EXPERIENCE IN REVENUE SHARING FROM HIGH VALUE RESOURCES:

Peru, Sudan, Iraq, Sierra Leone

Natural resources are not distributed equally in space. When the central government unilaterally controls resource extraction in areas of resource wealth that coincide with the territories of unique ethnic or religious communities, strong identity polarization and grievances that result can lead to violent conflict. This risk is especially high when the resources are high-value and their extraction causes local environmental damage (*e.g.,* timber, oil, gas, minerals, and precious gems). In such cases, local communities often bear the costs of damage resulting from resource extraction while the profits are removed to the capital with little return investment or even delivery of basic services to extractive areas. Situations like these have contributed to the cause of self-determination and even secession movements around the globe.

In some cases, the sharing of revenues from resource extraction has been used to address these grievances and end (or at least reduce) armed conflict, for example in the Kurdistan Regional Government of Iraq, the Aceh and Papuan provinces of Indonesia, and in the recently independent country of South Sudan. Measures to share revenues from the extraction of high value resources to local indigenous communities have also helped to stem conflicts between locals and companies, as well deep divisions between local and central governments (as in Peru and Iraq). Further, resource revenue sharing has sometimes been an important factor in peacebuilding by using revenue to improve the welfares of affected local communities. For example, explicit references to wealth-sharing were part of the peace agreement ending Sierra Leone's civil war: a percentage of annual diamond export revenues are shared locally to Diamond Area Community Development Funds managed by local chiefs.

These revenue sharing efforts have different goals, take different approaches and have achieved a variety of outcomes. This briefing outlines the successes and failures of revenue sharing from high-value resource extraction in South Sudan, Peru, Sierra Leone, and Iraq, particularly when intended as a conflict-ending and peacebuilding measure. (Note that revenue sharing in Indonesia is discussed in a chapter X).

It should be emphasized that grievances are not only related to access to revenue but also the ways in which the natural resources are managed and who participates in this process. Highly centralized or ambiguous lines of authority over resource-use have contributed significantly to grievance with governments when locals feel disenfranchised from important cultural and livelihood assets. Further, if decentralization empowers local politicians and/or bureaucrats to grant concession licenses, many local officials come to depend on this authority as a means to generate revenue to pay for their new functions, or fund re-election campaigns or merely to enrich themselves. Due to space constraints, this chapter addresses only the sharing of resource revenues and does not examine the decentralization of authority to allocate use rights or set policy related to resource management, although this is a key element of decentralization that is examined in detail in other chapters (1 & 2).

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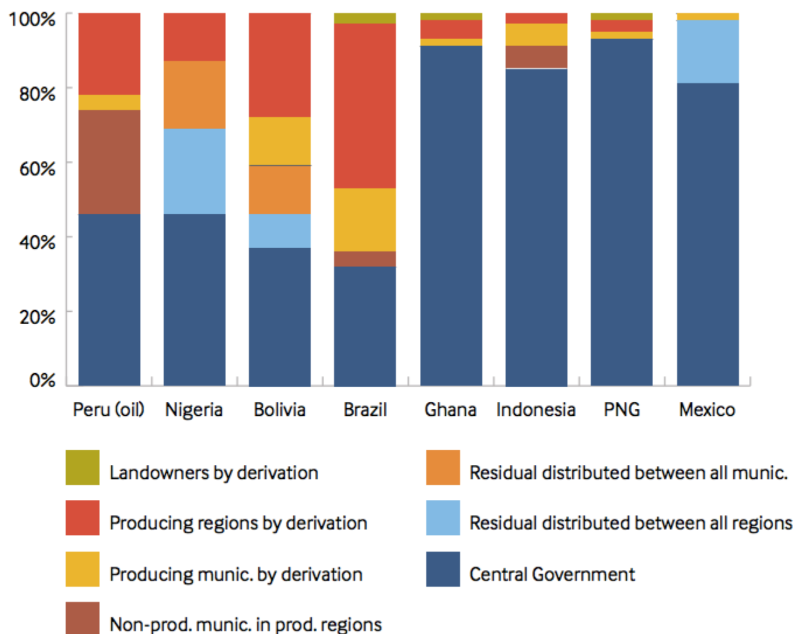
FIG 1: Extractive Industries Revenue Distribution at the Subnational level
Source: Marteo Morgundi, Natural Resource Governance Institute, 2008.
http://www.resourcegovernance.org/sites/default/files/nrgi_Subnational-Distribution.pdf



Note: The bar for Indonesia is for revenue sharing under Standard Regional Autonomy legislation and for not Aceh and Papua's Special Autonomy arrangements, which shares 70% of revenues to the producing province, at least for the first decade (see Chapter x).

Overview: Advantages and Disadvantages of Different Revenue Sharing Approaches

There are several approaches to revenue sharing. The most decentralized approach grants subnational governments (SNGs) the **authority to levy some taxes and fees directly** on extraction companies ("Direct Tax Authority"). Another approach is **to transfer a defined percentage of revenues collected by the central government** back to SNGs or individual citizens on a regular basis ("Direct Revenue Transfer"), such as in Nigeria, Peru, and Sierra Leone. The least decentralized approach is for central governments to **return revenues to SNGs through the regular budgeting process** using a formula that increases the share for producing regions ("Indirect Revenue Transfer", or "Intergovernmental Transfer"). Countries also may opt for a **hybrid approach** that combine two or more approaches (e.g., Iraq). For example, some arrangements grant SNGs authority to levy some fees and taxes directly, while also directly transferring a designated percentage of fees and taxes collected by the central government to producing regions, and allowing additional consideration in intergovernmental transfers according to factors such as "population" and "need" in order to address inequities between resource-rich and resource-poor regions (e.g. Indonesia, Canada, Bolivia).

The types of revenues, possible beneficiaries, and uses of the revenues also vary. Revenues may be **transferred to governments of producing regions, traditional authorities, or as cash**

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dividends to individual citizens. The **source of revenue** that is to be shared may include royalties, export fees, license fees, and/or taxes on profits derived from resource extraction. Extractive commodities are known for their price volatility, so taxes and fees collected by local governments might be only those based on production, rather than value, so as to stabilize revenue flows. The revenues shared may be **earmarked for specific spending** like education, health care, infrastructure, or other development expenses, or the revenues may be disbursed "with no strings attached." Each approach to revenue sharing has its advantages and disadvantages.

Direct Taxation

Direct taxation is the option that most **meets expectations for local control** in contexts where self-determination is a central demand (of warring parties, for example). However, this option also **suffers if the SNGs have low capacity**:

- To **set and collect complex taxes** from large foreign firms (taxes based on volume of production are less volatile than taxes based on profit or volume of exports);
- To **budget for and spend the new revenues**, as evidenced by growing reserves year-on-year; and,
- To **devise counter-cyclical fiscal policies** to protect from boom/bust commodity prices.

Further, inexperienced SNGs are often inefficient and develop **overlapping tax and fee structures** with those imposed at the national level, which creates disincentives for investment. Other problems are not from lack of capacity but of **insufficient "political will" of SNGs to implement transparency and oversight mechanisms**, in part to preserve corruption opportunities for themselves. Therefore, **corruption and a lack of accountability** are frequent problems in newly decentralized states with direct taxation authority.

Direct Cash Transfer

The difficulty for SNGs to set and collect taxes, especially from large foreign firms, can be avoided through direct cash transfers from central government as a legally-defined share of revenue collected (e.g., 50% of revenues from minerals and oil fields in Peru and regions bordering Sudan with South Sudan). However, this method **does not avoid the weaknesses in SNG's fiscal management of new revenues**, especially given that extractive commodities are notoriously volatile making income uncertain. Both direct tax authority and direct transfers can also **exacerbate inequalities between regions**, a dynamic that can be problematic for peacebuilding where tensions already exist between them.

In direct transfers, the funds **can be disbursed to SNGs, including traditional authorities, or to individual citizens as cash dividends,** or some combination of these. Transfers to individuals are often argued as a useful method in post-conflict environments where governance is weak and corruption high, resulting in little spending that benefits local communities adversely affected by extraction. Further, cash disbursement to citizens **sends the message that the resources are owned by "the people"** and raises public expectations about how they will be managed and how revenues are collected and shared (Sandbu, 2012). It is hoped that these **expectations may help generate accountability**, although whether this is true in practice is far from clear.

Indirect transfers

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The least decentralized approach to revenue sharing is through indirect transfers through a national budgeting process. Budgets have the advantage of **making use of centralized government revenue collection and management capacities**. The budget process can be customized to use specialized formulae reflecting preferential treatment for producing regions, as well as other filters for population, equity, needs, "national interest" (e.g., national unity), as is done in Iraq and Indonesia. This approach can still address self-determination demands for a "fair" share of resource benefits extracted from local territories, which can be used to offset environmental costs of extraction. However, it requires trust in the central government to adequately collect and fairly allocate revenues. This trust may be lacking, in part because of the track record of the central government when it had monopolized the collection and spending of resource revenue in the past. It should also be noted that central governments also frequently lack capacity, making fiscal management, transparency and accountability also significant challenges for them—and not just SNGs—to implement.

Post-Conflict's Unique Challenges to Revenue Sharing

In assessing the case studies, several important themes emerge that are specific to post-conflict situations. The conditions present in post-conflict make revenue sharing an important element of peace building but at the same time make it particularly challenging, including, for example:

- A lack of trust and tendency to political expediency;
- A lack of oversight & accountability;
- A lack of reliable information & transparency;
- A large amount of unlicensed production and trade;
- Unrealistic expectations of revenues to be generated; and,
- Lack of clear ownership of land and resources.

Trust is an especially scarce commodity during immediate post-conflict periods (even more so during peace negotiations), particularly between central government and ethnic/religious groups that have been at war with each other. This makes agreeing on the precise mechanisms for revenue sharing post-conflict a challenging task. Legal drafters must walk a difficult line between allowing sufficient flexibility to reach agreement on the one hand, while on the other, avoiding overly broad and ambiguous principles in the interest of political expediency that will simply delay an intractable disagreement (and therefore threaten implementation) or ultimately become useless with changing markets or availability of resources.

Virtually all cases so far suffer from significant challenges related to ***oversight and accountability*** (resulting in corruption and/or lack of implementation), which have interfered with their success. However, it must also be noted that post-conflict contexts suffer from weak governance in virtually all areas of fiscal administration and that there is no reason to suspect that the central government would perform better had revenue sharing mechanisms not been established.

Information and transparency are key elements to oversight and accountability, as well as building trust—elements that are unfortunately also in short supply in post-conflict. Indeed, post-conflict institutions are weak, as are both the will and the capacity for collecting timely, accurate, and accessible data on production, revenue collection, disbursement, and spending. In many post-conflict arenas, production and fiscal data are critical to not only tracking revenue flows and

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planning for their use, but also to ensure resource production is controlled and not "off the books" (thereby exacerbating corruption). Information-poor sectors, and especially those in resource-rich areas, are usually also characterized by large amounts of ***unlicensed extraction and trade***, which will need to be acknowledged and addressed to maximize effectiveness of any revenue sharing scheme. The political realities associated with who is benefiting from this illegal trade often complicates revenue sharing schemes.

One way of simultaneously addressing the lack of reliable information (whether due to lack of will and/or poor capacity) and the problem of lack of mutual trust is to temporarily outsource this function to a third-party technical institution. This will serve as one independent source of information and ensure that all sides have access to the same information. This "single document" approach can also aid in addressing another common problem post-conflict of ***unrealistic expectations*** related to revenues, which if not met, can serve to re-ignite grievances that may spoil the peace. Often government promises of growing wealth from the exploitation of natural resources fail to materialize when investors shy from the high risk, post-conflict environment.

Another problem that is especially acute in post-conflict contexts is the *lack of clear ownership* of land and resources found on or under it. Contradictory laws at once recognize the rights of local people (often enshrined in the constitution), yet are ignored in other legislation that grant broad authority to the central government to manage resources and collect revenues (even if ostensibly for the benefit of "the people") are common sources of ambiguity in ownership. This ambiguity is compounded when customary rights are ignored in favor of statutory rights. Other sources of uncertainty common in post-conflict settings are the widespread movement of people who were either forcibly displaced or who fled their homes and farms to escape fighting. When they return they find squatters on their land who may claim adverse possession.

Likewise, during periods of conflict, governments often look to raise revenue needed to thwart insurgencies by issuing new contracts for the exploitation of natural resources. In their haste, corners are cut and multiple contracts overlap. Even in post-conflict periods of weak governance, corrupt governments will issue overlapping contracts to cronies. This corruption is exacerbated a proliferation of forged documents related to land titles and resource extraction rights, further muddying the picture of who owns the resource rights. Unless the problem of unclear resource rights is addressed, an attempt at sharing resource revenues is unlikely to maintain peace over time

Finally, if not handled with careful attention to the context in which revenues will be divided, revenue sharing may work to address some disputes while only serving to create new ones. Revenues from non-renewable resources are, by definition, finite ,and the division of these revenues will have both winners and losers. In a post-conflict context, tensions run high, weapons and fighters are readily available, as are elites willing to fan grievances among their constituents in order to maintain their power and wealth. In such an environment, if poorly executed, revenue sharing might not only be ineffective, it might itself catalyze violence rather than prevent it.

CASE STUDIES

South Sudan: A partial success in ending conflict…but for how long?

(Adapted from Wennmann, 2012)

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Sudan's 2005 Comprehensive Peace Agreement contains a separate Agreement on Wealth Sharing (AWS) stipulating that net oil revenues from the fields located on the border between Sudan and South Sudan would be shared equally between the two governments. This agreement has been successful in one of its aims: to end the protracted violence between Sudan and South Sudan; but it has proven less successful as a long-term solution to conflict or to improving the welfare of the under-developed south.

The AWS was only intended to last until the 2011 referendum on South Sudan's independence. The temporary nature of the measure enabled the negotiating parties to focus on the technical aspects of revenue sharing, and thereby to agree to work from a single, technical document rather than competing opinions and proposals. Further, this arrangement allowed peace negotiators to postpone contentious discussion of ownership of the natural resources until a later date so it would not bog down the peace process. Some observers have suggested that these were critical elements to the peace agreement's (at least short term) success (Haysom and Kane, 2009; Wennman, 2012).

However, weaknesses in the capacity of the Government of South Sudan (GOSS), the will of the Government of Sudan (GOS) to comply with the agreement, and the lack of mechanisms to improve compliance meant the agreement did not prevent future tensions between the two governments (ICG 2008). First, the nascent GOSS lacked capacity and was, therefore, forced to rely on the GOS to collect and distribute its share of the revenue. Further, the agreement did not require transparency or independent oversight of production or revenue collection by the GOS. As a result, the GOS for several years delayed implementation of revenue distribution to the GOSS, thus, eroding trust between the two parties. However, by 2008, more than three years after the peace agreement was signed, the GOS reportedly transferred some $2.5 million to the GOSS, which the GOS claimed cleared its arrears. But because the GOS does not make data on production accessible, it was impossible to know if this was the full amount due (ICG 2007, 2008). Indeed, some estimate that the amount transferred was only half of the share that should have been distributed (Global Witness, 2009). Nevertheless, tensions have not erupted into full violence between the countries. Some analysts have attributed the AWS in providing incentives to the parties to continue their disputes through non-violent means.

Although so far successful in containing overt violence, benefits accruing from the AWS have been viewed by some analysts as contributing to outbreak of other forms of violence. Among these conflicts are groups in the oil-rich Abyei region, near the border, who have begun to wage a violent campaign against the GOSS in hopes of winning their own share of lucrative oil revenues. However, due to high levels of extraction by the GOSS prior to the 2011 referendum on independence, production in the Abyei fields is in decline. This decline means that revenues distributed to the GOSS will also continue to decline. This reduction in transfers has implications for the significance and function of wealth sharing in maintaining the peace with both the GOS as well as any peace process with the armed groups in Abyei. It may turn out that the practical decision to delay resource ownership negotiations may have only been a short-term solution and avoided addressing head-on the underlying roots of resource conflict.

Further, revenue sharing has not yet provided a measureable boost in human development for the South Sudanese. However, there are many reasons behind this lack of progress, including:

- The lack of capacity of GOSS to manage and spend the new revenues;
- Severe prewar underdevelopment, worsened by negative impacts of the war on impoverished populations, infrastructure, as well as administrative capacity (Bure 2005);
- Revenue losses from corruption enabled by weak institutions (Jooma 2007);

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- A risky investment climate created by security problems and political instability; and,
- Limited treatment of land and water rights in the peace agreement, even though these resources are critical to pastoral livelihoods in the south. Widespread population movements and the lack of clarity around rights has spawned an epidemic of small-scale, internal conflicts related to land and water – conflicts that also drain resources and push people further toward vulnerability.

IRAQ: Vague legal language fans sectarian violence
(Adapted from Al Moumin, 2012)

Iraq has the fourth-largest endowment of oil in the world (EIA 2009). The most significant oil fields are in the north, in Kirkuk Governorate near the minority Kurdish semi-autonomous region, and in the south, in Shiite Muslim territories. Under Saddam Hussein's 35-year rule, the interpretation of the 1970 Constitution as granting the central government control over oil fields and revenues allowed him to use this oil wealth to wage brutal campaigns against the Kurds and the Shiites in order to control oil management and revenues, as well as regional wars in an attempt to control the oil fields of surrounding Iran and Kuwait (Revenue Watch 2005).

Since the fall of Hussein, Iraq has been engulfed by religious conflict that some suggest is a contest over power sharing in government, and centers around control over the country's oil wealth and the revenues that are derived from it. Because Iraq's political system is deeply rooted in ethnic and religious identities, these identities have profound implications for competition around the distribution of oil revenues. Since the post-war removal of the Sunni Ba'ath Party, which had monopolized oil revenues under Hussein, Iraq's ethnic and religious groups have been fighting to increase their own share of oil revenues. As the transitional government Environment Minister Mishkat Al Moumin observed: "The post-war constitution was intended to resolve such questions, but the vague and ambiguous language with which it addresses the contentious issue of oil prevented it from playing the role that was envisioned for it—as a legal document that describes how wealth and power will be shared, and thereby contributes to peacebuilding".

The 2005 Constitution reconfigured Iraq into a federal state with eighteen governorates and one autonomous region (the Kurdistan Regional Governorat, or KRG). Disagreements over revenue distribution stem from ambiguity in articles 111 and 112 of the 2005 Constitution. Article 111 grants ownership of oil and gas to "*all the people of Iraq* in all the regions and governorates". Meanwhile, Article 112 states that :

> "The federal government, *with the producing governorates and regional governments*, shall undertake the management of oil and gas extracted from present fields, *provided that it distributes its revenue in a fair manner* in proportion to the population distribution in all parts of the country, specifying an *allotment for a specified period for the damaged regions* which were unjustly deprived of them by the former regime, and the regions that were damaged afterwards in a way that ensures balanced development in different areas of the country, and this shall be regulated by a law." (emphases added)

Deep disagreement remains on what constitutes "fair" distribution of revenues, how much compensation for damage is due to which regions, for how long and to whom (to all residents or only to members of the–ethnic or religious based—ruling party). Neither article provides a framework for ensuring that the various religious and ethnic groups within a region or governorate receive their "fair" share of oil revenues; nor do the articles

specify how much influence governorates have in relation to the federal government. A subsequent oil and gas law to clarify these terms has proven too contentious to be passed by the ethnic and religious parties in parliament.

Iraq's 2009 Budget Law goes some distance toward clarifying the distribution regime. It specifies hydrocarbon revenues must first be used to meet "sovereign expenditures" for national government functions. Of the remaining revenues, 17 per cent is allocated to the KRG, and the remainder is allocated to national ministries in hydrocarbon producing and non-hydrocarbon producing governorates in proportion to their population and needs (Blanchard, 2009). The Budget Law enables the federal government to withhold proportional amounts of national budget transfer to the KRG if the KRG does not pay the revenues it owes to the national government (Blanchard, 2009). However, disagreements over the basic constitutional principles of authority and revenue sharing persist, often violently.

The conflicts between Arabs and Kurds over the KRG, considered by some to be one of the main threats to peace in Iraq, offers an example of the connections between religion, ethnicity, the management of oil reserves, and the distribution of oil revenue (ICG 2008). The dispute concerns whether Kirkuk, an oil-rich territory 150 miles north of Baghdad, is part of the Kurdish region. But this question has implications for who will control ownership and management of Kirkuk's large oil reserves and the distribution of the associated revenues. The absence of a clear legal framework has created fierce competition and violent conflict between the city's two largest communities: the Kurds and the Arabs. It is not clear which group makes up the majority and both sides believe that whichever ethnic group is larger will receive a larger share of oil revenues (Anderson and Stansfield 2009). Each has accused the other of attempting to change the demographics of Kirkuk to gain an advantage (Khalil 2009).

Peru: Containing violence, but not meeting development goals
Adapted from Aresti, 2016 and Munilla, 2010

Rich in minerals and hydrocarbons, Peru has one of the world's largest gold mines, booming silver and copper export industries, as well as widespread oil and gas production. The country also holds significant reserves of coal, iron ore, tin, sulfur, and zinc. In 2014, mining sector contributed 12% to Peru's GDP, and minerals made up 52% of total exports.

However, Peru's increasing extraction of its natural resources and resulting economic growth has yet to significantly reduce poverty for the nearly 60% of the population who live in rural areas, a problem that contributes to ongoing violence between communities and the state as well as with extractive companies. Entrenched poverty and the lack of positive state presence in isolated highland communities were deemed by some to have created the fertile ground for the rise of the communist Shining Path guerilla movement and associated violence during the 1980s and 90s—violence mainly perpetrated by both the Shining Path and the state against highland indigenous communities (Peru TRC).

In addition to the lack of service delivery, indigenous communities have borne the brunt of negative environmental and social impacts from extraction. These impacts have become flash points for conflict between companies and local communities, especially the uncontacted indigenous groups living in voluntary isolation in the Peruvian Amazon. In 2008, for example, an estimated 12,000

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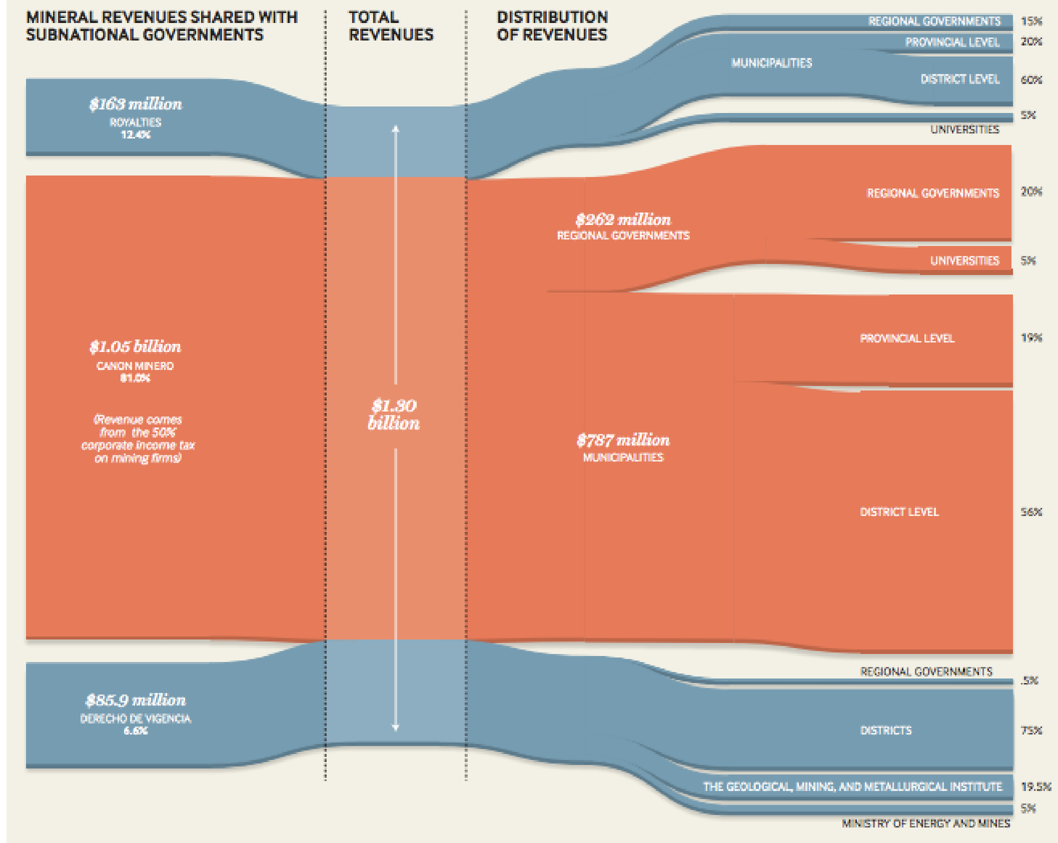
indigenous people throughout the Peruvian Amazon occupied oil and electricity plants until national congress repealed decrees that would have eased requirements for the sale of native land for oil and gas extraction. Protest re-ignited when subsequent laws were found by indigenous groups to be unsatisfactory and a larger suite of laws was passed aimed at catalyzing development in the Peruvian Amazon—a situation that was perceived by communities as a threat to their right to self-determination. Indigenous communities held two months of protests and blockades of roads and major oil pipelines throughout the country. Communities directed their protest at the oil and gas sector, fearing that these laws would facilitate entry into their territories by this and other sectors. In June 2009, clashes between indigenous protesters and police led to fatal violence in the Bagua region of Amazonas after police attempted to break up a road blockade by protesters. After international and domestic outcry, the government was forced to repeal the laws and a national dialogue was established to determine next steps. In 2010, however, the Amazon Interethnic Development Association of the Peruvian Rainforest (AIDESEP), a major national federation representing indigenous peoples, pulled out of the dialogue, citing a lack of progress and the reluctance on the part of the government to accept its share of responsibility for the violence and for addressing underlying causes.

Prior to this, in 2002, Peru's national government launched a decentralization process intended to improve the delivery of basic services to citizens by devolving authority and resources to local governments and by creating regional governments. The Peruvian government created a number of tools for improving coordination among varying levels of government, building SNG capacities, and increasing fiscal transparency and accountability. Focus areas included financial management, investment project management, citizen participation, and outcomes-based management, all of which, in theory, must be adapted and applied by SNGs to manage their budgets, investments, and projects. Implementation has been slow, however. Not all SNGs are yet represented in the centrally tracked financial management system, which provides public access to government budgets, and the investment project-management process has created bureaucratic bottlenecks for inexperienced local governments. The participatory budgeting process, which allows citizens to influence decisions on projects to be financed at the local level, is vulnerable to capture by local elites.

In 2001, Peru passed its first legislation establishing the gas and mining Canons—funds composed of 50% of royalties and 50% of income tax received from the company, and which are transferred from the central government to SNGs in regions, provinces, and municipalities where the resource is extracted. The Canons allocate revenues linked to SNGs according to formulas that give different weights to producing areas. In addition, the Ministry of Economy and Finance uses annual household survey data to formulate a yearly distribution index that weights population, poverty levels, and unsatisfied basic needs. The distribution is progressive, with poorer districts and provinces receiving a greater share per capita than wealthier districts and provinces.

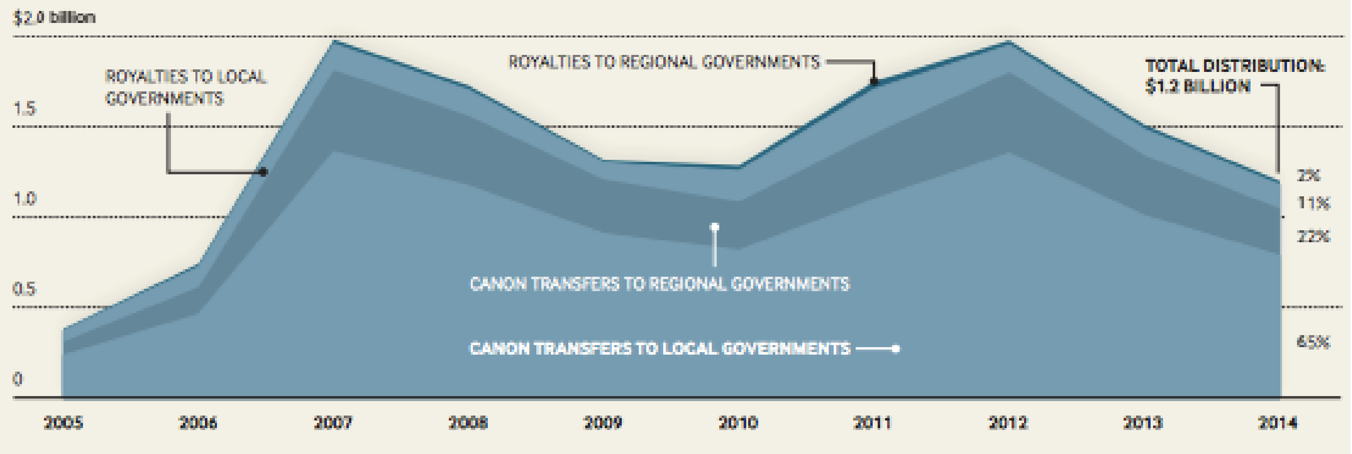
There are also intergovernmental transfers to SNGs of 25% of oil and gas royalties of specific hydrocarbon projects (like the Camisea pipeline) that are distributed to affected areas and earmarked specifically for socio-economic development. However, these royalty payments are considered to be operating costs and therefore are subtracted from company profits and therefore reduce the gas revenues paid to the Canons. A third source of revenue, the subsurface fee (*derecho de vigencia*), is also distributed, but only represents around 5.1% of the total revenue was shared with subnational governments in 2014.



From: Aresti, 2016

Resource revenues are earmarked for development programs and infrastructure capital expenses that benefit the community, rather than SNG operating expenses such as salaries and facilities. However, there is weak evidence that any development indicators have improved in the eight years since the beginning of revenue distribution began.

In fact, there is some evidence for a subnational "resource curse" developing in producing areas of Peru. SNGs have become very dependent on resource revenue distributions to fulfill their new functions. At the same time, transfers have fluctuated wildly with global prices, especially in the last decade since the global financial crisis, making it difficult for local governments to plan long-term spending. Local governments have not instituted "revenue smoothing" mechanisms like saving accounts during price windfalls to buffer periods of low prices. The 2003-2008 commodities price boom and the subsequent decline highlights an important risk for SNGs. Local dependency on natural resource funds can also lead to an erosion of the local tax base and can increase government exposure to fiscal volatility in the form of falling prices for natural resource commodities.



From: Aresti, 2016

The lack of improvement in local welfare is likely due to a mix of corruption and poor revenue management by SNGs. Indeed, studies have found a lack of capacity of SNGs in managing new revenues (Munilla, 2010; ODI, 2006) including problems of:

- "Leakage" prior to the disbursement of funds (embezzlement or misappropriation);
- Poor fiscal reporting;
- Absence of clear laws and regulations regarding revenue collection that creates inefficiencies and disincentives for investment;
- Insufficient institutional and administrative budgeting and spending capacity;
- Limited or no reporting and monitoring of expenditures after they have been made; that
- Result in a lack of accountability.

A study by Munilla (2010) found:

- SNG expenditures have increased substantially, but the majority of investment spending is in infrastructure.
- SNGs are still carrying over significant surplus revenues from year to year, indicating that they not fully addressing development spending needs, as well as missing opportunities to address risks of oil price volatility and to prepare for the eventual decrease in gas revenues.
- SNGs have made progress in establishing institutions and procedures for fiscal management, as evidenced by the existence of almost all of the legally mandated operational documents and units, and by new models to manage projects in more remote locations. However, these documents are rarely used in day-to-day administration.
- A lack of planning documents at the municipal level suggests that SNG strategic planning and implementation capacity remains weak and that investment choices are not based on a medium-to-long-term view or on a coherent strategy. SNGs may be ill-prepared to assess and mitigate the potential impacts of infrastructure expansion in environmentally and socially sensitive regions or to ensure an equitable distribution of costs and benefits.
- SNGs have made progress in designing mechanisms for providing public access to information, but these mechanisms still fall short of what is required by Peruvian law and what is necessary to enable citizens to hold SNGs accountable. Further few members of the

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public and civil society have the capacity to make use of this information to conduct oversight.

Finally, some view the revenue sharing mechanisms to have been a political tactic to contain rural violence while avoiding the deeper and more difficult problem of obtaining community consent and participation in resource management (Arellano-Yanguas, 2009). This is a particularly contentious topic in indigenous areas, where communities have constitutionally recognized territorial rights but where these do not include subsurface rights to minerals or hydrocarbons. The state reportedly has remained reluctant to engage local communities in resource management decision-making or require Free, Prior and Informed Consent (FPIC) because they fear it will amount to granting communities "veto power" in resource allocation. (Arellano-Yanguas, 2009)

Sierra Leone: Direct cash transfer to delivers aid to communities but cannot uproot inequality

Adapted from: Maconachie, 2009, 2012

Sierra Leone is a constitutional republic divided into thirteen districts. Each district is subdivided into chiefdoms, which is the basic unit of local government outside the capital, Freetown. The model of decentralization adopted in Sierra Leone assumes that traditional leaders at the chiefdom level (that is, the paramount chiefs and the native administrations) will work alongside elected councilors, with the chiefs taking responsibility for rural security, justice, and land issues, and the councils taking responsibility for service delivery and rural development.

Sierra Leone endured decades of a brutal civil war that engulfed neighboring countries and deeply scarred its population and economy. Diamonds were a central feature of the conflict because they provided funding to allow the various factions to continue fighting. The Diamond Area Community Development Fund (DACDF), an initiative of the central government in Sierra Leone, was designed to change the use of diamond revenues from supporting war to supporting peace and development.

Chiefdoms benefit from the DACDF in accordance with the number of mining licenses issued and the value of the diamonds recovered from their territory. The DACF is funded by 3% of diamond export taxes (amounting to 0.75% of the total export value) and is disbursed to paramount chiefs in diamond extraction areas, to fund projects that improve community welfare and development status. The fund is also designed to provide incentives for artisanal miners (who make up 80% of the country's alluvial diamond production) to be licensed (and taxed) by government and their production reported, thereby bringing this sector "onto the books".

Even though the revenue share is a tiny fraction of the true value of the diamond wealth extracted, under the DACDF, an unprecedented amount of diamond revenue has been returned to diamond-mining communities. The first tranche was made in 2001, and by the end of 2006 US$3.5 million had been disbursed to diamondiferous communities (Temple 2008). Much evidence suggests that some chiefdoms and local councils have used the fund wisely, financing local infrastructure, education, health services, and vocational-skills training centers (Temple 2005).

However, considerable challenges—particularly in the early days of the initiative—impeded the achievement of the fund's goals. Concerns about the DACDF focus primarily on four areas:

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- The effective use of funds by local government;
- Transparency and accountability in the use of funds;
- The lack of impact on the unlicensed and unreported mining and trade; and,
- A lack of public awareness and citizen participation, particularly youth and women, in decision-making about the use of the fund.

While some chiefdoms have demonstrated the capacity to use the DACDF effectively, many have not due to their lack of capacity, corruption, as well as lack of participation by the local community. The first disbursements from the DACDF were made directly to the paramount chiefs by the central government in the form of a check, which was often presented publicly in the community town hall, with the entire community present. There was little effort to prepare the community for the arrival of the disbursements or to explain the origins of the revenue. A number of chiefs, as well as community members, were confused about the intended use of the fund. During these initial years, accountability was poor, and many chiefs were unable to explain how their DACDF allocations had been spent.

In 2002, a series of reports found that a number of chiefdoms were not making competent decisions about the use of the fund (Temple 2005). Consequently, in 2003, the DACDF Coalition—consisting of representatives from the Ministry of Mineral Resources, the Ministry of Local Government, national and international nongovernmental organizations (NGOs), the Anti-Corruption Commission, and the Miners' Union—was set up to improve public awareness and ensure that the fund was used more effectively. Evidence suggests that since its creation, the coalition has helped chiefs improve their fiscal management skills and their responsiveness to community interests. However, the government's High Level Diamond Steering Committee (HLDSC) continued to be concerned about the misuse of the DACDF, which eventually led to the suspension of disbursements at the end of 2006.

To improve participation and improve oversight, civil society lobbied for the creation of chiefdom development committees (CDCs) to be composed of a wide cross-section of elected chiefdom residents. Reports suggest, however, that the CDCs have more often been composed entirely of members of the rural elite, such as section chiefs and other "yes men" (Temple 2005). One study noted that a "consistent trend of poor participation by grassroots stakeholders in project decision-making" explains why most DACDF projects are concentrated around chiefdoms or district headquarters towns (NMJD 2006). Because the CDCs have handled the funds at the local level, without any reporting mechanisms or systematic oversight from the Ministry of Mineral Resources, local abuses of power have flourished (NMJD 2006).

One report suggests that a technical team with experience and skills in participatory community programming could provide technical assistance to strengthen community capacity and ensure that the CDC represents a genuine cross-section of the community; help communities identify their needs; and review proposals for development projects (NMJD 2006). However, the ability of a technical team to successfully circumvent the hierarchical power structures within Sierra Leonean society and facilitate more equitable community participation remains unlikely. **Consequently, one of the most important lessons is that citizen engagement is always mediated by existing power relationships, which are deeply entrenched in rural Sierra Leone.** In fact, some argue that it was power imbalances between older rural elite and youth that were a central cause of the war; inequalities that have remained unaddressed post-conflict (Richards, 2005). An uncritical,

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depoliticized vision of precisely who constitutes "community" and what it will take to sufficiently empower people so they can meaningfully participate in the development process not only risks the failure of the DACDF but may further fuel the divide between rural elite and the disenchanted youth and risk spoiling the peace.

In August 2008, with the hope of addressing the Fund's weaknesses, the Ministry of Mineral Resources developed a new set of procedures and guidelines. The new system features rigorous monitoring and an extensive paper trail: communities are now required to elect chiefdom project-committees, which then submit a project proposal form for approval to a local review committee made up of the district administrator, the provincial administrator, and the government mines engineer, from the Ministry of Mineral Resources. If the local review committee accepts the community proposal, the work is put out to bid to local contractors in the chiefdom, followed by monitoring and evaluation to ensure that the funds are being spent properly. To be successful, significant support to local communities to meet these new requirements is essential.

In February 2009, to get the ball rolling, the government released the first of four backdated allocations (January–June 2007) without having received any community proposals. Communities that wish to access the remaining three allocations, however, must submit proposals. The strict new monitoring procedures are intended to improve the use and management of the fund and to increase accountability. But the underlying issue of how community members participate in decision-making remains largely unaddressed. Whether communication between the CDCs and the community will improve—allowing for greater transparency in the selection of projects, the hiring of contractors, and payments to suppliers— remains to be seen.

Local government, however, is not the only site of corruption and lack of capacity. For decentralized resource management to be effective, there must be a clear line of accountability, both at the local and at the central government level. As Jesse Ribot (2002) has pointed out in other contexts (see Chapters 1 &2), decentralization is more successful if there is a capable and accountable central government to guide and oversee it. In the case of Sierra Leone, there are significant concerns about the lack of transparency and accountability within the central government, where most diamond revenues accrue (UNDP 2007). Further, the government continues to suffer from significant leakage of funds from illegal mining and smuggling operations that continue to thrive, with protection from powerful elite. Some estimates are that 50% of the countries diamonds are exported illegally (Partnership Africa Canada and Network Movement for Justice and Development, 2006).

Some argue that for all the destruction and disruption caused by civil war, peace in Sierra Leone has opened up new spaces for participation that could potentially change social rules and institutional practices if they continue to be fostered. However, many of the patrimonial institutions and practices that shaped natural resource access during the pre-conflict era may have been preserved, and in some cases even strengthened, during the post-conflict period.

The DACDF is one example of these dynamics. Among the major goals of the DACDF are to redress unequal power relationships within the diamond industry and to ensure local decision - making about diamond resources is more equitable. But the DACDF has so far largely failed to address many of the underlying power issues that shape decision-making at the local level. Although the Sierra Leone Ministry of Mineral Resources has developed a new set of procedures and guidelines to address the shortcomings of the DACDF, it remains unclear whether these guidelines

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will address the fundamental issue: namely, how community members participate in decision making about natural resources.

Security concerns remain high in diamondiferous areas, where large numbers of uneducated, unemployed, and potentially volatile youth have little ability to make meaningful choices in their lives. The legacy of economic oppression and political exclusion from public decision-making continues to be a source of considerable concern: history has shown that identity and interest-based inclusion (and exclusion) in public decision-making can fragment communities and ignite conflict (Ribot 2004). Observers warn that, if the Sierra Leone government chooses to give priority to the sustainable development of mineral resources as a key part of its reconstruction program, it must rethink the impact of these policies given its resilient power structures. Even where citizens are invited to participate in intentionally-designed institutional spaces, local actors' full and fair participation in the decision-making process cannot be assumed. Furthermore, although participation and transparency are necessary for accountability to develop, they are not *on their own* sufficient where strong interests are in place that favor the *status quo*.

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