.

Apart from these three types of explanations there are other explanations in the literature. It has for example been noted that resource abundance is associated with civil conflicts (Collier and Hoeffel, 2005). Resource rents can weaken the state and also provide resources for rebels (Olsson, 2007). Resource abundance tends to lead to increased inequality, since it is not uncommon that much of the revenue ends up in the hands of a small elite (e.g. Engerman and Sokoloff, 2002). This may influence growth negatively through various channels. For example, it could be detrimental to the quality of institutions and lead to domestic conflicts or unrest. It has also been observed that countries that earn huge rents have become credit worthy and have borrowed externally against the resource rents (Kuralbayeva and Vines, 2006).

3.3. Investigating the short-term vs. long-term paradox

So we are faced with a puzzle. The literature seems to identify positive short-run but negative long-run growth effects of resource booms. In a recent study, Collier and Goderis (2007) try to sort out this conflict by using a panel co-integration methodology that makes it possible to disentangle the short-run effects of commodity booms from the long-run ones. Analysing 1963-2004 panel data, they introduce fixed effects and regional time dummies to try to eliminate the effect of omitted variables as much as possible and allow prices to vary among different commodities.

Collier and Goderis investigate whether the effect is the same for different types of commodities. They distinguish between oil, other non-agricultural and agricultural commodities, and show that there are significantly negative long-run effects of oil booms. In the case of Nigerian oil, for example, they find a long-run elasticity of -0.60, which means that a 10% price increase lowers long-term output by 6%. This is certainly a very dramatic effect. The estimated elasticity for Angola is even larger at -1.10. This suggests that Mozambique needs to be very concerned about what the long-run impact of a significant oil production could be. With regard to other non-agricultural commodities there is a significantly negative effect, although only at the 10% level of significance. The negative elasticity estimated for the case of Mauritania is as high as -0.70. When it comes to agricultural commodities they do not find any resource curse effect but instead a positive long-run effect. Hence, the natural resource curse only seems to apply to non-agricultural commodities.

On the other hand, Collier and Groderis' estimates of the short-run effects of commodity exports are positive for all categories of commodities. The short-run growth effects are positive, and they estimate that in 2005 and 2006 the commodity boom added about 2.5 percentage points of extra growth in a typical African economy over and above the effect from the terms of trade gains. On top of this, the terms of trade effect can be large. If for example export prices double, income increases by the same percentage as the share of exports in GDP. This is a tremendous positive shock to the economy, which needs to be handled with great care. If these extra incomes are wisely invested, the economy can gain a lot from a boom.

As an example of the interpretation of their results, they imply that a 10% increase in the price of the Zambian commodity export leads to a 5% decline in the real GDP per capita in

the long run. At the same time the higher price leads to an increase in the purchasing power of the country, although with a reasonable assumption about magnitudes it is not enough to compensate for the negative long-run effect even if it does mitigate the effect. Thus, in the long term the country will see both lower output and lower incomes due to the price boom.

3.4. Explaining the long-run curse

The real challenge is to sort out what explains the long-run effects. Collier and Goderis (2007) start by considering six different potential explanations, namely the Dutch Disease, governance, conflict, excessive borrowing, volatility and inequality, and find that although they get a negative estimate for the coefficient for exchange rate appreciation or the Dutch Disease, it is not significant. Thus, the Dutch Disease only explains a small part of the negative long-term growth effect of commodity booms. Collier and Goderis also find that while the volatility explanation does have some validity, it is not a major explanation.

The estimated coefficient for their governance indicator is positive, but is not significant either when entered directly. Collier and Goderis then go on to investigate the hypothesis of Mehlum et al. (2006) and Robinson et al. (2006) that the resource curse occurs conditional on weak governance. They rank countries according to their average ICRG (International Country Risk Guide) score and then split the sample into two groups: good governance and bad governance countries. When their regression is then run for the bad countries only, the coefficient for the commodity export price is negative and significant at the 1% level; these countries thus seem to suffer from the resource curse. When the same regression is run for the good governance cases, the coefficient is positive and significant at the 5% level. Hence, their conclusion is that not only is the resource curse absent in the good governance countries, their higher export prices even have a significantly positive effect on long-run growth. Various checks of this result are tried, but it seems robust.

Hence, Collier and Groderis conclude that it is primarily bad governance that causes the resource curse. But which of the two approaches is most relevant? The Mehlum et al. (2006) approach was that high resource rents make it profitable to enter into lobbying and rent-seeking, and that these activities pay off in grabber-friendly but not in producer-friendly environments. This means that entrepreneurs have strong incentives in weak policy environments to shift their efforts away from productive activities to rent-seeking activities, with detrimental effects on long-run growth. Their hypothesis was that this results in a lower share of manufacturing in GDP. While they could not test this in their cross-section data, Collier and Goderis (2007) could, with the help of their panel data set. The alternative approach by Robinson et al. (2006) argues that the cause of the resource curse is rather misallocation of government resources, or more specifically that resource booms provide incentives and resources that can be used for inefficient redistributions to buy political support (e.g. public employment, farmer subsidies and protection of domestic industries).

The governance hypothesis is tested by considering several indicators of government activity. Again they had difficulties finding a general effect on the whole sample. They then went on to check whether there could be a non-linear effect. Experimenting with different specifications where the variables were interacted with the proportion of non-agricultural commodity exports in GDP, they found that a combination of three channels could explain the resource curse: the government consumption as a share of GDP, de jure trade liberalisation, and total consumption in GDP.

Collier and Goderis (2007) then draw the conclusion that ‘the resource curse occurs conditional on weak governance/institutions and that it works through inefficient redistribution’. So if it can be concluded that the resource curse does not occur in countries with good institutions, then it seems clear that what is needed to prevent it from happening is the creation of good institutions. The challenging question is then how this can be done. The EITI is one example of an attempt to provide incentives for good governance, and the usefulness of this initiative is what this paper will investigate.

3.5. Economic policy for booms

Effective public spending is crucial for good long-term growth outcomes according to the supported third explanation (see Section 3.2). The aspects that are important are first to allocate public money to the right activities and second the ability of the government to make sure that the money is effectively used. How well the government can perform these tasks depends both on the skill levels of the civil servants and on the incentive structure. For the incentive structure to be effective there must be pressure on both the government and the public sector institutions to be accountable. This typically requires that they are accountable to the citizens of the country, which in turn requires a set of checks and balances and good opportunities for the citizens to scrutinise how the money is used. The EITI constitutes one option to strengthen the process of scrutiny and then also policy making and growth effects. Collier and Hoeffler (2006) show that a higher number of checks and balances have a significantly positive effect on economic growth. They also find that as resource rents increase, the number of checks and balances seems to decline. So instead of better accountability when rents increase, the reverse is typically found.

A major problem associated with efforts to make an initiative such as the EITI work is the so-called free-rider problem. Government scrutiny is a public good (i.e. the benefits accrue to all citizens), which implies that it is not in anyone’s individual interest to exert control for everyone’s benefit. Sometimes citizens can organise themselves to exert control. This may be the case when there are large effects of certain government policies, such as high taxation. However, there is a risk in resource-rich countries, where much of the taxes come from resource rents paid by firms, that citizens do not feel it is their obligation to get organised and to scrutinise government activities. So the dilemma is that it is in these cases that the need for scrutiny is the highest, while the incentives to undertake the scrutiny are the lowest.

From a policy-making perspective the most important decisions are taken during booms. However, they are often taken without consideration of their long-term implications. Decision makers should take into account that the high prices (and hence income) are unlikely to persist, and evaluate what the appropriate long-term policy choices are. Moreover, it is during the boom and not the bust periods that there is a reasonable scope for choices. It is less painful to hold back spending somewhat during the boom than to be forced into panicky measures once there has been a bust and there are much less resources available.

Collier (2007) discusses how policy makers should deal with booms. The key issues are how much revenue should be saved, how much savings should be invested domestically, and how this investment should be divided between public and private sectors. There might also in some instances be a need to consider how much revenue should be transferred directly to households.

For economies that depend heavily on highly fluctuating incomes from non-agricultural resource exports, it is very important that public expenditures are handled well. Savings decisions are vitally important when dealing with the problem of volatility of revenues, and if policy makers manage to smooth the income flow, it is more likely that they will be able to maintain the quality of public expenditures.

Collier (2007) points out that when taking decisions on how to deal with revenue from a natural resource such as oil, one needs to assess the trend of international prices for that commodity and whether they are below or above its trend value. It may be reasonable to expect that the trend in real oil prices in the long term points upward, but with large swings around the trend. The savings decision has two dimensions: First, a long-run decision that makes it possible to achieve a sustainable (possibly increasing) path of consumption must be taken. The choice here depends on the real price trend and the extraction rate. With reasonable estimates of these, one would probably set more aside for investment than for current consumption. To come up with reasonably realistic estimates in cases like Mozambique where extraction is in its early stages is of course difficult. However, once production gets underway the government will need to take a decision on the consumption-investment trade-off.

Second, this long-run decision then needs to be complemented with decisions on how to smooth the fluctuations generated by the oil price swings. The notion here is basically that incomes from prices above normal should be saved and then used in periods when prices are below normal. This means that the government should be able to draw on these savings in periods of decline, which suggests that they should be held in liquid forms. By holding them in liquid form abroad and then bringing them back home when the prices of the commodity fall, the government can also help smooth the path of the real exchange rate.

Collier (2007) compares the handlings of the copper boom in 2005 in Chile and Zambia. Chile applied the strategy presented above, i.e. all extra revenue was saved, while Zambia continued to run a fiscal deficit.⁴ In the case of Chile the exchange rate actually depreciated, while in Zambia it appreciated by as much as 80%. This of course was extremely problematic for Zambian non-copper exporters.

It should be clear at this point that the handling of large and volatile inflows of foreign exchange is a concern. If the inflow represents a permanent shift in the earning ability of a country, then the appreciation of the exchange rate is only appropriate and hence not a misalignment, since the economy should adjust to the new situation. However, if the boom is temporary, then a short period of appreciation may well lead to the bankruptcy of industries that in the long-term would have been viable. Thus, industries where the country has comparative advantages in the long-term would be closed down and capital that had been invested would go to waste.

Fluctuating exchange rates also increases the riskiness of investments, and thus holds back private investments. Hence, the handling of booms has both a fiscal and an exchange rate aspect. In booms, the government should run a fiscal surplus and the central bank should build up its foreign exchange reserves.

⁴ It may be noted, though, that in the case of Zambia the government at the turn of the century when copper prices were extremely low had entered agreements with the mines about tax holidays, which now means that very little of the extra revenue ends up in the government coffer (except indirectly via increased income taxes and the like).

Another policy issue is the investment choice. Should the money be invested at home or abroad? This decision to some extent depends on the relative returns. The returns at home depend on the scope for profitable domestic investments. Experiences in Africa show that the cost of domestically produced capital goods increases very significantly during booms discouraging domestic investments (Bevan et al., 1990). With regard to the allocation of investments between the private and public sectors, the government can of course control public investments directly, while it has to use indirect means to influence private investments. This may for example be done via a purchase of domestic debt from the public, leaving money that can be used for investments in the hands of the citizens (Collier and Gunning, 2005).

When government revenues are very large it may even be appropriate to transfer some of the resources directly to the citizens, or else the public sector may become too large relative to the private sector. However, this is not easily done in poor African economies, so one may need to think of effective ways of managing the transfer. One way would be to use the schooling system. There are some non-African experiences that transfers of money to children who attend school may have beneficial effects on both school attendance and poverty reduction.

3.6. Incentives for implementation of sound policies

Democracy has two important dimensions: electoral competition and checks and balances. Particularly resource rich countries need democracy to avoid elite capture of rents, but they also need checks and balances to prevent elections from being converted into corrupt patronage games financed by the resource rents. Furthermore they need a process of scrutiny to achieve honesty and other processes to achieve efficiency. While resource rich countries often have resources, they also need good systems of public spending. A serious constraint here is political will, and since much of government income comes in the form of resource rents the elite may be tempted to capture the rent for itself. For rents to be effectively used it is probably necessary that power is diffused. It is crucially important that money from resource booms is used well, and this requires accountability. Since scrutiny is a public good it is subject to collective action problems. Donor initiatives could here help organise citizens and maybe also stimulate peer group evaluations.

There is a general political problem in handling money from a windfall such as those due to temporarily high commodity incomes. The problem is that a government in power will normally soon be up for re-election, which means that it has a strong incentive to try to 'deliver' during its term in office. If it behaves prudently it may instead lose power. It is also politically very difficult to argue for prudence and high savings in a situation where the immediate needs of the population are very obvious. It has been politically problematic even in rich countries to pursue a prudent policy, and even in the case of Norway, negative criticism of such a policy has led to great progress for populist politicians. It is of course even harder to pursue a prudent policy in a poor country, both because the pressure from the population is larger and because the costs for policy makers of being thrown out of power are probably higher.

The agency problem of the process of scrutiny can be reduced by improved information to the principals. There should be support for the building of capacity to analyse information and incentives for agents to perform. External pressures from donors can help the local civil

society and citizens by insisting that rewards and penalties be built in and implemented.⁵ Audit systems and parliamentary scrutiny are key areas of intervention. A top priority is competitive bidding for government contracts. When this was introduced in Nigeria recently, costs of projects fell by an average of 40%. Ensuring efficiency of resource use calls for ex ante authorisation, scrutiny during implementation, and ex post evaluation.

If solutions cannot be achieved domestically, or as a complement to domestic mechanisms, then external agents of restraint could be relied on. In for example Eastern Europe major policy reforms were undertaken quite quickly once it was realised that this was necessary for the countries to become EU members. In Africa the external agents of restraint have been the World Bank, the International Monetary Fund and other donors, but their track record has been mixed. While policy reforms have been decided upon, their implementation has often left a lot to be desired⁶ since the domestic interest in fulfilling the promises has been too small. It therefore seems reasonable to try to find a solution where citizens can influence and control policy makers. Donors could support such a process by pushing for governance conditionality, which can restrict the power of the governing elite (Collier, 2006). Unfortunately, there is a knowledge gap about how to implement governance conditionality.

Collier (2006) desires a shift in aid policy from policy conditionality to governance conditionality. The former undermines accountability to the citizens, while the latter reinforces it. In the Paris Declaration there is a point about ‘mutual accountability’, meaning mutual progress assessments by donors and recipients and a mutual accountability mechanism. When it comes to budget support there is extensive use of performance indicators. The structural adjustment lending during the 1980s and 1990s was based on ex ante conditionality, i.e. on promises of policy reforms. Since this did not work very well, there has been an argument that donors should shift to ex post conditionality, that is to say aid based on recipient performance according to certain ultimate goals. The European Commission pioneered this type of aid allocation, and since 1999 financing conventions with ACP countries include a ‘variable financing tranche’, where aid transfers are based on the outcomes of certain social and economic variables (Adam et al., 2004). The idea is that performance-based contracts lead to better ownership, which in turn is considered essential for good performance. This new modality was gradually introduced and has in several instances existed alongside conventional conditionality.

3.7. Concluding remarks

Our analysis of African experiences of handling resource rents clearly shows that governance and public resource management are key areas. It is of course also essential to get the economic policy analysis right, but this is significantly easier than to bring about an institutional set-up that guarantees effective policy choice and policy implementation. The EITI can be an important component in the institutional development required to ensure that resource booms are used for the long-term good of citizens.

⁵ The EU successfully influenced institutions in Eastern European countries by requiring reforms as a condition for EU accession. Since African and other developing countries are not candidate countries, the EU cannot exert such an influence there. Nevertheless, the issue is certainly worthy of consideration.

⁶ There has been some modest reduction in the extent of conditionality relative to the old structural adjustment programmes. The constraint is that the reduction of conditions that donors are willing to accept depends on whether the recipients are able to put adequate reporting systems in place.

4. The EITI – structure of the initiative

4.1. Background

The resource curse has resulted in resource rich developing countries having poor results in socio-economic development, often as a result of corruption, clientelism and political instability. Many countries have made efforts to avoid the curse by improving transparency and accountability. The international community has supported these attempts towards improving governance through a number of important initiatives and as a complement to these, the Extractive Industries Transparency Initiative (EITI) was announced by the former UK Prime Minister Tony Blair in September 2002 at the World Summit on Sustainable Development in Johannesburg. The June of the following year, the initiative was launched at an Inaugurating Conference in London.

The EITI is a voluntary multi-stakeholder initiative open to governments, international organisations, companies, civil society, investors, and business and industrial organisations, and sets a global standard for greater transparency and accountability in resource rich countries. For instance, at the inauguration conference the statement of principles was signed by a broad alignment of governments, important players in the international oil industry, and the civil society coalition Publish What You Pay (PWYP).

The PWYP campaign was launched in June 2002 by a small group of civil society organisations such as Global Witness, CAFOD, Open Society Institute, Oxfam GB, Save the Children UK and Transparency International UK. The coalition has grown extensively to currently include more than 300 members. The background to the campaign was a report on Angola by Global Witness (1999) that made clear that major oil companies' refusal to release financial information had aided and abetted the mismanagement of oil revenues in the country. The report concluded with a call on the oil companies to 'publish what they pay'.

4.2. Main idea

The EITI provides a global standard for transparency and accountability, assisting resource-rich countries in avoiding mismanagement of revenues from oil, gas and mining, since these revenues can contribute to sustainable development and poverty reduction (EITI, 2005). Although the initiative is supported internationally, the focus of the initiative is on the national level and its implementation is government-led. The EITI is a voluntary multi-stakeholder initiative, and its benefits vary among the different involved organisations. Overall, the participants gain from the signalling effect of the government and companies committing themselves to high standards of transparency and accountability in public life, government operations and in business. More specifically, the implementing countries improve resource management, promoting economic and political stability. In addition, the investment climate improves, possibly resulting in increasing investments from investors and international financial institutions (EITI, 2005).

Reductions in political and reputational risks are the main benefits for companies and investors. Political stability is important for revenue generation, especially since investments in extractive industries are capital intensive and long term. Greater transparency improves companies' possibilities to show their contribution to the socio-

economic development of the host country. In addition, competition is increased when the playing field is levelled. The civil society benefits from improved public information, making it easier to hold the government accountable for resource allocations (EITI, 2005).

The EITI aims at increasing transparency and accountability through two mechanisms:

- By publishing all payments made by extractive industries to the government and all revenues received by the government from those companies. These figures should:
 - Come from all companies operating in a country.
 - Be audited to international standards.
 - Be reconciled by an independent organisation.

- By involving local civil society groups in the design, management and monitoring of the initiative.

It is important that all payments and revenues are reported. These could include the host government's production entitlement, national state-owned company production entitlement, profit taxes, royalties, dividends, bonuses (e.g. signature, discovery and production bonuses), licence fees, rental fees, entry fees and other significant benefits to the host government.

The cornerstones of the EITI are the so-called principles and criteria. The EITI Principles were agreed upon at the Lancaster House conference in 2003, and the EITI Criteria were agreed upon at the EITI London conference in 2005. They establish the common, mutually agreed upon, minimum requirements for all countries implementing the EITI. The principles summarise in broad strokes the international consensus on the importance of transparency and the need for collaborative efforts by public and private sectors in ensuring accountability and good governance (Ocheje, 2007). The criteria are based on verification of payments and receipts by an independent administrator, a publication, involvement of the civil society and the participation of all extractive industry operators.

Box 4.1: EITI Principles

1. We share a belief that the prudent use of natural resource wealth should be 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.
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.
3. We recognise that the benefits of resource extraction occur as revenue streams over many years and can be highly price dependent.
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.
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.
6. We recognise that achievement of greater transparency must be set in the context of respect for contracts and laws.
7. We recognise the enhanced environment for domestic and foreign direct investment that financial transparency may bring.
8. We believe in the principle and practice of accountability by government to all citizens for the stewardship of revenue streams and public expenditure.
9. We are committed to encouraging high standards of transparency and accountability in public life, government operations and in business,
10. We believe that a broadly consistent and workable approach to the disclosure of payments and revenues is required, which is simple to undertake and to use.
11. We believe that payments' disclosure in a given country should involve all extractive industry companies operating in that country.
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 civil society organisations.

Box 4.2: The EITI Criteria

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.
2. Where such audits do not already exist, payments and revenues are the subject of a credible, independent audit, applying international auditing standards.
3. Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the administrator’s opinion regarding that reconciliation including discrepancies, should any be identified.
4. This approach is extended to all companies including state-owned enterprises.
5. Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contributes towards public debate.
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.

Administratively, the initiative is since 2007 governed by a board supported by an international secretariat in Oslo, Norway.⁷ The board consists of members from EITI implementing countries, supporting countries, civil society organisations, companies and industrial associations.

4.3. The validation process

According to the EITI website,⁸ there are 22 EITI countries: Azerbaijan, Bolivia, Cameroon, Chad, Democratic Republic of Congo, Equatorial Guinea, Gabon, Ghana, Guinea, Kazakhstan, Kyrgyz Republic, Mali, Mauritania, Mongolia, Niger, Nigeria, Peru, Republic of Congo, São Tomé and Príncipe, Sierra Leone, Timor-Leste, and finally Trinidad & Tobago. As can be seen, most of them are African, but countries from Europe, Asia and Latin America have also endorsed the initiative.

The EITI countries have reached various levels of implementation. When the PWYP coalition in 2006 last year presented an analysis of the EITI progress (Publish What You Pay, Revenue Watch Institute, 2006), it was noted that many countries had not yet even taken the initial step of appointing individuals to lead the EITI process. The coalition pointed out that some countries might have endorsed the EITI without being politically committed to implementing it. These governments might have signed merely to be politically correct or to gain Heavily Indebted Poor Country (HIPC) status. The coalition suggests that action needs to be taken to protect the credibility of EITI by ensuring that rhetorical commitments are matched by concrete actions.

At the time of the PWYP report, only Azerbaijan and Nigeria had published fully audited and reconciled EITI reports. By July 2007, an additional five countries, Cameroon, Gabon,

⁷ Before the move to Oslo, the administrative secretariat was located at the United Kingdom’s Department for International Development (DFID).

⁸ www.eitransparency.org

Guinea, Ghana and Mauritania, had shown political commitment and published EITI reports.

The civil society critique was an important input into the work of the International Advisory Group⁹ (IAG) that was formed in July 2005 to look into ways to strengthen the EITI. The IAG recommended EITI to introduce a validation process to be run at least every two years (EITI, 2006). The process has now been introduced¹⁰ and is focused only on implementation in order to assess whether a country is a compliant or a candidate, or if no meaningful process is being undertaken. The compliant countries are those that have fully implemented EITI and candidate countries are those that have committed to implementing EITI, but where implementation is still ongoing.

The purpose of the validation process¹¹ is to provide a measure of implementation progress for EITI countries. For compliant countries, the process is more of an independent assessment of the EITI process (World Bank, 2007b). The validation process will surely affect the 'free rider' problem and thereby positively influence the political will of hesitant policy makers.

4.4. Participation of the oil, gas and mining industries

The EITI is supported by three industry associations, 28 extracting industry companies and more than 70 global investment institutions. Peter Clapman of the TIAA-CRED has emphasised that improved transparency standards would benefit investors both as lower business risks for existing operators as well as expanded investment opportunities that would ensue as a result of the improved business climate (EITI Newsletter, 2004).

The industry associations are the American Petroleum Institute, the International Council on Mining and Metals and the International Organisation of Oil and Gas Producers.

The companies are Amerada Hess, Anglo American, AngloGold Ashanti, Areva, Barrick Gold, BG group, BHP Billiton, BP, Burren Energy, ChevronTexaco, ConocoPhillips, DeBeers, Eni, ExxonMobil, Katanga Mining Limited, Lonmin, Marathon, Newmont, NorskHydro, Petrobras, Repsol YPF, Rio Tinto, Shell, Statoil, Talisman Energy, TOTAL, Woodside and Xstrata.

The more than 70 global investment institutions, including some of the world's largest pension funds, are listed on the EITI website <http://www.eitransparency.org/section/supporters>

⁹ The IAG includes representatives from seven governments, four companies and four civil societies, and one global investor.

¹⁰ Endorsed by the October 2006 EITI Conference.

¹¹ For details on the EITI Validation Guide see <http://www.eitransparency.org/section/abouteiti/keydocuments>

4.5. Participation of the supporting countries, international organisations and the civil society

The EITI is supported by: Australia, Belgium, Canada, France, Germany, the Netherlands, Norway, USA and the UK. In addition, G8 also supports the EITI.

In August 2004, the United Kingdom's Department for International Development (DFID) and the World Bank established the multi-donor trust fund for the EITI. Germany, Norway and the Netherlands joined in 2005. The goal of the trust fund is to broaden support for the EITI principles and processes in EITI countries. It currently funds activities in twelve countries.

Multilateral organisations such as the African Development Bank, the European Bank of Reconstruction and Development, the International Monetary Fund, the Organisation for Economic Co-operation and Development, and the World Bank Group support the EITI.

It is also supported by civil society organisations such as the Catholic Agency for Overseas Development, the Georgia Revenue Watch and the NGO Coalition 'For Transparency of Public Finance', Global Witness, the Open Society Institute, the Publish What You Pay coalition, the Revenue Watch Institute and Transparency International.

4.6. Initiation, implementation and governance structure

The EITI is government led, and each implementing country develops its own unique governance structure for implementing the initiative. The EITI does however provide some guidance.¹² The first step of the EITI process is of course the endorsement by the government. Thereafter, the initiation is made in consultation with stakeholders. This phase includes the establishment of the governance structure for decision making, outlining a work plan, and arranging for capacity building and sustainable financing of the programme. In the implementation stage, each government and the involved companies and civil society organisations together disclose, disseminate and discuss reported revenues. Finally, the process includes a review of the implementation, and the identified concerns and opportunities for improvements are used to enhance the process (EITI, 2005).

The basic institutions reported to have been established in all EITI countries are the multi-stakeholder steering group and the secretariat. This basic set-up can then be supplemented with a cross-governmental group, a broader consultative group and sub-groups (see Figure 4.1 below).

The key institution in EITI implementation is the multi-stakeholder steering group, or committee, in each country, which needs to be large enough to be representative of the key stakeholders but small enough to be able to meet easily and function efficiently. This group is responsible for the key decision making in the EITI process; thus, the representatives must be able to participate in decision making. Typically a group consists of 10-15 people drawn from government, industry and civil society. Common tasks for the steering group are:

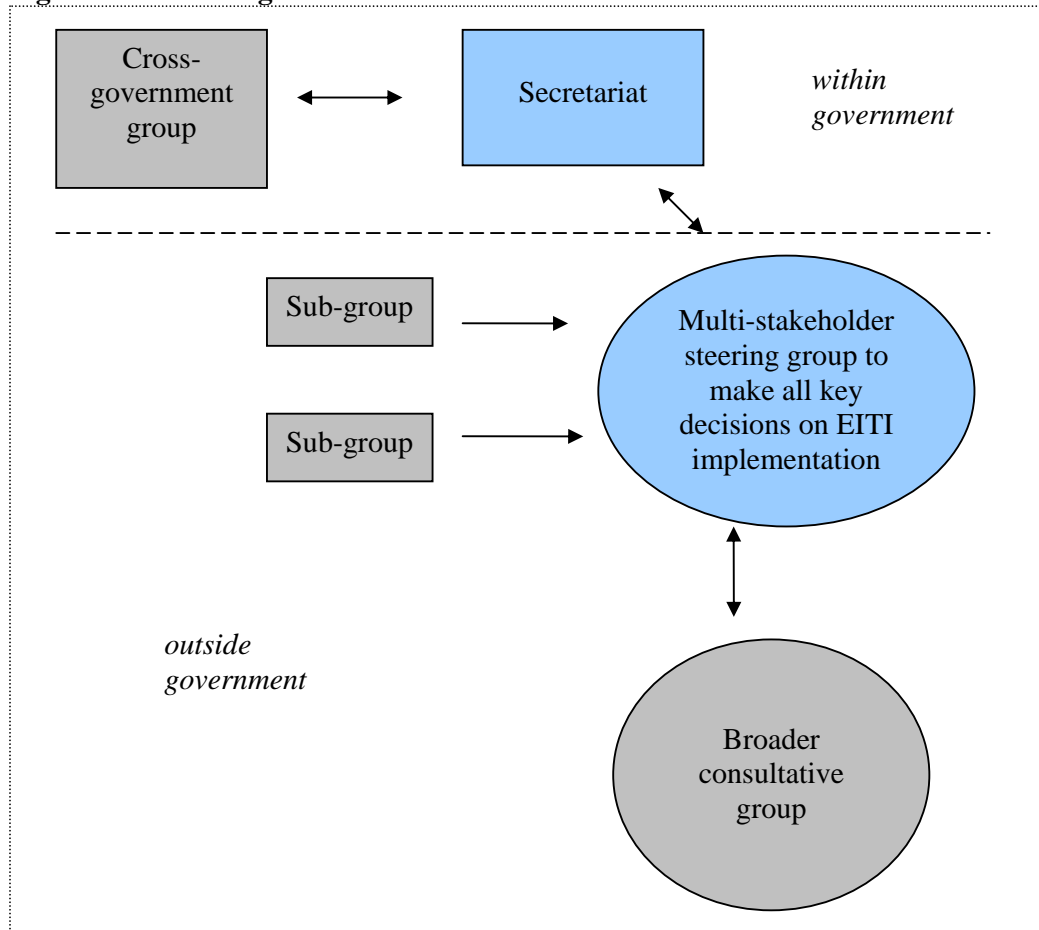
¹² This section is based on information provided by Sefton Darby of the World Bank and by the EITI (2005).

- Taking responsibility for overall strategic decision making;
- Developing a work plan;
- Appointing an auditor;
- Raising public awareness;
- Assessing and removing barriers to implementation;
- Reviewing a validation report.

Membership in a steering group can be established in different ways. For example, the government can make the selection or different stakeholders can be invited to nominate representatives. However, it is important that the process is carried out in a transparent and open manner. Thus, some representatives of the steering group might have constituency arrangements, representing a broader group outside the steering group.

The secretariat, or implementing unit, oversees the development of the initiative. These units are almost always based inside the government, at a revenue ministry, a sector ministry, or in a cross-cutting ministry or agency. Typically, the secretariat is responsible for supporting the work of the steering group and carrying out all the work required in the government to implement the EITI. Important tasks are of course to develop a fully financed work plan and look into necessary regulatory or legislative changes.

Figure 4.1 Possible governance structures



Some countries have created broader consultative groups to allow for interested stakeholders to participate in the EITI process. This allows for interested organisations to participate in a regular manner. Other countries have instead chosen another way for broader consultations, holding regular workshops and conferences in order to consult with all interested stakeholders. Also, it is not unusual that countries have introduced small multi-stakeholder subgroups to address specific questions.

The EITI often involves many different government ministries and agencies, and there is therefore a need to coordinate government positions before going to stakeholder group meetings. Hence, in addition to the secretariat some governments have introduced special cross-governmental groups. However, it should be noted that these groups are for internal coordination only and must not be mistaken for decision-making bodies in rivalry with the multi-stakeholder steering group.

Organisations that might need to be involved in EITI design, implementation and monitoring as members of stakeholder groups according to EITI are presented in Textbox 4.3 below (EITI, 2005).

Box 4.3 Candidate organisations to the multi-stakeholder steering group

- | |
|--|
| <p><i>Public institutions</i></p> <ul style="list-style-type: none"> • Executive <ul style="list-style-type: none"> ○ Agencies responsible for management of natural resources ○ Agencies responsible for revenue collection and management ○ Agencies responsible for economic development, private-sector regulation and public administration • Legislature <ul style="list-style-type: none"> ○ Budgetary and/or natural resource committees ○ Sub-national levels of government • Supreme audit institutions <p><i>Private sector</i></p> <ul style="list-style-type: none"> • Companies operating in the country <ul style="list-style-type: none"> ○ Domestic state-owned companies ○ International state-owned companies ○ Domestic private companies ○ International private companies • Investors • Business associations <p><i>Civil society</i></p> <ul style="list-style-type: none"> • Community-based organisations • National civil society organisations • International civil society organisations NGOs and their local affiliates • Media, trades unions, academic and research institutions, and faith-based organizations <p><i>EITI implementers</i></p> <ul style="list-style-type: none"> • Administrators, auditors and/or disclosure agencies <p><i>International partners</i></p> <ul style="list-style-type: none"> • International institutions (IMF, World Bank, United Nations) • Donors |
|--|

The PWYP assessment of the EITI in 2006 pinpointed some important issues for successful implementation (Publish What You Pay, Revenue Watch Institute, 2006):

- Appoint the 'right' leader for the implementation;
- Make sure to recognise and get genuine civil society participation;
- Support the civil society participation;
- Allocate sufficient funding;
- Institutionalise the EITI in statutory law.

4.7. Way forward for the EITI

The EITI is an international instrument combining government commitment with business interests and civil society demands. It receives support from OECD countries and companies based in these countries. On the international scene, companies from emerging countries such as Brazil, Russia, India, China, Mexico and South Africa are becoming more active in international exploration and production of natural resources. The IAG therefore suggests that the EITI work with these emerging economy governments to encourage their greater engagement in the initiative (EITI, 2006). If the EITI is only applied to some companies active within a country, they may face a loss of competitiveness from disclosing their payments (Schultz, 2007).

The initiative arose in the aftermath of a number of scandals where international oil companies played significant parts. As mentioned earlier, Global Witness reported involvement of oil companies in the severe mismanagement of resources in Angola.

Internationally, the increasing focus on good governance has forced the oil industry to face either some kind of own governed self-regulation or an externally imposed system via international law (Schumacher, 2004). Within the EITI, the oil industry has pushed for a voluntarily nature (thus self-regulation), while the international civil society organisations would prefer an international mandatory regulation. One option available, chosen by Nigeria, is to make EITI participation mandatory on a national level by passing a law. Companies from emerging economies are then obliged to participate in the national EITI.

The IAG also noted that EITI implementation in the mining sector was not proceeding as satisfactorily as in the oil and gas industry (EITI, 2006). There are fundamental differences between the industries that the EITI has not fully incorporated. First, while transparency in revenue payments is important for the oil and gas industry, contributing to a sustainable development and environmental issues are more important for mining companies. Thus, the EITI might need to expand beyond revenue transparency to cater for the needs of the mining industry (Rader and Sabater, 2006). Second, the revenue flows are significantly less in mining than in the oil and gas industry, and the payments to the government are not as complex as in the case of the oil and gas industry. Third, mining companies that are members of the International Council on Mining and Metals (ICMM) are already following a mandatory requirement of reporting tax revenue in a transparent way.

Finally, the IAG wanted the EITI to associate more closely with other transparency initiatives, especially with IMF and the World Bank. The EITI is only one of several international programmes promoting good governance, and is best implemented as part of a broader reform and as a complement to other programmes (EITI, 2006). The IMF and the World Bank promote efficient resource revenue management through policy advice, policy-based lending and technical assistance. The IMF has promoted good practise in terms of

fiscal transparency, resulting in the development of codes, guides and manuals published since 1998. These were last updated in April of 2007 (IMF, 2007b, 2007c, and 2007d).

The World Bank performed an Extractive Industry Review in 2001, concluding that it needed to implement serious reforms. Since then, the World Bank has been working on a worldwide governance indicators project covering 212 countries and six dimensions of governance (Kaufmann et al., 2007). It has also provided technical assistance to countries implementing the EITI.

The IFC and the European Bank of Reconstruction and Development have started to promote revenue transparency through the conditions they place on their support for investments in the extractive industries (Global Witness, 2007).

4.8. Concluding remarks

The EITI is a voluntary multi-stakeholder code of conduct. This kind of innovative instrument is becoming more and more important in an increasingly globalised world for the promotion of important ideals such as human rights, labour rights, environmental rights and anti-corruption practices. The adoption of codes of conduct is driven by corporate social responsibility and the anticipated benefits of good corporate citizenship displayed to stakeholders (Ocheje, 2007).

5. Experiences of EITI implementation in Nigeria and Ghana

5.1. Background

Seven countries have published EITI reports. This section takes a closer look at the implementation of the EITI in two of these, namely Nigeria and Ghana. Nigeria was the first country to endorse the EITI, and the initiative is an important part of a comprehensive anti-corruption reform package. The initiative has so far focused on the petroleum sector, while the mining sector will be included soon. In Ghana, the mining industry has been the focal point of the EITI implementation. Note that both these countries have taken the opportunity to enhance the EITI process further than requested by endorsing the EITI principles and criteria.

5.2. Nigeria

The resource curse is evident in Nigeria. The country is one of the largest crude oil producers in the world, with earnings of over 350 billion USD from 1960 to 2000. Nevertheless, poor economic management has led to decades of economic stagnation with rising poverty levels. Nigeria ranks as one of the 15 poorest countries in the world (Iyayi, 2005), and poverty¹³ increased from 26% in 1970 to almost 70% in 2000 (van der Ploeg, 2006). The poor management has resulted in a lack of public investments, implying large infrastructural bottlenecks.

When the former Nigerian president Obasanjo took office for his second term in 2003, he introduced a comprehensive reform programme focused on improving macro-economic stabilisation, pursuing structural reforms, strengthening public expenditure management, and implementing institutional and governance reforms. Nigeria has since the oil boom of the 1970s had a reputation of being corrupt and poorly governed. As a response, the institutional and governance reforms aim at tackling the corruption via two elements. First, anti-corruption measures are embedded in the reforms, making the battle against corruption an integral part of the broader economic reforms. Second, the government identified public procurement, public expenditure management and a lack of transparency in the oil and gas sector as specific areas where anti-corruption measures were felt to be most important. Thus, both government revenues and expenditures were included in the anti-corruption fight (Okonja-Iweala and Osafo-Kwaako, 2007).

Public procurement fraud was particularly severe in Nigeria. The government tackled this by introducing an open tender process with value for money audit in public contracts. Competitive cost bidding is ensured by openness and comparison with international prices. A public tender journal is published monthly, and completed government projects need to be certified before the final payment is made. It has been estimated that project costs have been reduced by 40% since the introduction of the value for money audit (Collier, 2007). Transparency of public expenditure management has been improved by a monthly publication presenting how government revenues are further distributed to federal and local governments. The publication has opened up dialogue on public revenues and expenditures (Okonja-Iweala and Osafo-Kwaako, 2007). In an attempt to improve transparency in the oil

¹³ Defined as surviving on less than one US dollar per day.

and gas sector, Nigeria has successfully adopted the EITI. We will discuss the implementation in the following sections.

Overall, Nigeria's reform programme and the fight against corruption have been successful. The country has recently experienced real economic growth per capita and the inflation rate has decreased. Further, the country's score in the Global Corruption report by Transparency International has improved from 1.4 in 2004 to 2.2 in 2007, resulting in Nigeria leaving the 132nd place of 133 countries in 2004 for a ranking of 142nd of 163 in 2007.

5.3. The Nigerian Extractive Industry Transparency Initiative (NEITI)

The Nigerian Extractive Industry Transparency Initiative (NEITI)¹⁴ is the Nigerian version of the EITI. As mentioned above, the initiative is an important part of the overall anti-corruption programme. The former Nigerian president Obasanjo announced in November 2004 that the government would start publishing its revenues from oil and require companies to do the same. On 16 February 2005, the president announced the formation of a Nigerian Stakeholder Working Group (NSWG) to guide the development of the EITI in Nigeria.

The NSWG oversees the activities of the NEITI and is made up of representatives of the government, the private sector and the civil society. The government has 14 members in the working group, while the national assembly and state legislature each has two. Private sector business associations has four members, the oil industry three, while the civil society has two and the media one. This working group also has an international advisor, Goldwyn International Strategies.

The NSWG is organised in five teams. The technical team evaluates all tenders for NEITI assignments. The legislative team has a mandate to develop the NEITI bill. The focal team designs and oversees technical assistance programme to the stakeholders. So far, this team has designed and implemented networking seminars, conferences and workshops for staff and stakeholders, as well as a variety of coordinated training programmes, inward secondments and infrastructure support for government agencies. The media team ensures that all NEITI work is published broadly, while the civil society team engages the wider civil society constituency. This team has developed a comprehensive civil society engagement strategy based on a grass roots communication strategy and the engagement of rural communities and regional civil society groups. The strategy aims to build capacity within civil society organisations, to find ways to deepen the NEITI ideas within the organisations and to develop feedback mechanisms from the civil society to the NEITI.

The NEITI commissioned the first comprehensive independent audit of Nigeria's petroleum industry for the period 1999 to 2004. An international consortium led by the Hart Group conducted the audit including a physical, financial and process audit. A draft audit report was presented in April 2006, while the final reconciled results were presented in December of the same year. The financial audit investigated the financial flows, and 99.99% of revenues were accounted for. However, the audit revealed serious limitations in government data keeping as well as weak coordination among government agencies.

¹⁴ See www.neiti.org

The physical audit produced a reconciliation of the amount of oil and gas produced, refined, exported and lost. This audit pointed to the systematic loss of crude oil between the wellhead and the export-metering terminals (Okonja-Iweala and Osafo-Kwaako, 2007). Furthermore, it was noted that the flow rate at night was lower than during the day, indicating night-time theft (Okogu, 2007). The audit also noted that the metering standard was poor and that the calculation of royalty liabilities was not standardised.

The process audit examined crucial extractive industry processes in licensing, capital expenditure proposals and importation of products, and found serious lapses in the governance of the oil industry in for instance allocation of oil blocks and petroleum importing licenses. The audit suggested the introduction of a simpler and more practical definition of royalty, an update of the petroleum act and the introduction of more transparency in licensing and bidding (Hart Group, 2006).

The government has responded to the critique from the auditors by launching an Inter-Ministerial Task Team with all relevant government agencies represented. The team will ensure data convergence and provide technical assistance to the agencies (Okogu, 2007). The government has already introduced a transparent and competitive auctioning of oil block licenses (Obasanjo, 2006).

The NEITI legislative team developed an NEITI bill that was sent to the National Assembly in December 2004. The bill passed the House of Representatives in 2006 and the Senate in 2007, and was finally signed into law on 28 May 2007. The bill, which became an act, provides legal teeth to the quest for increased transparency by authorising the NEITI to conduct comprehensive audits of the oil, gas and mining sectors every year, using international accounting standards. It also includes heavy penalties. If an extractive company defaults in providing timely and accurate information to the NEITI, it becomes liable to pay a thirty million Nigerian Naira fine. In addition, any underpaid amount has to be refunded, the company might lose its operating license, and the company's director and other officials involved become liable to pay a five million Naira fine or go to jail for two years. The same is true for government officials involved in misinformation activities.

The act implies that the NEITI has to continue its work in new ways, and the NSWG has set up a strategy committee to evolve modalities for bringing its activities in line with the law. A comprehensive remediation programme has been drawn up covering the following areas:

- Developing a revenue-flow interface among government agencies;
- Improving the oil and gas metering infrastructure;
- Developing a uniform approach to cost determination;
- Building human and physical capacities in critical government agencies;
- Improving overall governance of the oil and gas sector.

The act also includes the introduction of a budget line supporting the implementation of the NEITI.

The NSWG is also proceeding with more comprehensive audits. The NEITI is currently requesting tenders for two new audits. First, the financial and physical audit for 2006 is a continuation of the first NEITI audit. Second, there are plans for a value-for-money audit of the oil sector that will audit the terms, procedures and practices associated with joint ventures and production sharing contracts between Nigeria and commercial oil companies. This audit's objective is to investigate whether over-invoicing is common. This will be

accomplished by controlling whether the financial accounting represents actual costs incurred in exploring, extracting and transporting oil, and whether these costs are reasonably consistent with international costs.

So far the NEITI has focused on the petroleum sector, due to its sheer importance – it provides 70% of government revenues, 40% of GDP and more than 85% of foreign exchange earnings (NEITI, 2005). The government is currently looking for a revival of the mining sector, which was a key sector economically before the discovery of oil in 1965. The NSWG is therefore also extending the transparency initiative into the mining sector. The mining sector reform is said to transform government participation from ‘owner-operator’ to ‘administrator-regulator’ (Mining Journal, 2006). The government has reviewed the Mining and Minerals Act and removed discretionary powers of government officials. The reform also establishes transparent mechanisms for granting access to mining titles, improving the access to and security and transferability of the titles (Okogu, 2007; Mining Journal, 2006).

The civil society has praised one aspect of the NEITI implementation process, namely the appointment of a senior official to guide the implementation. The NEITI chairperson has had a close working relationship with the president, which has proved to be an important factor when gaining internal momentum (Publish What You Pay and Revenue Watch Institute, 2006). However, the government has been heavily criticised for interfering in the selection of civil society representation at the NSWG. The first three civil society representatives in the NSWG were actually appointed by the president, affecting the civil society’s independence. The interference also implied that no mechanism for the representatives to report back to the larger civil society was established. In addition, the civil society was not consulted about work plans and reporting formats. The situation was improved in 2005 when a civil society steering committee was established, with ten representatives selected by a broad civil society coalition. In 2006 the committee and the NSWG signed a memorandum of understanding, institutionalising a process that broadens the scope of civil society engagement (Publish What You Pay and Revenue Watch Institute, 2006).

5.4. The Ghana Extractive Industry Transparency Initiative (GEITI)¹⁵

The government of Ghana committed itself to participate in the EITI in 2003. The multi-stakeholder National Steering Committee (NSC) was set up as a governing body, consisting of ten members representing the Ministry of Finance and Economic Planning; the Ministry of Lands, Forestry and Mines; the Minerals Commission; the Ghana Chambers of Mines; the Office of the Administrator of Stool Lands; the Internal Revenue Service; the Wasswa West District Assembly; and civil society organisations. The NSC has established two sub-committees, one working with technical issues and the other with sensitisation. The GEITI is also supported by the Implementation Secretariat at the Ministry of Finance (Boas & Associates, 2006).

The GEITI is fully focused on the mining sector in Ghana. The sector is important to the economy, providing almost 40% of foreign exchange earnings and 11% of government revenues. Mining also contributes 5% of GDP and accounts for a significant percentage of

¹⁵ See www.geiti.gov.gh

formal sector employment. The most important minerals are gold, diamonds, bauxite and manganese.

To perform a financial and process audit, the GEITI appointed the audit firm Boas & Associates to present four semi-annual reports covering the years 2004-2005. The first GEITI financial audit report has been submitted to the EITI secretariat, providing information on financial flows (including mineral right licences, mineral royalties, ground rent, property tax, corporate tax and dividend) from mining companies to the government. The report also looks into financial flows from the government to beneficiaries in mining communities, and how these royalties have been utilised in the mining communities.

The first report investigates financial flows from eight major mining companies to the government from January 2004 to June 2004. In general, payments were well accounted for, but some shortcomings are reported. First, royalty payments depend on the purity of the minerals, and the mining companies themselves determine the purity of the minerals. No independent controls are made. Second, there are no guidelines on price determination, implying that mining companies use different pricing methods. Third, different exchange rates were used when determining royalties. Fourth, there is lack of coordination among government agencies. Fifth, and finally, no capital gains taxes were recorded (Boas & Associates, 2007).

The audit report notes that the government failed to provide adequate information on financial flows from the government to beneficiaries in mining communities, hindering assessment of the utilisation of mining royalties (Boas & Associates, 2007). The report also claims that accessing information from both mining companies and key government agencies was a big challenge, and therefore supports the idea of making GEITI mandatory by legislation (GEITI, 2007).

After completion of this audit report, GEITI followed the established work plan and the NSC organised a technical roundtable to share its content with relevant institutions, other key stakeholders and a team of experts. The notes from this high-level consultative roundtable discussion are published on the GEITI website together with the audit report.

The government seems to have had a good working relationship with the civil society. After endorsing the GEITI, the government approached the national civil society umbrella organisation and asked it to nominate a representative to the NSC (Publish What You Pay and Revenue Watch Institute, 2006). Initially, only one organisation was engaged in GEITI, but civil society participation has increased and today the Ghana chapter of the global PWYP includes twenty organisations. The chapter is involved in community mobilisation programmes and capacity building workshops (Civil Society Statement, 2007).

The NSC is looking into the Minerals and Mining Act and the Financial Administration Act to present recommendations on a possible EITI legislation to make the EITI mandatory (GEITI, 2007).

5.5. Concluding remarks

The experiences from Nigeria and Ghana clearly show that EITI implementation is country-led and can differ substantially among countries. In Nigeria, the NEITI is an important part of a comprehensive anti-corruption reform package, focusing primarily on

the petroleum industry although mining will soon be included. The first audit ever pinpointed severe bureaucratic shortcomings within government agencies and institutions that make corruptive actions possible. The successful completion of this first audit was due to government commitment from the president and other important policy makers. In addition, the process received support from international governments and institutions as well as from the companies involved. The government did make an initial mistake in the civil society participation, but this was corrected later. The process has been different in Ghana. The GEITI focuses on the mining sector and the civil society has been participating from the very beginning. The EITI process continues in both countries, and it is important to note that the EITI is a process and not an event.

6. Natural resources in Mozambique¹⁶

6.1. Background

The EITI focuses on the mining and the oil and gas industry. These industries are of course the centre of attention in this section as well. In mining we include Mozal, which is a mega-project producing aluminium billets from imported aluminium using electricity from Cahora Bassa. In addition, we treat the electricity sector as an integral part of Mozambique's resource wealth, due to its importance in the economy.

6.2. Exploitation of natural resources today

Table 6.1 presents Mozambique's principal natural resources coal, natural gas, hydro,¹⁷ mineral sands and oil. Hydro is by far the main source of electricity generation, with an estimated potential of 12,500 MW. For the time being, just over 2,000 MW of this potential is being generated, almost exclusively through the state-owned Cahora Bassa hydro dam. New hydro dams are planned with the Mphanda Nkuwa dam (1,300 MW) being the most important. In addition, a 700 MW natural gas-fired electricity plant and a 1,500 MW coal-fired power plant are planned for operation around 2010. The gas-fired plant will use natural gas from the Pande/Temane fields in the Inhambane province, while the coal-fired one will use Moatize coal from the Tete province.

The natural gas reserves of the Pande/Temane fields in the Inhambane province are estimated to consist of more than 5 million TJ. The South African company Sasol operates the project. Total coal reserves are estimated to amount to at least 6 billion tonnes, including the Moatize and Mucanha-Vuzi coal mines in Tete province. The Brazilian Vale do Rio Doce (CVRD) has the contractual agreement with the government on the Moatize project. The Central African Mining and Exploration Company (CAMEC) is another large holder of coal concessions in Mozambique.

In addition, large deposits of mineral sands have been identified in Moma in the Zambezi province and near Chibuto in the province of Gaza. The most recent figures indicate a reserve of 299 million tonnes of mineral sands in Moma, mainly consisting of contained ilmenite as well as zircon and rutile. The Irish-based Kenmare Resources holds the Moma concession, and production has recently begun. BHP Billiton holds the concession of the Chibuto heavy sands mine, which represents one of the world's largest deposits of heavy minerals and has a lifespan of well over a hundred years. Our figures indicate a reserve of at least 157 million tonnes, but is probably (much) larger. The reserves include mainly titanium slag, as well as zircon and rutile, leucosene and high-purity pig iron. Mineral ilmenite (iron titanium oxide) is smelted into titanium slag and then sold to the pigment industry, rutile can be used directly by pigment manufacturers and titanium by metal producers, and zircon is used in the ceramics industry, while high-purity iron is a by-product of ilmenite smelting.

¹⁶ This section is based on Bucuane and Mulder (2007).

¹⁷ Hydro is a renewable resource that serves to generate electricity. In the near future parts of the natural gas and coal reserves in Mozambique will also be used as (non-renewable) sources of electricity generation.

Table 6.1. Natural resources in Mozambique – potential/reserves

		Reserves Potential	Actual 2006	To be realised 2007/8	? 2009
Electricity	MW	14,700	2,185	2,265	5,885
Hydro	MW	12,500	2,185	2,265	3,685
HCB		2,150	2,150	2,150	2,150
Mavuzi & Chicamba		90	35	90	90
Massingir		25		25	25
Lúrio		120			120 (2012?)
Mphanda Nkuwa		1,300			1,300 (2014)
Rio Zambeze (outros)		6,800			
Outros		2,015			
Thermal - Natural Gas	MW	700			700
Inhambane		700			700 (2010)
Thermal - Coal	MW	1,500			1,500
Moatize		1,500			1,500 (2012/15)
Natural Gas	TJ	5,334,000			
Panda/Temane		5,334,000			
Mineral Coal	1000 ton	6,000,000			
Moatize		2,400,000			
Mucanha-Vuzi		3,600,000			
Minerals (Heavy Sands)	1000 ton	456,220			
Moma		299,000			
Contained Ilmenite		273,000			
Zircon		20,400			
Rutile		5,600			
Chibuto*		157,220			
Titaniferous (titanium) slag		100,000			
Zircon		6,250			
Rutile		1,220			
High-purity pig iron		49,110			
Leucosene		640			
Oil (crude)	1000 ton				?

* based on: annual exploration x 100 years

Source: Bucuane and Mulder (2007).¹⁸

In addition, Mozambique probably has still unidentified reserves of oil. Recently, a number of companies were licensed to investigate the supposedly considerable potential of oil reserves in Mozambique, both on-shore and off-shore (Mozambique and Rovuma-basins). Unfortunately, since the investigation is in its initial phase no useful data yet exists on the potential oil reserves of Mozambique. Among the licensed companies we find StatoilHydro and DNO from Norway, Anadarko and Terralliance from USA, Artumas from Canada, the Italian ENI, Petronas from Malaysia and Sasol from neighbouring South Africa.

6.3. Future exploitation of natural resources

So far the major part of Mozambique's natural resources has been underexploited, but this situation is rapidly changing. Table 6.2 summarises the existing and foreseen production of electricity, natural gas, coal and minerals. As shown, the total electricity production is expected to increase from today's 15,000 GWh/year to over 41,000 GWh over the next seven years. The major part of electricity is and will be generated from hydro, followed by

¹⁸ The authors used information from the Ministry of Energy, the Ministry of Mineral Resources, and a variety of other sources including the United States Geological Survey (USGS) Minerals Yearbook, the African Mining Review journal and websites of the involved companies.

coal and natural gas. Large scale natural gas production started in 2004 with the exploration of the Pande/Temane gas fields in the Inhambane province by the South African company Sasol, and is expected to grow steadily over the next few years to approximately 145 thousand TJ per year. Coal production used to be small-scale, and even became marginal during the civil war. This situation is, however, going to change since the Brazilian Company Vale do Rio Doce (CVRD) won a bid in 2004 to develop the Moatize coalfield in the Tete province, with an expected coal production of 15 million tonnes per year, starting in 2009/10. The Moma heavy sands mine, explored by Kenmare Resources, began its operations in 2007 and is expected to gradually increase its annual production from 900 thousand tonnes to over 1,300 thousand tonnes. The start of the exploration of the Chibuto heavy sands deposits has been delayed due to difficulties with power supply. After having redesigned the project, BHP Billiton is expected to start production by the end of 2008 at a level of approximately 590 tonnes per year, with production gradually increasing to over 1,500 thousand tonnes per year by 2017.

Table 6.2. Natural Resources in Mozambique – Annual production

	<i>Annual</i>	<i>Actual 2006</i>	<i>To be realised 2007/8</i>	<i>? 2009</i>
Electricity	GWh	14,732	15,873	41,242
Hydro	GWh	14,732	15,873	25,824
HCB		14,502	15,067	15,067
Mavuzi & Chicamba		230	631	631
Massingir			175	175
Lúrio				841 (2012?)
Mphanda Nkuwa				9,110 (2014)
Rio Zambeze (outros)				
Outros				
Thermal - Natural Gas	GWh			4,906
Inhambane				4,906 (2010)
Thermal - Coal	GWh			10,512
Moatize				10,512 (2012/15)
Natural Gas	TJ	102,494	123,494	144,494
Pande/Temane		102,494	123,494	144,494
Mineral Coal	1000 ton	5	5	15,000
Moatize		5	5	15,000
Minerals (Heavy Sands)	1000 ton		1,466	2,888
Moma			877	1,316 (2010)
Ilmenite			800	1,200
Zircon			56	94
Rutile			21	32
Chibuto			589	1,572 (2017)
Titaniferous (titanium) slag			375	1,000
Zircon			22	63
Rutile			5	12
High-purity pig iron			184	491
Leucocoxene			3	6
Oil (crude)	1000 ton			?

Source: Bucuane and Mulder, 2007.

Most natural resources exploited in Mozambique are exported. With respect to the coal from the Moatize mine, we expect 15% to be marketed in Mozambique (including the consumption by the electricity plant), while the remainder will be exported for consumption by steel plants in Brazil (USGS, 2005).

The vast majority of natural gas is and will be exported to South Africa, although the domestic consumption is increasing (and is expected to continue) as a result of the realisation in 2005 of a new pipeline to the Bebeluane industrial park near Maputo and because of the planned construction of a natural gas-fired electricity plant. Also in terms of electricity, almost all production is exported, mainly to South Africa but also to Zimbabwe and in the near future to Malawi. However, some of the electricity export is re-imported to

the aluminium smelter Mozal.¹⁹ Table 6.3 summarises natural resource export figures for Mozambique, both in terms of quantity and average prices. The prices are best estimates based on projections of world market prices and on existing long-term contracts.

Table 6.3. Natural resources in Mozambique – annual exports

	Annual	Quantity				Price of Exports		
		2006	2007/8	≥ 2009		2006	2007/8	≥ 2009
Electricity	GWh	10,877	11,300	27,366	US\$/kWh			
Hydro	GWh	10,877	11,300	15,102	US\$/kWh	1.66	1.83	2.48
HCB		10,877	11,300	10,547		1.66	1.83	2.21
Mavuzi & Chicamba		0	0	0				
Massingir			0	0				
Lúrio				0				
Mphanda Nkuwa				4,555				2.75
Rio Zambeze (outros)								
Outros								
Thermal - Natural Gas	GWh			2,803	US\$/kWh			3.20
Inhambane				2,803				3.20
Thermal - Coal	GWh			9,461	US\$/kWh			3.50
Moatize				9,461				3.50
Natural Gas	TJ	101,162	119,789	137,269	US\$/TJ			
Pande/Temane		101,162	119,789	137,269		1,200	1,200	1,200
Mineral Coal	1000 ton	4.9	4.9	13,500	US\$/Ton			
Moatize		4.9	4.9	13,500		30	32	35
Minerals (Heavy Sands)	1000 ton		1,466	2,888	US\$/Ton		136	142
Moma			877	1,318				
Imenite			900	1,200		85	87	92
Zircon			56	84		700	714	743
Rutile			21	32		450	457	471
Chibuto			599	1,572			398	408
Titaniferous (titanium) slag			375	1,000		425	429	438
Zircon			22	63		700	714	743
Rutile			5	12		450	457	471
High-purity pig iron			184	491		300	303	309
Leucocene			3	6		500	505	515
Oil (crude)	1000 ton			?	US\$/Barril			50-70?

Source: Bucuane and Mulder (2007).

Using projected export quantities and prices, we calculated the total projected value of natural resource exports from Mozambique for the period 2006-2020 and combined this with 2000-2005 data from the SADC Trade Database (SADC, 2007). We also estimated the total value of exports until 2020 by assuming that non-natural resource exports will grow 10% annually.²⁰ The results are shown in Figure 6.1, including the value of aluminium exports by Mozal. The figure shows a spectacular export growth from about 365 million USD in 2000 to almost 6,500 million USD by 2020. Of the latter, approximately 1,800 million consists of non-natural resource-related exports (under the assumption of a 10% annual growth rate). A large part of the primary exports consists of aluminium products, the growth of which will be due to an expanded production capacity at the Mozal factory (Mozal 3, in 2009/10).²¹ In addition, electricity, mineral sands and coal will be major elements of Mozambique's export, while the share of natural gas is small compared to the other natural resources.

To further illustrate the importance of natural resource-related exports in Mozambique, we plot in Figure 6.2 primary exports (fuel, ores and metal) as percent of total exports for the period 2000-2020. The figure shows that the share of primary exports will fluctuate around

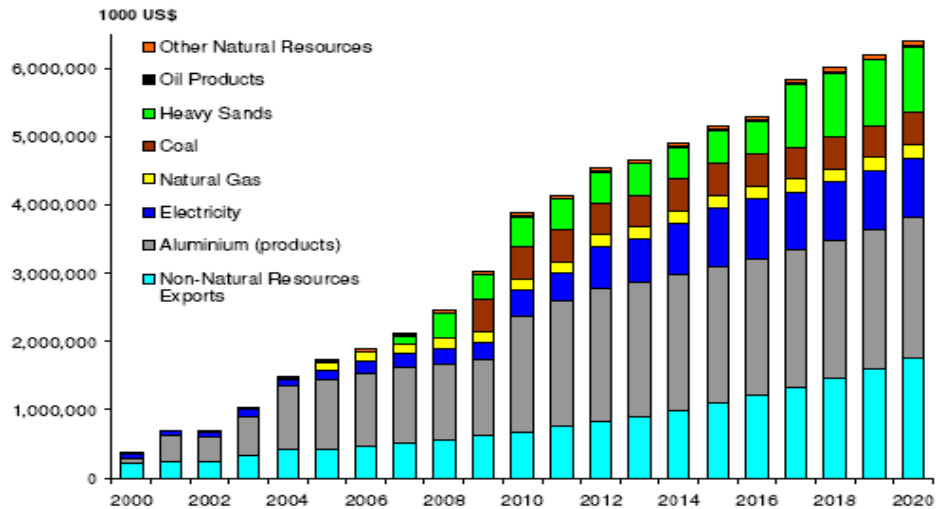
¹⁹ Mozal is a mega-project producing aluminium billets from imported aluminium using electricity from Cahora Bassa.

²⁰ This is in line with the projections of the Quadro Macro of the Ministry of Planning and Development (until 2010).

²¹ We assume a doubling of production capacity in 2010, as well as the following annual growth figures: 2007 (3%), 2008-2009 (1%), 2011 (10%), 2012, (5%), 2013-2014 (1%), 2015-2020 (0.5%).

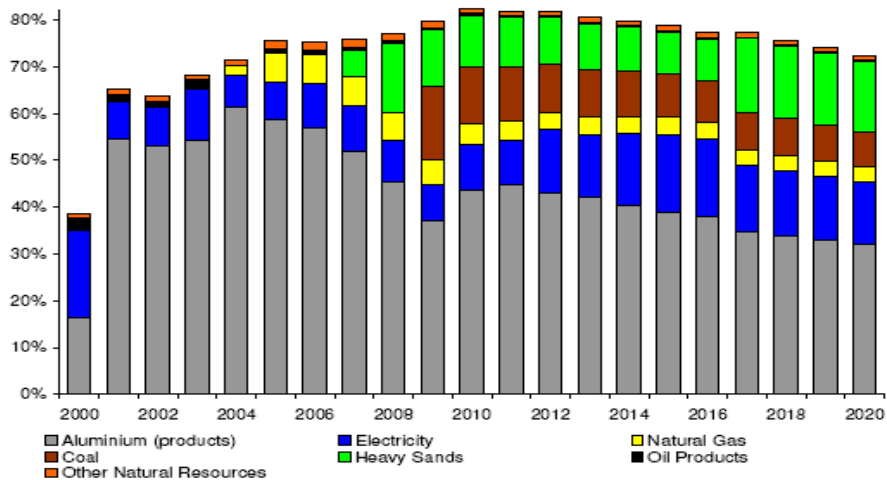
70-80%. Again, it can be seen that aluminium (products) produced by Mozal constitutes a major part of this. Without aluminium, the share of natural resource-related exports in total exports will be around 40-50%.

Figure 6.1. Projected exports



Source: Bucuane and Mulder (2007).

Figure 6.2. Natural resources as a percentage of projected exports



Source: Bucuane and Mulder (2007).

As noted earlier, no data yet exists on Mozambique's potential oil reserves, since investigation of potential reserves is still in its initial phase. Instead we decided to do a kind of thought experiment to see what we can expect to happen to natural resource exports if Mozambique becomes an oil-producing country like one of the existing oil-producing nations. We investigated three different scenarios, assuming a constant oil price of 50USD/barrel. In addition, we assume full-scale oil production to start in 2015.

First, if Mozambique becomes a small oil producer like Chad or Gabon, producing around 200,000 barrels/day, then exports may increase to approximately 10 billion USD in 2020 as compared to 6.5 billion USD without oil. Second, if the oil production reaches 1,500,000 barrels/day, as in Brazil or Libya, then Mozambique's export will reach 30 billion USD by 2020. Third, if Mozambique manages to produce oil as Norway at around 3,000,000 barrels/day, then the export will reach 60 billion USD by 2020.

6.4 Concluding remarks

Mozambique is a country with large natural resource assets, the majority of which is still not exploited. This section projects that exploitation of natural resources will become more and more important in the near future when several large projects begin to show results in production and exports. Thus, an EITI implementation might be an important tool in reassuring that the benefits from the exploitations are properly taken care of. We also note that some of the main companies active in Mozambique already support the EITI. These are BHP Billiton, Eni and StatoilHydro. We also consider it appropriate to include Mozal into the EITI discussion, since this mega-project is of great importance for the Mozambican economy and since its owner BHP Billiton supports the EITI.

7. The institutional system for handling oil, gas and mineral revenues

7.1. Financial governance in Mozambique

The main objective of Mozambique's government policy is to reduce absolute poverty by promoting far-reaching and sustainable economical growth in a participatory process where special attention is given to districts through decentralisation. Good financial governance is an important component of this process, and in 2001 the government launched the Public Sector Reform Strategy. This ten-year strategy contains the adoption of measures that can help improve the management of public finances and fight corruption.

The institutional framework for good financial governance in Mozambique comprises the following actors:

- The Ministry of Finance, responsible for the coordination of the public financial management system (SISTAFE), which is based on components such as budget, treasury management, public accounts and public resources. The most important instruments are the state budget and the Government General Account;
- The Ministry for Planning and Development, responsible for the coordination of planning activities and the development of policy instruments such as the National Poverty Reduction Plan (PARPA), the Economic and Social Plan (PES) and the Medium Term Expenditure Framework (CFMP);
- The Parliament, which approves the government's programme, the Economic and Social Plans (PES) and the state budget, and deliberates the Government General Accounts;
- The Supreme Audit Institution (Tribunal Administrativo), which audits government activities and national accounts.²²

7.2. Strengthening of the tax system

The need to strengthen public finance management became important after the introduction of economic reforms in 1987, and the importance increased even further after the end of the armed struggle in 1992. Peace and political stability brought about opportunities for modernisation of the system to increase fiscal revenues, especially in the customs field by facilitating legal trade and discouraging fiscal evasion. The government has aimed for good governance by implementing best international practices. As a result, the transparency of the system and the credibility of the budget have increased.

The public finance management reforms include three important stages. First, the value added tax (VAT) was introduced in 1999. The VAT substitutes the circulation tax, which proved to be inflationary due to its cascading nature, and is currently the most important component of fiscal revenue. Second, the SISTAFE was introduced in order to modernise the public expenditure management system in 2002. The implementation of the SISTAFE is ongoing. The new system includes the establishment of a single treasury account,

²² The audits are presented at www.ta.gov.mz

enabling the government to broaden the budget by including all off-budget donor projects. SISTAFE also includes reclassification of expenditures and expenditure ceilings, improving account quality and reducing gaps between actual and budgeted expenditures. Third, the Mozambican Tax Authority (ATM) was established in 2006 as the central authority for revenue collection to strengthen revenue mobilisation. The authority is a semi-autonomous institution handling both tax and customs administration.

The reforms follow best international practices. Mozambique abides by the International Monetary Fund Code of Good Practices on Fiscal Transparency, which comprises the following main elements:

- The government's responsibilities should be made public;
- Detailed reliable information about the fiscal activities should be made public;
- The process of preparation, execution and preparation of reports should be open and disseminated;
- The need for mechanisms and procedures to confirm the integrity of published information.

Mozambique has participated in the annual meetings of the Collaborative Africa Budget Reform Initiative (CABRI), an initiative that aims at improving the processes of budget preparation and formulation, introduction of new theoretical and practical approaches of budget management, and making the budget process more participatory. CABRI is a network of senior government officials in ministries of finance and planning, which holds regular meetings in order to discuss and share ideas about a multitude of questions of financial nature that affect the African continent. The members of CABRI are: South Africa, Angola, Botswana, Ethiopia, Ghana, Guinea, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Nigeria, Rwanda, Senegal, Sierra Leon, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe. All African countries are eligible for CABRI membership.

7.3. Establishment of transparent and far-reaching budget procedures

Mozambique has made significant progress towards adopting a more transparent and reliable budget. The state budget is an instrument of public finance produced annually and based on the data contained in the Economic and Social Plan (PES). The PES is, in turn, an operational instrument of two medium-term instruments: the Government Five-Year Plan (PQG) and the PARPA; the former comprises policy undertakings to be implemented during the government's term (in Mozambique the government's term coincides with the parliament's five year term), and the latter is an implementation priority matrix of the public expenditure necessary to attain the objectives defined in the PQG.

In order to make the process more transparent, the PQG, the PARPA, the PES and the state budget are published, even on the Internet.²³ Since 1990, the government has been producing the Government General Account, which along with being sent to the Parliament and to the Supreme Audit Institution is also published. Since 2000, the government has been producing quarterly reports about budgetary performance. These reports are published as well.

²³ See for instance www.mpd.gov.mz or www.portaldogoverno.gov.mz

The introduction of the SISTAFE caused the budget to become more far-reaching and reliable, in fact to the extent that all financing of the government's activities is included in the budget. The elaboration of the budget respects the limits defined in the medium-term fiscal framework, which is updated every year.

Through the National Directorate for Budget (DNO), Mozambique has participated in CABRI seminars. CABRI has already organised three annual seminars about budget reform – first in Pretoria, South Africa, in 2004, then in Maputo, Mozambique, in 2005 and finally in Addis Ababa, Ethiopia, in 2006.

7.4. Accountability and transparency

Three institutions have a fundamental role in securing compliance with good financial governance principles in Mozambique: the Parliament, the Supreme Audit Institution and the Finance General Inspection.

The Parliament approves the budget, deliberates about the Government General Account and supervises the execution of the state budget. The Supreme Audit Institution audits the Government General Account, producing reports that form the basis for Parliament deliberations. The Finance General Inspection (IGF) is an internal auditing authority with the country's public sector roles.

The IGF has together with the Supreme Audit Institution produced external audit reports of Mozambique's municipalities. There are also auditing committees at the central and provincial levels. These committees are already operating in four ministries and two provinces, contributing to the evaluation of implementation of auditing carried out in the sector.

In order to improve the quality of the public sector auditors, IGF has begun implementing a new auditing basis with international standards, pursuant to the International Organization of Supreme Audit Institutions (INTOSAI) and the Institute of Internal Auditors (IIA).

In 2004 the government adopted and performed an independent evaluation of the public finance system, using the criteria of the Public Expenditure and Financial Accountability (PEFA). A second evaluation was performed in late 2007. Besides these evaluations, the government conducts regular joint evaluations together with partner countries²⁴.

Mozambique considers it important to establish the mechanisms that allow a harmonisation and comparison of the public finance quality. It is within this context that Mozambique actively participates in international mechanisms such as the New Partnership for Africa's Development (NEPAD), the CABRI and the African Organisation of Supreme Audit Institutions (AFROSAI).

In 2006 the government launched its Anti-Corruption Strategy for 2006-2010. The main objectives of this strategy, inspired by e.g. Global Strategy for the Reform of the Public Sector and the United Nations Convention Against Corruption (UNCAC), are:

- To encourage transparency culture, integrity and responsibility in the public sector;

²⁴ See Lawson et al. (2006) and Lawson et al. (2008).

- To improve quality and efficiency of the legal system services;
- To improve the mechanisms for the participation of local communities in the governance and monitoring in order to promote transparency and responsibility;
- To improve the management system of public finance, thus improving transparency, efficiency and efficacy in the usage of public resources.

In line with this, the government recently launched its National Anti-Corruption Forum (Forum Nacional de Anti-Corrupção). The government also provides information on larger public tenders at <http://www.concursospublicos.gov.mz>

7.5. Transparency in extractive industries revenues

The Mozambican government is not a member of the EITI, but does follow its principles when it comes to analyses and approving contracts of concession. The government has also elaborated the following decrees, which were approved by the Parliament:

- Decree n° 11/2007, which updates the tax legislation, especially related to the mineral activity;
- Decree n° 12/2007, which updates the tax legislation, especially related to the petroleum activity;
- Decree n° 13/2007, which concerns revision of the fiscal incentives regime in the mineral and petroleum areas.

These instruments also consider the local developments when determining that a percentage of the revenues accrued from the activity should be channelled to the communities of those areas where the projects are located. It is the Council of Ministers' responsibility to calculate and publish the revenues accrued from petroleum operations on a periodical basis.

Mozambique has participated in workshops and seminars where the EITI principles are evaluated and discussed, and has plans to organise a seminar locally.

The National Petroleum Institute (INP) manages the petroleum resources of Mozambique. The institute is already publishing vital information on its website at www.inp.gov.mz in a transparent way. The site presents the legal framework, bidding results, and both the historical and current exploration situation.

7.6. Supporting the decentralisation of the fiscal policy

The legal framework of the decentralisation process in Mozambique is created by the following legislation:

- Decree n° 8/2003, dated 19th of May, the decree on local state (LOLE), concerning districts and provinces;
- Decree n° 13/2005, dated 10th of June, the LOLE Regulation.

Within the scope of decentralisation, there were achievements made in 2006: (i) establishment of a structure for district governments with four integrated services; (ii) decentralisation of competences in the management of human resources; (iii)

implementation of consultation councils; (iv) establishment of an investment budget of local initiative.

In order to stimulate reforms, the Public Sector National Authority was established. This authority is directly accountable to the state president and is responsible for conducting the second phase of the Public Sector Reform Programme for the 2006-11 period. The second phase comprises three cornerstones: (i) human resources management including payroll systems, (ii) evaluation of performance and remuneration policy, and (iii) decentralisation policy.

7.8. Concluding remarks

The Mozambican government aims for good financial governance and has implemented a vast range of reforms within the framework of the Public Sector Reform Strategy. The tax system has been strengthened by the introduction of VAT and a new public expenditure management system. Revenue collection has been reinforced by the establishment of a tax authority. As a result, the credibility of budgets, programmes and plans has increased.

An important part of the Public Sector Reform is making the government's responsibilities and activities public. Today the different plans and programmes of the government as well as the budget and the report on budget performance are made public, some even on the Internet. This is valid also for the audits of the Government General Account by the Supreme Audit Institution. In addition, the INP presents important information on the Internet.

8. Concluding remarks – benefits from joining and barriers to implementation

This study investigates the possible costs and benefits for Mozambique of implementing the EITI to guarantee an effective and transparent handling of oil and mineral revenues in the future. Since Mozambique is becoming increasingly dependent on natural resource extraction, this is an important issue in itself, but the features of the EITI are equally important as a tool for deepening the democratic process.

Recent research on the bad performance of resource rich countries suggests that there is a clear relationship between weak institutions and the occurrence of the resource curse. To put it simply, countries with good institutions have no resource curse. Thus, Mozambique needs to create a good governance system with an effective public sector resource management. The government is already moving towards a good fiscal governance system by implementing a comprehensive public sector reform improving transparency and credibility. The EITI could clearly contribute to such a system.

Effective public spending is crucial for long-term growth. This includes both the allocation of resources to the right activities and effective use of the resources. The process of scrutiny is important and would be strengthened by the EITI. Equally important for long-term growth, especially when it comes to extractive industries, are foreign investments. The EITI is endorsed by industrial associations, global investment companies as well as individual companies. The EITI leads to lower business risks for existing operators as well as expanded investment opportunities.

Domestic accountability is important in a functional democracy. Since the budget process should reflect the aims and aspirations of the people, it has to be transparent, making the government accountable for priorities and spending. The citizens need to practice surveillance and scrutinise the use of revenues in the public sector.

Today the government of Mozambique is not fully accountable to its people. First, the high aid dependence and donor interventions in central policy processes have led to distortions in domestic accountability. Second, the civil service actors in Mozambique lack adequate involvement and capacity (World Bank, 2007a). The EITI assists in the surveillance and scrutiny by educating and organising civil society groups, thereby providing an opportunity for Mozambique to improve democracy by shifting powers from foreign donors to domestic agents such as the civil society and citizens. Experiences from Nigeria and Ghana show that an early involvement of the civil society together with capacity building and training are important components of successful EITI implementation.

The government is committed to following international best practices in the tax and transparency regime related to mining and petroleum resources. An EITI implementation seems to be a natural step in improving the governance system. New fiscal laws for mining and petroleum have recently been approved by the Council of Ministers. The main extractive industry operators have also committed themselves to the EITI principles. Companies like BHP Billiton, Eni and StatoilHydro have endorsed the international EITI. Let us conclude by briefly outlining the main features of a possible EITI in Mozambique. First, the EITI should preferably be expanded beyond the oil and mining sectors to include energy and mega-projects such as Cahora Bassa and Mozal. Second, experiences from Nigeria and Ghana show that there is a great deal of flexibility within EITI, implying that

its implementation may differ substantially among countries. Thus, before implementing EITI, the government of Mozambique needs to decide what the main objectives should be. Is it a deepening of democracy? Or maybe the EITI should mainly be used to combat corruption, as in Nigeria. Securing future investments might be another important objective. The choice of objective will needless to say affect the implementation. Third, key features in setting up and implementing the EITI are the appointment of the 'right' leader for the implementation, and gaining and supporting genuine civil society participation. Fourth, this study has not looked into details about how revenues stream from the companies to the tax authority. Neither has it investigated the possible existence of regulatory and institutional barriers to EITI implementation. Furthermore, the stakeholders have not been given an opportunity to voice their views. Therefore, an EITI scoping study might be called for before implementation starts. Finally, it should be noted that there are costs involved. These are however of administrative nature and the overall benefits clearly outweighs these costs. Moreover, the government might get assistance in cost covering from the multi-donor trust fund for the EITI.

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