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Good governance and the management of natural resource endowments

by Gerhard Erasmus

The importance of good governance for regional integration arrangements is a constant theme in tralac writings. We consider respect for the rule of law and the availability of sound institutional arrangements as vital for regional integration and economic development. The more comprehensive and ambitious regional arrangements become, and the more advanced the integration process, the stronger the need to heed this call.

The good governance argument obviously applies at both national and inter-state levels. Bad governance at home and the failure to respect the rule of law will not inspire virtuous behaviour when it comes to how legal instruments adopted between governments will be implemented.

What are the consequences of bad governance? It leaves societies poor and vulnerable to exploitation, without remedies and transparent regulatory regimes. The benefits associated with market access opportunities will mostly not materialise, while the cost of doing business within and between societies will remain unnecessarily high. On the regional level, official plans about integration and increased trade will remain incomplete. Economic development generally will suffer and investment decisions will be negatively affected.

Certainty and predictability in governance will not in themselves guarantee development, just as ambitious National Development Plans or government announcements won't do the trick. However, since good governance is essentially about how state power is exercised and corruption tackled, transparency, accountability, and effective remedies will signal how governments approach their policy making and execution functions. Good governance makes sense and inspires confidence.

Why has it remained so difficult to pursue effective legal and institutional arrangements in the African RECs? Political scientists offer many explanations, from colonial legacies, weak states, and the effect of poverty itself, to sensitivities about loss of sovereign policy space. We have written elsewhere why the latter fear is mostly overstated and based on wrong assumptions about the nature of sovereignty in the context of inter-state arrangements. Sovereignty is an attribute of states, not governments. And it is an act of sovereignty to conclude international agreements. They will presumably not be entered into unless considered beneficial.

There is also evidence that the "natural resources curse" is a specific problem and another explanation for governance failures. The discovery of mineral wealth and the export practices around such commodities frequently lead to bad governance. There is corruption in awarding mining licences, while governments lose billions through tax evasion, failures to police foreign companies, or bribes. Some commentators suggest that governments in countries "blessed" with recent mineral discoveries are also tempted to ignore the disciplines associated with implementing regional trade agreements and other laws. Mining and the extraction business are considered outside the ambit of the regulation associated with the implementation of international or regional legal agreements.

This is a short sighted and in many ways a misguided view. Essential services, transport and finances, which mining operations rely on, are regulated by inter-state legal arrangements, while the good governance imperative remains extremely relevant in terms of the public interest aspect of governance. The International Monetary Fund has just published a "Staff Discussion Note" which argues specifically for good governance in this context.[1] It writes:

> *Sizeable natural resource endowments and potentially large financial inflows from their extraction provide an unparalleled opportunity for economic growth and development in a growing number of sub-Saharan African countries. Empirical evidence suggests, however, that translating this resource wealth into stronger economic performance and a higher standard of living has proven challenging. Much has been written about the resource curse. This publication focuses on solutions to the challenges and outlines the main policy considerations and options in managing natural resource wealth, drawing on experience within and outside sub-Saharan Africa and referring closely to the latest analysis and policy advice in this area by the IMF, the World Bank, and leading academic research.*

This is a useful document, which deals inter alia with matters such as domestic investment arrangements and agreements, as well as taxation regimes. These are frequently cited areas where weak laws or corrupt practices are encountered. The various technical challenges need to be explored in more detailed papers later. For the present discussion, the concluding part of this study, which emphasizes the public interest dimension as part of the broader pursuit of good-governance, is repeated here; and fully endorsed:

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[1] Lundgren, C. J., Thomas, A. H. and York, R. C. 2013. *Boom, Bust, or Prosperity? Managing Sub-Saharan Africa's Natural Resource Wealth.* Washington, DC: International Monetary Fund. Available: http://www.imf.org/external/pubs/cat/longres.cfm?sk=40476.0

Good governance is critical to ensuring that the state gets a fair financial return from the exploitation of its natural resources and that resource revenue is effectively and fairly used. Although the effects of waste and abuse of public assets are particularly large in resource-rich developing economies, their capacity to prevent or prosecute abuse tends to be limited. Opportunities for corruption are magnified by the limited number of players involved, the technical complexity of resource operations, and the size of resource rents that can be captured. Meanwhile, the loss of revenue can impede development policy and expose the economy to external volatility.

Safeguarding the public interest requires action across the whole value chain of extractive industries. From the granting of exploration and development rights, to the sharing of rents and profits, to the monitoring of subsequent public expenditure or savings, national authorities need to actively close off opportunities for corruption and abuse. For instance, a lack of competition in the granting of mineral rights both constrains the state's ability to ensure efficient production and presents potential for corruption through insider deals. Similarly, failing to provide adequate resources for tax administration gives free rein to well-informed producers to exploit tax loopholes. Yet such deficiencies may not be evident to the general population because, as long as some positive benefits are visible from resource revenue, less attention may be paid to lost opportunities and waste. (p. 63)

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