

Independent Oversight of Natural Resource Funds

August 2014

Andrew Bauer



Key messages

- Oversight motivates a government to follow its own rules, meet its own objectives or manage public funds in the public interest.
- Independent oversight provides assurances of integrity that internal controls alone cannot provide.
- Legislatures, the judiciary, regulatory agencies, external auditors, the media, civil society organizations or citizens provide strong independent oversight of natural resource funds in Alaska (USA), Alberta (Canada), Chile, Ghana, Norway, Texas (USA) and Timor-Leste, among others.
- Natural resource funds in Abu Dhabi, Algeria, Azerbaijan, Equatorial Guinea, Libya, Kazakhstan and Qatar suffer from a lack of independent oversight. In Libya, this has resulted in huge losses on fund investments. In Azerbaijan, large arbitrary withdrawals have undermined macroeconomic policy objectives without the possibility of objection.
- Independent oversight bodies can encourage good financial management by praising compliance with the rules and good fund governance. In some cases, they can also discourage poor behavior by imposing punitive measures ranging from reputational damage to fines, imprisonment or international sanctions.
- Independent oversight is most effective when the oversight body has expertise in the topic under investigation, possesses the power or capacity to investigate, has access to information, holds enforcement powers, and is integrated with the institutional environment.

What is independent oversight?

Public oversight is the supervision of government behavior. Oversight bodies identify noncompliance with rules, waste, fraud, abuse and mismanagement, and suggest or enforce corrections. They are a chief force that induces a government to follow its own rules or principles—and meet its own objectives. They can also encourage governments to manage public funds in the public interest, rather than for private gain, and to follow the rule of law.

Internal government agencies can provide natural resource fund oversight. In fact, effective internal oversight mechanisms may be essential for good natural resource fund management (see the NRGI-CCSI brief on Natural Resource Fund Management). However, independent oversight provides assurances of integrity that internal mechanisms alone cannot provide. Truly independent oversight bodies are not subject to political interference and provide honest assessments of compliance with rules or whether funds are being used for the public benefit.

Contents

Key messages	1
What is independent oversight	1
Why is independent oversight important for natural resource fund governance?	2
Independent oversight bodies	3
Conclusion	6

Policy Brief

ABOUT THE AUTHOR

Andrew Bauer is an economic analyst at the Natural Resource Governance Institute, where he focuses on technical assistance and research to help policymakers improve their natural resource revenue management.

Independent oversight bodies gain their influence through different channels. In some cases, oversight bodies have the legal authority to force a government to change its behavior (e.g., the judiciary; some parliaments; some independent regulatory agencies). In others, they must rely on their legal or informal powers to persuade policymakers to change course (e.g., auditor general; supervisory committees; international financial institutions). For those without direct access to policymakers, they can try to persuade the public or influential groups to pressure the government (e.g., media; some civil society groups).

Why is independent oversight important for natural resource fund governance?

Natural resource fund management may be rules based, discretionary or a combination of the two. At one extreme, funds may be governed by a strong set of procedural and transparency rules, such as limitations on withdrawals and asset disclosure requirements. The Alaskan (USA), Chilean, Ghanaian, Norwegian and Timor-Leste natural resource funds are all governed in this way. These rules are usually enacted with the public interest in mind, and there is a general expectation that they will be followed. At the opposite extreme, funds may be managed with full discretion by the executive or by the Ministry of Finance, as in Algeria, Equatorial Guinea, Saudi Arabia and Qatar. In these cases, natural resource funds may still be governed by a set of principles or national policy objectives, such as fiscal sustainability, mitigating Dutch Disease or safeguarding resource revenues.

Whether or not rules are in place, independent oversight bodies have important roles to play in promoting good resource revenue governance and holding governments to account. They can incentivize compliance with rules or consistency with objectives in a number of ways: First, independent oversight bodies can raise concerns or identify gaps in good governance standards to help the government implement reforms and manage resource revenues better. For example, Ghana's Public Interest and Accountability Committee (PIAC) 2012 report (see Box 1) identified gaps in both surface rental payments and receipts from the Saltpond oil field. Within a few days, the Ministry of Energy issued a statement offering new information on royalty amounts paid in 2011 and the unpaid surface rental bill.¹ The PIAC report also raised concerns about overly optimistic petroleum revenue projections, which allowed for greater spending under Ghana's fiscal rule. The Ministry of Finance has since committed to addressing this issue, and 2013 projections are generally considered to be more realistic.

Second, independent oversight bodies can draw public and international attention to mismanagement of public funds, putting pressure on a government to rectify problems. In Chad, the Collège de Contrôle et de Surveillance des Ressources Pétrolières (aka, the Collège), a multistakeholder oversight committee, must approve disbursements from the Chad fund and oversee the management and use of revenues from the Chad-Cameroon pipeline. Publication of its 2005 report highlighting wells and schools that were paid for but not completed and inflated costs of computers, not to mention government efforts to undermine the institution, was a key factor in convincing the World Bank to suspend its program in the country.²

Third, they can provide a check on overconcentration of power in the hands of the executive or fund managers. For example, without adequate independent oversight, the executive may freely use natural resource fund assets as patronage or may withdraw funds arbitrarily, undermining long-term fiscal sustainability or macroeconomic stability objectives, as in the Azerbaijani and

1 Emma Tarrant Tayou, "Ghana Citizen Oversight Report Yields Debate, Disclosures," May 25, 2012, <http://www.revenuewatch.org/news/blog/ghana-citizen-oversight-report-yields-debate-disclosures>.

2 Ian Gary and Nikki Reisch, *Chad's Oil: Miracle or Mirage? Following the Money in Africa's Newest Petro-State* (Catholic Relief Services and Bank Information Center, 2005), <http://internationalbudget.org/wp-content/uploads/Chads-Oil-Miracle-or-Mirage.pdf>; Lydia Polgreen, "World Bank Ends Effort to Help Ease Chad Poverty," *New York Times*, September 10, 2008, http://www.nytimes.com/2008/09/11/world/africa/11chad.html?_r=0.

Kuwaiti cases. The threat of parliamentary or judicial hearings or penalties, or reputational damage leading to electoral defeat, can be major deterrents.

Independent oversight bodies

Legislature: Parliaments, congresses and legislative councils are often tasked with reviewing and evaluating selected activities of the executive branch of government. In many cases, legislatures have an explicit mandate to approve budgets and oversee budget formulation and execution. This oversight role often covers the management and flow of funds into and out of natural resource funds. In Norway, for example, the Storting (legislative body) is mandated to pass legislation governing the fund, approve its annual budget, appoint members of a fund supervisory council and review the council's reports. In addition, legislative committees are often established to hold hearings and report on legal compliance, as well as identify cases of government mismanagement. In the Canadian province of Alberta, a standing committee is tasked with reviewing and approving the fund business plan annually, reviewing quarterly reports on fund operations, approving the fund's annual report, reporting to the legislature on whether the fund is meeting its objectives and holding public meetings with Albertans on fund activities.³

Judiciary: In many countries, the courts are explicitly mandated to determine the constitutionality of legislation and ensure government compliance with laws, including those governing natural resource fund management. Where the courts are free from political interference, judicial review is a strong form of independent oversight insofar as courts are able to enforce their decisions on the government. While this type of independent oversight is not commonly used to promote good fund governance, there have been cases of judicial review of fund operations. In 2008, the Timor-Leste appeals court found that a \$290.7 million withdrawal from the Petroleum Fund was illegal. The rationale was that it violated the 2005 Petroleum Fund Law requirements that the government provide a detailed explanation for the withdrawal and that petroleum revenues be managed for the benefit of current and future generations.⁴

Regulatory Agency: Some countries have established special government agencies to review performance of natural resource funds. For example, Norway's Supervisory Council, consisting of 15 members chosen by the Storting from Norwegian society, public administration and industry, supervises the Norges Bank's (Norway's central bank) activities and compliance with its rules, including the management of the Government Pension Fund Global. The council has a right to access all Norges Bank information and conduct independent investigations. In addition to its own investigations, it relies on the external auditor's statement to write its report, which is submitted to the Storting.

Independent Auditor: Some funds, such as Botswana's Pula Fund and Trinidad and Tobago's Heritage and Stabilization Fund, are subject to audit by an auditor general. In these countries, the Office of the Auditor General has a degree of independence; however, this is not always the case. In other jurisdictions, independent external audits are also conducted to ensure their integrity. For example, Chile's Economic and Social Stabilization Fund, Norway's Government Pension Fund Global and Texas' (USA) Permanent University Fund were last audited by Deloitte; Alaska's (USA) Permanent Fund was last audited by KPMG.

Multistakeholder Group: Some countries have established formal multistakeholder oversight bodies to reinforce and support the work of traditional bodies such as parliament and the judiciary or to provide an additional source of oversight. In Chad, Ghana and Timor-Leste, civil society

3 World Bank Institute, *Parliamentary Oversight of the Extractive Industries Sector*, 2010. http://www.agora-parl.org/sites/default/files/parliamentary_oversight_and_the_extractive_industries.pdf.

4 La'o Hamutuk, *Timor-Leste Appeals Court Invalidates 2008 State Budget*, 2008. <http://www.laohamutuk.org/econ/MYBU08/BudgetRuledUnconstitutional08.htm>.

Policy Brief

groups such as chartered accountants, trade unions, religious organizations and traditional leaders, as well as those closer to the government such as judges, politicians and central bankers, form formal oversight committees. Ghana's Public Interest and Accountability Committee (PIAC) (see Box 1) is mandated by law to simply monitor the management of petroleum revenues as outlined in the Petroleum Revenue Management Act. Timor-Leste's Petroleum Fund Consultative Council must advise parliament on fund operations and compliance with the fund's mandate. Chad's Collège has a stronger mandate not only to ensure that revenue management laws are followed but also to approve withdrawals from special oil revenue accounts. Recently, some Extractive Industries Transparency Initiative (EITI) multistakeholder groups have also begun examining the flow of monies into and out of funds. For example, Mongolia's last EITI report covers payments made from the Mongolian-Russian joint state-owned Erdenet Mining Corporation to the Budget Stability Fund.

Media: Television, movie, radio, newspapers and Internet coverage of fund management can encourage good fund governance. In Timor-Leste, for example, compliance with the Petroleum Fund Law is viewed by a proxy for good governance more generally. News of unjustified withdrawals from the Petroleum Fund caused a degree of disenchantment and indignation among some voters. In Libya, media coverage of Libyan Investment Authority mismanagement is anecdotally contributing to international and domestic congressional efforts to improve the fund's management and procedures.

International Organizations: A number of international organizations and think tanks provide independent assessments of fund operations and management. For example, the International Monetary Fund (IMF) includes regular assessments of natural resource fund performance in its Nigerian and Norwegian Article IV consultation reports. The International Working Group on Sovereign Wealth Funds (IWGSWF) government members have released a self-assessment of their own adherence to the *Santiago Principles* (see NRG-CCSI brief on Natural Resource Fund Transparency). NRG assesses natural resource fund transparency and management as part of its Resource Governance Index. And Edwin M. Truman at the Brookings Institution periodically grades sovereign wealth funds using indicators of structure, governance, transparency, accountability and behavior.



Whether or not rules are in place, independent oversight bodies have important roles to play in promoting good resource revenue governance and holding governments to account.

Policy Brief

Box 1: Ghana's Public Interest and Accountability Committee (PIAC)

In 2011, the Parliament of Ghana passed the Petroleum Revenue Management Act, which included the establishment of the Public Interest and Accountability Committee (PIAC). The 13 civil society members of the committee—who include representatives of the unions, traditional chiefs, journalists, lawyers, chartered accountants and religious groups, and who are appointed by the Minister of Finance for two to three year secure terms—were mandated to:

- Monitor and evaluate compliance with the Petroleum Revenue Management Act;
- Provide a platform for public debate on whether petroleum revenues are being used to advance development priorities; and
- Provide an independent assessment of the management and use of petroleum revenues.

The PIAC represents the only legislated petroleum revenue management oversight body consisting entirely of civil society members and therefore completely independent. As such, there is keen interest from the international community to determine if it provides an effective model to promote compliance with fiscal rules and improve natural resource fund governance.

In May 2012, the PIAC released its first report. It provided basic information on petroleum revenue receipts and the flow of funds from the Petroleum Holding Fund to the two natural resource funds (Ghana Heritage Fund and Ghana Stabilization Fund), the national budget and the Ghana National Petroleum Company (GNPC), Ghana's national oil company. The PIAC highlighted several major challenges facing the system in Ghana, including:

- The GNPC retained 47 percent of all petroleum revenue collected in 2012. While legal, this represents a large implicit investment in the oil sector at the expense of other sectors.
- Under the Ghanaian system, higher revenue forecasts allow for greater spending and less saving in natural resource funds. The PIAC revealed that the Ministry of Finance overestimated corporate income taxes by nearly 100 percent, thereby creating extra fiscal space for the government.
- The Ghanaian petroleum revenue management act requires a minimum of 30 percent of oil revenue not allocated to the budget or the GNPC to be deposited into the Ghana Heritage Fund, with the rest allocated to the Ghana Stabilization Fund. In fact, 21 percent was allocated to the Ghana Heritage Fund and 79 percent to the Ghana Stabilization Fund.

Following the release of their report, PIAC members, led by chairman Major Daniel Sowa Ablorh-Quarcoo, met with officials from the government, including the Ministry of Finance and the GNPC, to share their concerns. They also held two public consultations on their findings, one in the oil-producing region. The press coverage and national debate that ensued led to at least one immediate result, the disclosure of new information on oil payments made to the government.

Conclusion

While there is no one-size-fits-all independent oversight model, several elements can improve oversight body effectiveness. First, expertise in natural resource fund management is essential. Expertise engenders credibility, which can help persuade policymakers to implement recommendations or influence the public or international community to pressure policymakers. While there are individuals and institutions in most countries with a strong understanding of natural resource fund governance, oversight bodies can also request support from organizations such as the African Center for Economic Transformation, IMF, Norwegian Agency for Development Cooperation, NRG, and the World Bank, to improve their understanding of global good practices.

Second, the legal power to investigate fund operations could aid in assuring accuracy of information and comprehensiveness of assessment reports, provided that oversight bodies have easy access to information. Investigative powers also help keep fund managers in check.

Third, enforcement powers, such as the Chadian Collège's right to deny withdrawals from the oil fund, ensure that the government complies with legal obligations.

Finally, oversight mechanisms should be context specific. For instance, media coverage may be most effective in open, democratic societies, while multistakeholder groups may be most effective where civil society is an influential force.

Ultimately, the effectiveness of independent oversight will rely on the supervisory body's ability to incentivize the government to comply with its own rules or meet its own objectives. This can be done with carrots—for example, by publicizing that fund performance is improving—or with sticks, such as fines or imprisonment by the courts or sanctions by the international community for misappropriation of public funds. Which carrots and sticks are most effective depends wholly on the country's political and institutional environment.

Policy Brief



The Natural Resource Governance Institute, an independent, non-profit organization, helps people to realize the benefits of their countries' oil, gas and mineral wealth through applied research, and innovative approaches to capacity development, technical advice and advocacy. Learn more at www.resourcegovernance.org.

80 Broad Street
Suite 1801
New York, NY 10004
Phone: 1.646.929.9750
nrqi@resourcegovernance.org



The Columbia Center on Sustainable Investment develops and disseminates practical approaches and solutions to maximize the impact of international investment for sustainable development. The Center undertakes its mission through interdisciplinary research, advisory projects, multi-stakeholder dialogue, educational programs, and the development of resources and tools.

435 West 116th Street
New York, NY 10027
Phone: (212) 854-1830
ccsi@law.columbia.edu
www.ccsi.columbia.edu