The African State and Natural Resource Governance in the 21st Century

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A. INTRODUCTION

1. Good morning – and let me begin by apologizing for not being able to join you at this meeting in Ottawa today. I am attending the World Economic Forum Africa Meetings, which are currently taking place in Cape Town, South Africa.

2. I am pleased that the Ottawa Forum this year has chosen the topic of natural resource governance in Africa. As I mentioned to Joe Ingram, I was recently invited to Tianjin, China to address the China Mining Congress on a related topic. And again, in December last year, I delivered a lecture at Oxford on natural resources governance in Africa. Clearly, this subject of governance in resource rich countries is becoming an important topic for policy-makers and the investment community – both in Africa and abroad. And I hope my brief remarks will stimulate further discussion at this year's Ottawa Forum.

3. As you may know, the natural resource map in Africa has changed significantly in the past decade. For example, new oil deposits have been discovered in Ghana, Uganda and Kenya. In East Africa, Tanzania and Mozambique are also developing offshore gas deposits which are likely to be some of the largest in the world. For other solid minerals, we know that explorations are continuing in countries such as Guinea, Zambia and Democratic Republic of Congo.

4. Canada is also an important player in the global natural resources sector. We know that the Toronto Stock Exchanges have become the leading capital markets for firms and investors interested in investing in natural resources. There are more mining firms listed on the Toronto exchanges (about 1646 firms), than the Australian Stock Exchange (700 firms) or even the London Stock Exchange (191 firms).

5. Moreover, Africa has also become an important destination for Canada's natural resource investments. From recent estimates, Canada's publicly traded mining firms have invested approximately about C$27 billion in Africa. There are about 185 Toronto-listed firms operating in Africa at present, with nearly 700 projects across 35 African countries. We welcome these investments – and are pleased that Canada stands as a partner to Africa in developing our natural resources.

6. However, natural resource investments raise challenges for policy-makers in developing countries, and also for foreign mining firms. Let me discuss each of these in turn.

B. CHALLENGES FOR DEVELOPING COUNTRY GOVERNMENTS

7. First, the challenges for developing country governments.

8. For policy-makers in host countries, I would argue that there are <u>three main</u> challenges namely:

a. First, tackling the macroeconomic consequences of natural resource revenues;
b. second, ensuring transparency in the award of mining contracts and also in the utilization of resource revenues; and
c. third, building capacity to negotiate better fiscal terms for mining contracts.

9. I have discussed many of these challenges in my recent book, *Reforming the Unreformable,* published by MIT Press. Let me share with you some of the main ideas.

10. First, natural resources and macroeconomic management. For the macroeconomist, natural resource revenues raise challenges because commodity prices tend to be volatile, and also because resource endowments are depleting and exhaustible assets. As a result, many resource-dependent countries tend to have high macroeconomic volatility and low growth. The recommended policy solution is to decouple public expenditures from commodity revenues, in order to limit the transmission of commodity price volatilities into the national budget.

11. We have adopted this policy advice in Nigeria to manage our oil revenues. Since 2003, we have adopted an oil-price based fiscal rule where revenues accruing above a reference benchmark oil price are saved in a special account, "The Excess Crude Account". The introduction of this fiscal rule has enabled us to reduce the macroeconomic volatility which previously plagued the Nigerian economy. In addition, we have also increased the public savings in our Excess Crude Account. Today, this account has a balance of over $7 billion – and provides us with an important fiscal buffer in this uncertain global economy. In addition, we have also

been able to launch a Sovereign Wealth Fund for Nigeria, with an initial capitalization of about $1 billion.

12. A second challenge for policy-makers in developing countries the need to ensure transparency and good governance in the management of their natural resources. They must ensure transparency both in the award of mining concessions and contracts, and also in the utilization of resource revenues. Civil society groups in Africa have become more vocal, and are seeking greater transparency and accountability in resource management. Now, more than ever before, African leaders are standing up to the challenges of managing their natural resources.

13. For the purposes of managing natural resource revenues, I have found frameworks such as the Natural Resource Charters and the Extractive Industries Transparency Initiative (EITI) to be helpful.

14. As you may know, the *Natural Resource Charters*, were developed by Prof. Paul Collier and his colleagues. The Charter provides 12 principles which encompass the key economic and social dimensions of natural resource exploitation. I believe that by working through this framework, governments, businesses and civil society in resource-dependent economies can engage more actively with the challenges of natural resource extraction. We have some initial benchmarking work by a panel of experts which applies the *Natural Resource Charter* framework to Nigeria.

15. In Nigeria, we have also made some progress in developing institutions to manage our oil revenues – although this remains a constant challenge. During my previous tenure as Minister of Finance, we made progress in introducing institutions such as

the Nigerian Extractive Industries Transparency Initiative (NEITI) to improve the audits of Nigeria's hydrocarbon reserves and financial flows. Today, twenty African countries have signed on to these principles. Investors and mining firms also benefit from the EITI guidelines on how to conduct transactions transparently and legally. So at this point, let me add my voice to the recent letter by Joe Clark, Lord Browne and Jeff Sachs and others in entreating Canada to commit to mandatory disclosure rules for Canadian natural resource companies. Prime Minister Harper – this would be a great opportunity for you and your administration to make a big difference!

16. In Nigeria, we have also introduced the practice of publishing monthly revenues distributed from our government coffers to the Federal, State and Local Governments. This publication quickly became a bestseller – a boring bestseller. And it has provided factual evidence for civil society groups to challenge their elected leaders on the use of public revenues.

17. <u>Finally, the third challenge for developing countries arises in the negotiation of fiscal terms for mining contracts</u>. In many instances, there tends to be wide information asymmetries between foreign contractor firms and host government officials, so that contract negotiations tend to be on uneven playing fields. Developing country governments would be well-advised to invest more in building technical capacities, improving their negotiation skills and researching international best practices before signing off on agreements.

C. CHALLENGES FOR MINING FIRMS

18. Now let me switch to the second part of my talk, and discuss some of the challenges for foreign firms operating in Africa's extractive sectors. How should they think about their engagement with the host governments and their host communities? I think this is a subject which Canadian investors and policy-makers need to take seriously, given your large investments in the mining sector in Africa and other developing countries. There is also a *brand Canada* in the natural resources sector abroad, and I think the Canadian private sector and government must work hard to preserve this brand.

19. Let me suggest <u>five key principles</u> which I believe can guide foreign firms in making smart and responsible investments in the natural resource sectors in African countries. I shared these five principles recently with investors at the Chinese Mining Congress and also at a lecture at the Oxford Blavatnik School. The key principles are as follows:

    a. *First, align your investments with host countries' development priorities*. Basically, it is important for firms to ensure that their investments fit within the broader development agenda of their host countries. For many African countries today, job creation is the number 1 concern of policy makers. There is a pending demographic bulge, and our youth are looking for apprenticeships and employment. So in such a setting, if mining firms want to align with the host countries' priorities, then they may consider employing local technicians, rather than bringing in foreign craftsmen!

b. *The second principle is to practice transparency*. In this case, it is important for foreign firms to ensure transparency in the negotiation of their mining contracts. For example, the recent practice of exchanging natural resource licenses for infrastructure projects is inherently difficult to evaluate, and will thus be perceived as non-transparent. We will only generate hostility from local communities if contract negotiations and tax payments by foreign firms are believed to be mired in secrecy. There are also several instances when foreign firms collude with corrupt local officials in African countries to win lucrative mining licenses or related contracts. In my book, *Reforming the Unreformable,* I described the story of how a foreign consortium TSKJ (comprised of France's Technip, Italy's Snamprogetti, Haliburton's subsidiary Kellogg Brown & Root, and Japan's JGC) made secret payments in excess of $180 million to Nigerian officials in order to win multi-billion dollar oil services contracts. The era of foreign business men, carrying briefcases, and bribing local officials for lucrative contracts in Guinea, in DRC, in Nigeria or elsewhere must cease!

c. *My third principle is to, add value*. In contrast to the previous colonial practice of simply extracting and shipping out raw commodities, today, foreign firms investing in developing countries must add value to the raw materials. This will ensure greater economic spillovers to the local economy, by creating employment and developing skills.

d. *The fourth principle – which is very important – is to pay what is due and do what is right*. Here, it is important for foreign investor firms to pay their taxes that are due and also do the right thing in their accounting practices.

Developing countries need the tax revenues to invest in infrastructure and to provide public services for their citizens. These investments would improve the business environment for mining firms operating in their countries. But for these public investments to happen, you will need to pay your taxes! Practices such as transfer pricing and other clever accounting tricks must stop. You may have seen the editorial in the Financial Times last week estimating that Zambia loses about $2 billion annually due to tax avoidance. Moreover, in spite of all their mining, DRC and Guinea also have tax revenue to GDP ratios of about 8 percent! (compared to IMF benchmark of 15% of GDP). We owe the people of Zambia, DRC and Guinea more!

e. *Finally, principle #5 says: engage with local communities*. It is important for natural resource firms to engage more closely with their host communities, by investing in social infrastructure (such as schools and hospitals) in these communities. Many of your firms in Africa would be operating in challenging environments – whether in Katanga province in the DRC or in the Niger Delta in Nigeria. I would encourage you to take your Corporate Social Responsibility seriously. It is important that your host communities realize that you have a shared and vested interest in their economic development. You must also pay close attention to maintaining the environmental impacts of your activities. In my own country, Nigeria, dysfunctional relationships between the local community and oil companies led to disruptions in operations in the Niger Delta. These disruptions cost the Government Treasury a lot of money, but it also raises costs for mining firms due to security concerns. So clearly, good CSR would remain important for good business.

D. CONCLUSIONS

20. Let me now conclude. So to sum up, I am glad that the Ottawa Forum has taken the lead in organizing this discussion in Canada on the governance of natural resources in Africa. And I hope it will lead to greater dialogue between investors and policy-makers in Canada and Africa.

21. I believe the natural resource sector has great potential in contributing to Africa's economic development. But we must get the governance of the sector right – both on the government side, and also on the side of the mining firms. We, policy-makers in Africa, must work hard to manage our resource revenues and also ensure transparency in the utilization of our resource revenues. For the foreign mining firms, my advice is simple: that *align your investments with countries' development priorities; practice transparency; add value to the country and its people; pay what is due and do what is right; and engage with local communities.*

22. There is a proverb in my part of Nigeria which says:

> "*aka nni kwo aka ekpe, aka ekpe akwo aka nni. nwacha adi ocha*!!"

which translates to:

> if the right hand washes the left hand, the left hand washes the right hand, they will both be clean.

23. I am confident that Canada and African countries can work together in an open and transparent way in our extractive sectors – and that our relationship would be mutually beneficial.

24. Thank you very much for your attention.