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Managing Resource Wealth: What Have We Learned?

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Managing Resource Wealth: What Have We Learned?

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Developing countries which experience major foreign investment and revenue flows from natural resource development have struggled to manage the economic, political and social impacts of this newfound wealth. These problems, often called the "natural resource curse" or "paradox of plenty", have been extensively researched in recent decades, but avoiding the "curse" remains a challenge.[1]

While every nation that anticipates the income from a major discovery of oil, gas or minerals hopes to convert this wealth into sustainable development and long-term prosperity, most often the results are just the opposite. Public accountability declines, authoritarianism rises, currencies are distorted and non- extractive industries atrophy. Borrowing rises in anticipation of income and monies are not spent wisely. Expectations of newly-invested private companies fluctuate from cautious optimism for taking on the initial investment risk, to excitement when discoveries are made, to resentment at the length of time it takes for projects to mature and repay costs. Indeed, within governments (and the new investors themselves) divisions emerge over whether these companies should be the new providers of major social services or simply be law abiding and silent guests. These internal debates are heightened when expectations meet reality, and promises of the benefits from resource development disappoint an eager public. The reasons for these failures in macroeconomic management and political accountability are several, but they result largely from weak governance. Disappointed expectations are also aggravated by the deep misalignment between political cycles and investment cycles. The questions of whether countries can avoid the resource curse, and what role investing companies should play, are highly salient today.

While responsibility for national development lies first with host governments, who have the sovereign rights and responsibility to determine how extraction will be conducted and how revenues will be managed, investing companies need to know how to comport themselves both to secure their investments and maintain their social license to operate (SLO) but also to be at least helpful to government efforts to avoid the resource curse rather than aggravate them. Enlightened leadership can go a very long way toward avoiding the mistakes of others who mismanaged their resource inheritance.

[1] This paper has been developed from a prior publication "Confronting the Resource Curse: Advice for Investors and Partners" by David Goldwyn and Andrea Clabough (© 2020 Rice University's Baker Institute for Public Policy).

Who Is Responsible for Avoiding the Resource Curse?

Importantly, many countries that enjoy resource wealth do not suffer from the vagaries of the resource curse. Norway, Botswana, Chile, and Canada all successfully developed high-value resources while largely avoiding the numerous pitfalls described in the literature. This raises two important questions, 1) what distinguished these few successes from the more numerous failures, and 2) which stakeholders have responsibility for enabling countries to avoid the resource curse and achieve more sustainable, just and equitable development? Key factors distinguished the countries that successfully managed their resource wealth. Broadly, their governments have consistently practiced sound macroeconomic management and either had effective political and regulatory institutions before they accessed resource wealth or successfully developed them later; Norway, with its highly effective sovereign wealth fund (SWF), is a notable example.

Governments are interested in maintaining political support and developing resources to generate revenue and produce new wealth. A government with its country's long horizon interests in mind would pursue initiatives which prioritise sustainable economic growth and human development, but immediate political and economic motivations can easily (and often do) overwhelm multi-generational considerations. On the other hand, companies invest to earn a competitive return. The decision to risk capital, especially in a new or frontier area where there is significant geological risk, is tied to the reward offered. Oil and gas development, for example, is a long-term business – projects are expected to have a 20-30 year life span at minimum – and project economics are calculated for that time period based on the terms offered in the contract. Investors expect to weather commodity cycles and take their risk based on expected long term prices and host government fiscal terms. Predictability and stability are essential to profitability. Although host governments and investors may be aligned on the desire to produce a given natural resource, such as oil and gas, there are fundamental misalignments around their respective goals, needs and time horizons.

Efforts to Exorcise the "Curse"

National governments and private sector companies have employed a variety of tools to overcome the "paradox of plenty". The results have been, at best, mixed.

One popular tool is sovereign wealth funds (SWFs), where a national government sets aside funds for designated purposes, usually related to macroeconomic fiscal and investment goals. In reality, these funds can also be abused or manipulated to serve vested interests. They are only as effective as the rules which guard their usage.[2] Likewise, host governments have often sought to adapt legal and fiscal frameworks as resource revenues begin rolling in, writing new transparency rules which emphasise revenue and payment disclosures among companies, local communities, regions and states. Unfortunately, as with sovereign and savings funds, the tools are only as good as the rules - or rather, the willingness of the state to implement and enforce them. Implementation of the laws is a challenge, especially as governments are in the process of building up institutional capacity.

Private sector companies have also tried a variety of strategies to overcome the resource curse; prominent among these is partnering with local and international development organisations already at work in their new countries of operation. However, development partnerships are only as effective as the commitment behind them. The durability of a development relationship could be variable with the company's public relations or budgetary needs or may be discontinued if perceived as ineffective in supporting social license. Shared value is another approach to foster positive corporate-community linkages. Shared value refers to a business strategy in which creating economic value also addresses social

2 For further information on the advantages and challenges associated with savings and sovereign wealth funds, the authors recommend the 2010 IMF publication "Economics of Sovereign Wealth Funds Issues for Policymakers", eds. Udaibir S. Das, Adnan Mazarei, and Han van der Hoorn, Washington, D.C., International Monetary Fund, 2010, https://www.imf.org/external/pubs/nft/books/2010/swfext.pdf.

development challenges.[3] However, a shared value model may not work in all operating environments and companies must carefully calibrate any value creation approach to actually meet its own and stakeholders' needs. Anti-corruption efforts, local capacity building, technical assistance and working with independent external partners (such as the Extractive Industries Transparency Initiative) are also common approaches from companies – but none of these have yet proven to be a silver bullet.

Recommendations

Fundamentally, the divergent motivations of host countries and their private sector partners makes investors ill-suited to enhancing national or local governance – the issue at the heart of the resource curse - beyond embracing high standards of integrity in company operations. Realistically, private companies cannot (and should not) govern a country's natural resource industry as a bulwark against the resource curse even assuming the best possible intent. There are, however, important steps that companies, host governments and supporting governments can take to help.

Host Governments

Create Independent Regulatory Bodies

Although independent regulators are not a "sufficient" condition to prevent corrupt behavior, they are almost certainty a "necessary" one. Moreover, there exists a wealth of expertise and financial support to create an independent regulatory body and train new professionals to staff it.

Establish A Clear, Equitable Fiscal Regime

As with independent regulators, fiscal rules do not exist in a vacuum and must interact with the overarching economic conditions in a given country. Likewise, a strong fiscal regime works best when established early on well before a country is dealing with windfall rents and competing agendas for spending it. Developing and enforcing a sound fiscal policy can insulate a country from economic atrophy and make the benefits of resource development clearer and more accessible to wider constituencies.

Create Savings Funds

Savings funds should go hand in hand with a robust fiscal regime; host countries should accept early on that resource production is an inherently finite venture, and lay the groundwork for the future at the outset of resource development and not as an afterthought.

Practice Transparency

Host governments should sincerely, actively pursue anticorruption policies and enforcement tools as a prerequisite to resource development. Host countries cannot expect to reasonably hold their investors to higher standards than they themselves abide by; indeed, host governments should lead by example. EITI candidacy is an excellent starting point, as is empowering and educating civil society and stakeholders at all levels in advance of development.

Private Investors

Strike Fair Bargains

This is the most visible and public manifestation of company's presence in a host country, and consequently the most important aspect of good citizenship, is a fair allocation of the returns on the resource. This is most important in contract design and revenue allocation, especially with new producers who may have few or no legal frameworks governing revenue sharing.

Support Transparency – In Word and Deed

This includes support for and participation in standard setting groups like EITI, support for international efforts like the IMF's Article IV assessments, and support for transparency in the leasing process. Likewise, private investors should eschew corruption in all its forms, remembering that sunlight is the best disinfectant by welcoming proper oversight.

3 The concept of creating shared value (CSV) stems from a foundational 2011 Harvard Business Review article by Michael E. Porter and Mark R. Kramer, which dealt with questions of weakened social trust in business and the role of private business enterprise in managing issues of public concerns.

Support Bilateral and International Financial Institution (IFIs) Capacity Building Programs

Rather than attempt to duplicate these efforts, private sector investors should earnestly support the engagement of IFIs, nonprofit organisations and supporting governments if a host country seeks help – even if thesemore neutral observers make challenging demands of the private sector.

Integrate Sustainability Into Operations

The extractive industries are under growing scrutiny for their environmental and especially climate impacts. It behooves investors, in those countries which wish to develop resources like fossil fuels or critical minerals, to pursue the utmost standard of efficient, sustainable production, processing, etc. Methane management, for example, is one especially potent example of where sustainability-minded operators can make a big difference in outcomes.

Don't Take Sides In Political Disputes

Any government will have some form of opposition, institutionalised or otherwise. Investing companies should assume that, sooner or later, that opposition will have substantial political power. Companies should endeavor to be as neutral as possible in policy debates, especially where their own interests are concerned.

Stay In Your Lane

Private investors, especially in the early stages of development, should focus on their core competencies and the reason they are in-country to begin with. Where a private investor seeks to take on a bigger role beyond their operations, they should do so in robust consultation with their hosts and ideally at invitation.

External Partners

Move Early and At Scale

Emerging producers need the most concerted, in-depth assistance at the earliest stages of resource development. Ideally, host countries will ask for help at these stages, and not after serious mistakes have had negative repercussions. External partners should monitor resource industry developments and new discoveries and anticipate where capacity and technical assistance may be needed next.

Advise, Don't Dictate

Advisors, such as EITI and the Natural Resource Governance Institute, cannot usurp sovereignty and must always present choices – not prescriptions - for host governments to review when making the best choices for their own unique national. External partners should walk alongside new producer governments as an ally, not ahead as an instructor.

No Strings, Please

External governments often have their own agendas at play and may be far from neutral observers. Given these limitations, empowering and encouraging IFIs and nonprofits in this space is the fairest and most effective course. IFIs are especially well suited to support early capacity-building and training for government and regulatory officials.

Support Creative Approaches to Infrastructure and Debt Financing

New resource producers often lack capacity to meaningfully support development of a new project, especially in the form of infrastructure. To fill the gap, they have looked to new developers, private investors or otherwise. A better alternative would be to develop more effective and equitable options to financing the infrastructure that is desperately needed at the earliest stages of resource development. To better support these new producers, and steer them away from riskier financing options, the IFIs need longer term and ideally more flexible debt instruments to help countries bridge the gap from build out to repayment.

Conclusion

Easy solutions and one-size-fits-all policies for new resource producers are still elusive despite decades of global experience with resource development. Too many aspects of the problem come back to central questions of economic development, governance and institutional growth for the private sector to have any chance of changing a single country's trajectory. However, the private sector can and should do more than it has historically on this front. Alongside and in conjunction with multilateral institutions and supportive external partners, private investors can make important (if difficult) choices which are ultimately in the best interest of their hosts and the long-term viability of their businesses. These institutions and partners should back investors when they are taking the right steps, and offer oversight and constructive critiques when appropriate. Capable governments and the international donor community should not abandon resource development in emerging producers, but rather should continue advising and amend their toolkits to be the most effective facilitators possible. Put simply, the private sector cannot and should not go it alone. With far too much at stake on all sides, new producers deserve the best possible chance to get this right.

About the Speaker

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David Goldwyn is president of Goldwyn Global Strategies, LLC (GGS), an international energy advisory consultancy, and Chairman of the Atlantic Council Global Energy Center's Energy Advisory Group. He is a globally recognised thought leader, educator and policy innovator in energy security and extractive industry transparency. Mr. Goldwyn served as the US State Department's Special Envoy and Coordinator for International Energy Affairs from 2009 to 2011 and Assistant Secretary of Energy for International Affairs (1999-2001), the only person to hold both the US government's international energy leadership positions. He also served as National Security Deputy to US Ambassador to the United Nations Bill Richardson (1997-98) and Chief of Staff to the U.S. Under-Secretary of State for Political Affairs (1993-97). Mr. Goldwyn has been published extensively on topics related to energy security and transparency. He is the co-editor of Energy & Security: Strategies for a World in Transition (Wilson Center Press/Johns Hopkins University Press 2013) and Drilling Down: The Civil Society Guide to Extractive Industry Revenues and the EITI (Revenue Watch Institute 2008). Mr. Goldwyn's recent publications include "A New Energy Strategy for the Americas" (Atlantic Council 2020); "Confronting the Resource Curse: Advice for Investors and Partners" (Baker Institute 2020), "It's time to refresh the Caribbean Energy Security Initiative" (Atlantic Council, 2021); "Caribbean Energy Security: Regional Profile and Challenges to Integration" for the Handbook on Caribbean Economies (Routledge 2020), "Secure the Caribbean — with a modest addition to the BUILD Act" (The Hill, 2019), and "The waning of Petrocaribe? Central America and Caribbean energy in transition" (Atlantic Council, 2016). Mr. Goldwyn holds a B.A. in Government from Georgetown University, an M.A. in Public Affairs from Princeton University Woodrow Wilson School of Public and International Affairs and a J.D. from New York University.

About Goldwyn Global Strategies, LLC

Goldwyn Global Strategies, LLC (GGS) is a top provider of energy sector intelligence and strategy services to Fortune 500 firms. With extensive expertise in energy-producing nations and a deep grasp of global oil, gas, and renewable markets, GGS offers valuable insights. Their team, comprising advisors and analysts with decades of experience in U.S. government relations and international energy diplomacy, boasts 25 years of political and economic analysis expertise across various regions, including North and West Africa, Latin America, South and East Asia, Russia, and the Caspian region.

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