

**Lessons from Global Evidence & Experience on
Governance and Anticorruption -- and Implications
for Ukraine (*with Natural Resources focus*)**

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Panel at the Media Crisis Center,
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The Natural Resource Governance Institute (NRGI) & EITI

Ideas

- Extractive Industry Transparency Initiative (EITI) and mandatory disclosure standards
- Resource Governance Index
- Natural Resource Charter
- Research: Contracts, tax regimes, revenue sharing, revenue management, local content, transparency and accountability

Technical Assistance

- Fiscal regimes and contracts (e.g., Ghana, Guinea, Mongolia, Sierra Leone)
- Revenue management and distribution (e.g., Canada, Ghana, Indonesia, Libya, Mongolia, Myanmar, Nigeria, Peru, Timor-Leste)

Capacity Building

- Parliamentary training program
- Training hubs (e.g., Oxford, CEU, regional)



Outline

- **Challenges of managing non-renewable resource revenues**
- **International experiences (& Implications for Ukraine) of Natural Resource revenue management:**
 - **Macroeconomic frameworks**
 - **Sovereign wealth funds**
 - **State-owned company reform**
 - **Resource revenue sharing**
 - **Transparency & Accountability (& EITI)**
 - **Tax Reform & Anti-Corruption Considerations**

Macroeconomic management: Why treat oil, gas and mineral revenues differently?

Oil, gas and mineral revenues:

1

Can represent large capital inflows

2

Are volatile and uncertain

3

Are finite

4

Are “free money” that are not directly tied to citizens



Results in specific challenges

Common tools and institutions used to manage and distribute natural resource revenues

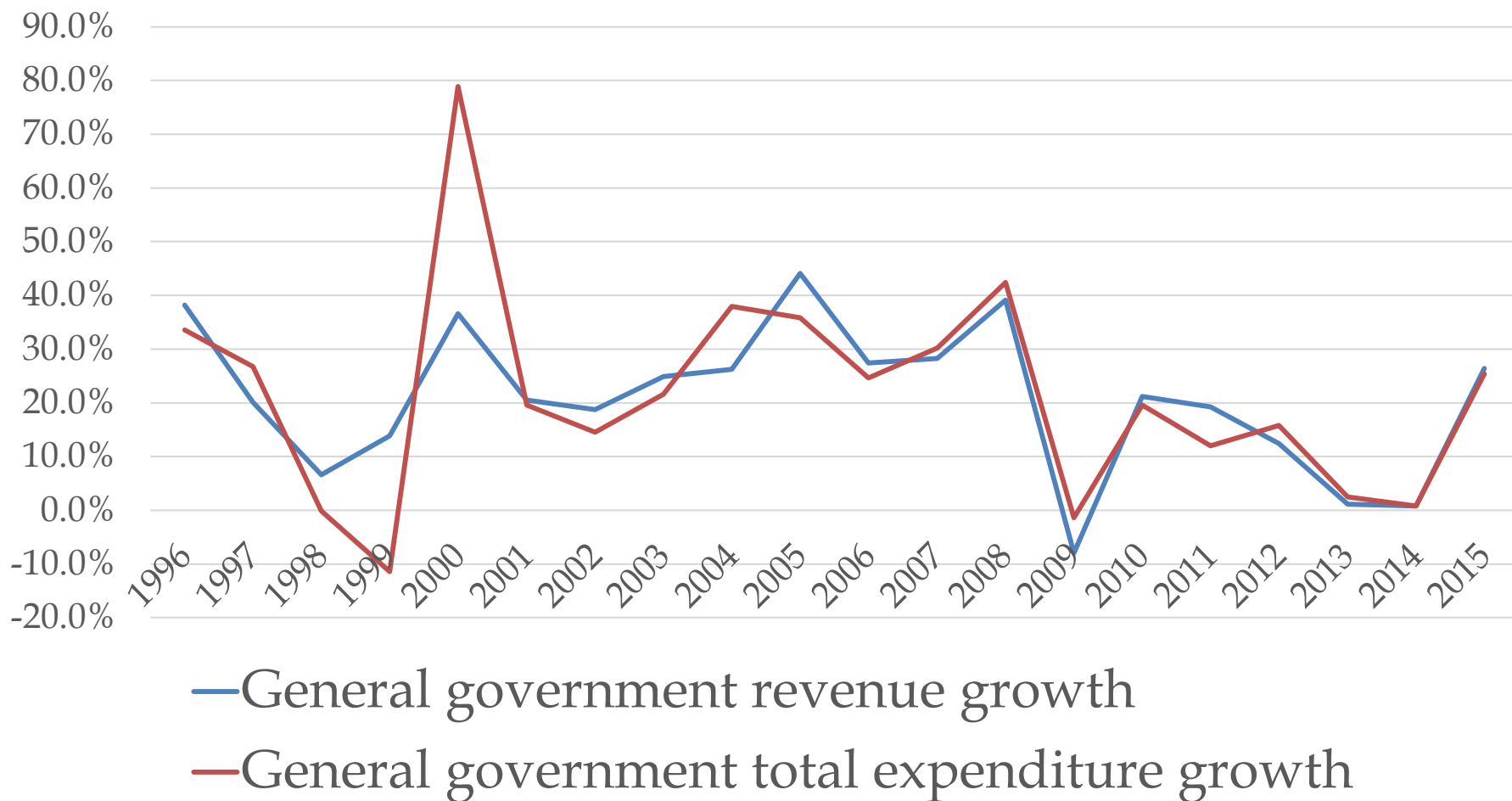
- Policies and tools
 - Macroeconomic frameworks and fiscal rules
 - Revenue forecasting
 - Transfers to subnational entities
 - Budget planning
 - Monetary policy
- Institutions
 - Sovereign wealth funds
 - National oil or mining companies
 - Development banks

How resource dependent is Ukraine?

- Coal, iron ore, titanium ore, uranium and manganese ore producer, plus some gas production.
- Non-renewable resource rents represented approx. 7.7% of GDP in 2013.
- Gas transit revenues represented USD 2-4 billion per year from 2013-15 (5-15% of fiscal revenue).
- Minerals and fossil fuels represented 33.4% of exports in 2012.

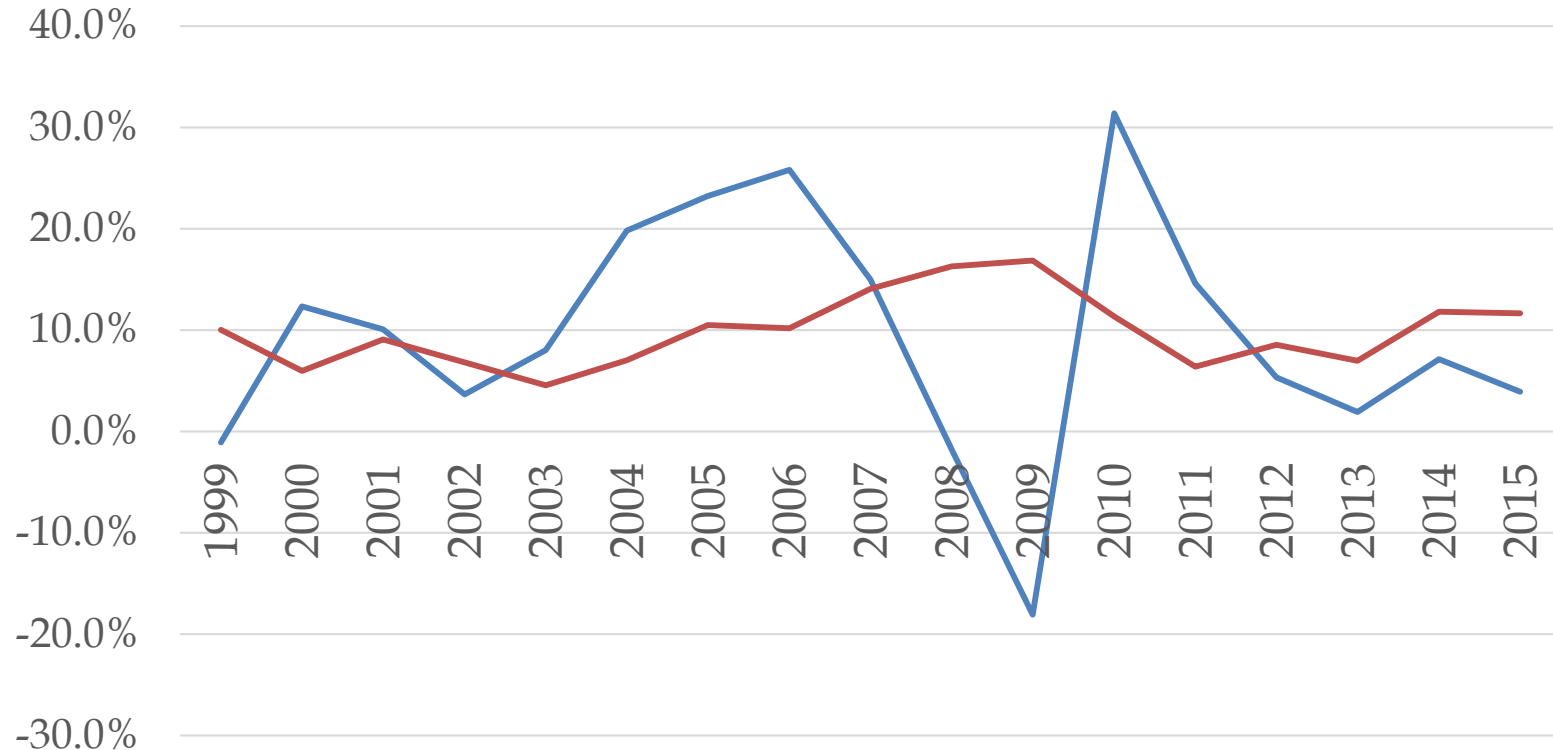
Is expenditure volatility a problem in Ukraine?

Pro-cyclical fiscal policy in Ukraine



Expenditure volatility in Chile

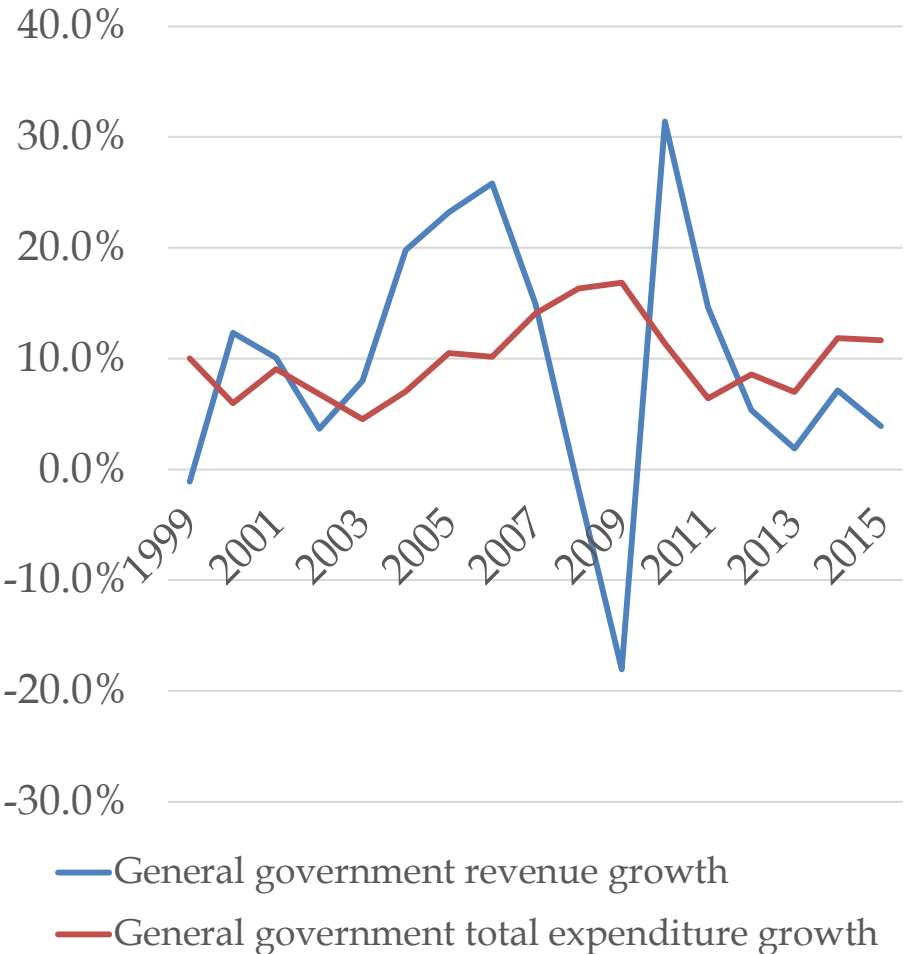
Counter-cyclical fiscal policy



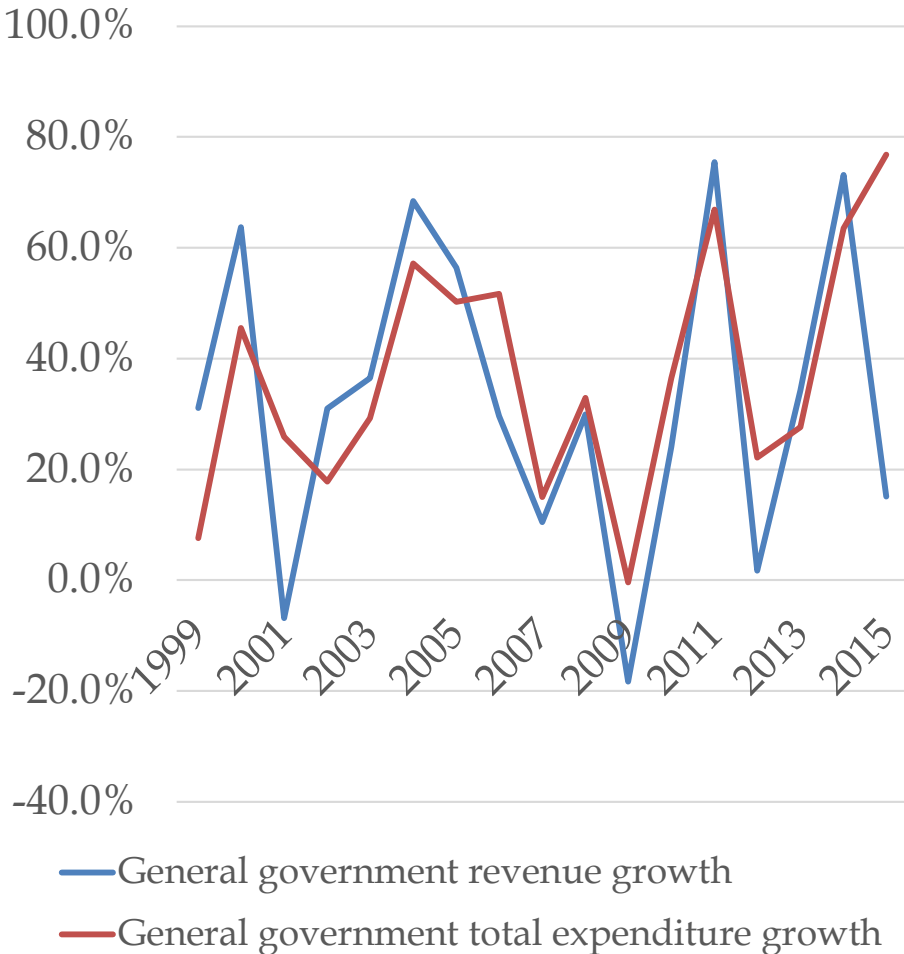
- General government revenue growth
- General government total expenditure growth

Expenditure volatility in Chile and Venezuela

Chile



Venezuela



Data source: IMF WEO

What revenue management tools exist in Ukraine?

- Macro management: Annual deficit targets as part of IMF program; no fiscal rules
- National oil / mining companies: Large deficits and cash calls; off-budget borrowing (e.g., Naftogaz; Severgeologiya; Zaporozhye Titanium & Magnesium Complex (ZTMK))
- Subnational transfers: Existing fiscal decentralization, currently under review
- No sovereign wealth fund (ok for now)

Three questions following a discovery in extractives

1. How much resource revenue should we *spend* and how much should we *save*?
2. How should we *save*, by paying down public debt or in a sovereign wealth fund?
3. What mechanisms should we use to *spend* our resource revenues most efficiently?

What is a fiscal rule?

Definition: A permanent quantitative constraint on government finances

How do they work?

- Constrain spending in good years so the government can spend more in bad years
- Stronger monitoring of government budgeting since there is a benchmark to measure against




What mechanisms promote compliance?

- Robust organizational structure
 - Economic development ministry or agency
 - Compliance or audit within the bureaucracy
- External oversight
- Consensus building




Sovereign wealth funds: Help or hindrance?



Some have helped countries escape the “resource curse.”

- Chile
- Norway
- Timor-Leste
- Some Persian Gulf states
- Several U.S. states



Others have been mismanaged, not met objectives or become slush funds.

Some in :

- Central Asia (e.g., Russia)
- Latin America (e.g., Venezuela)
- MENA (e.g., Libya)
- SE Asia (e.g., Malaysia)
- Africa (e.g., Equatorial Guinea)

What has made the difference are the rules, institutions and oversight.

Good Governance of SWFs

1. Set clear fund objectives
2. Establish fiscal rules
3. Establish investment rules
4. Clarify good institutional structure
5. Require extensive disclosure and audit
6. Establish strong independent oversight

If Ukraine establishes a Sovereign Wealth Fund at some point...

- **Stabilization objective is more important than savings**
- **Have clear deposit and withdrawal rules**
- **Limit investment risk in legislation**
- **Integrate with budget (no 'off-budget' funds)**
- **Require extensive disclosure and independent audit (& with EITI)**



www.resourcegovernance.org/nrf

SWFs & SOEs & Subnational

- SWFs: Not top priority now
- SOE reform & beyond: a key priority
- Subnational / Revenue Sharing: priority

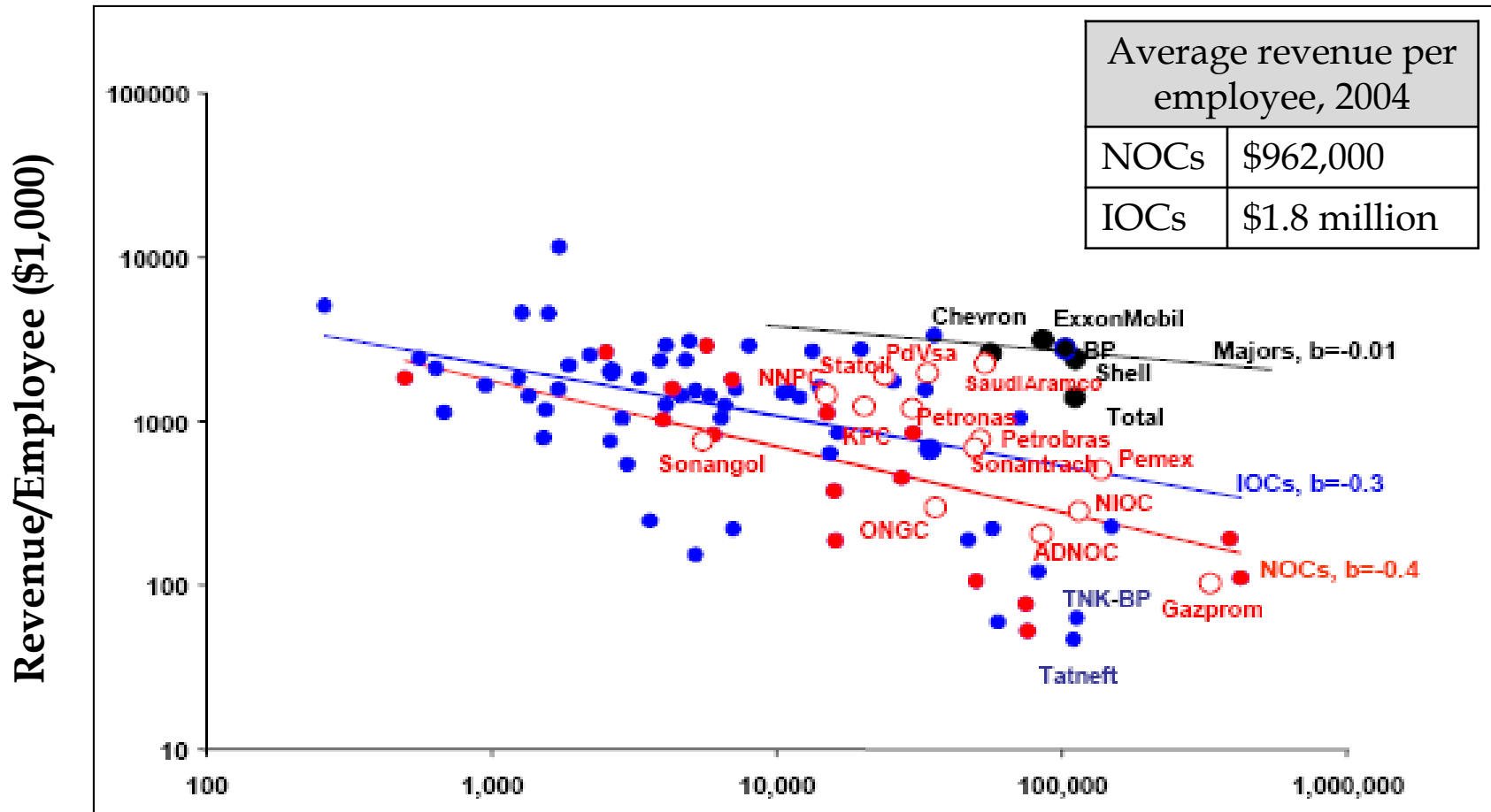
Benefits and risks of SOE participation

Some benefits that a country can gain from an SOE in NRs?

- **Development of national skills**
- **Long-term economic control and financial returns**
- **More effective state control over the pace and development of the industry**
- **Stimulator of local content and positive economic spillovers**



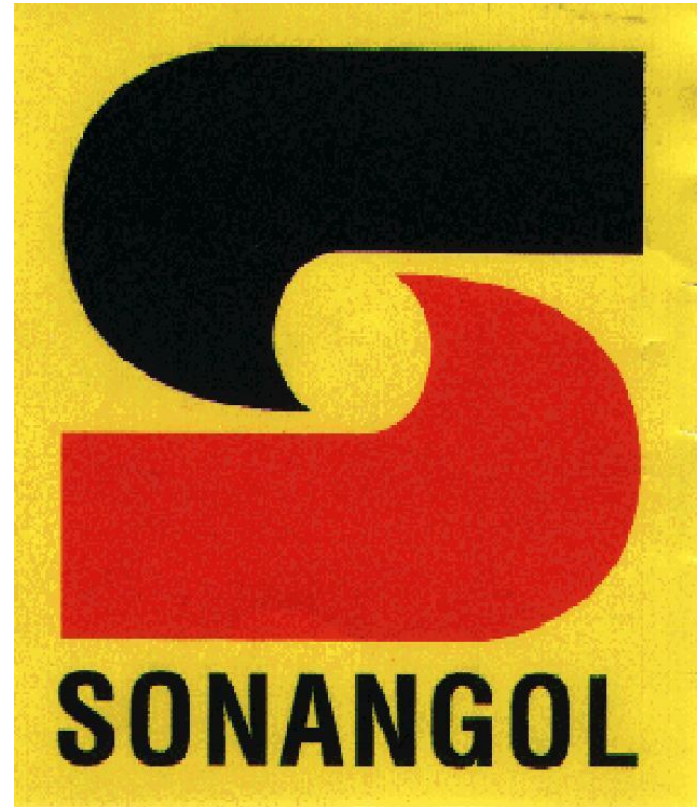
Inefficient project development and revenue collection



■ NOCs
 ■ IOCs
 ■ Majors

Extra-budgetary expenditure

**\$31
billion**



Financial risk to taxpayers

- Mexico
 - Pemex's \$127 billion in unfunded pension liabilities; one third to be taken over by Mexican government
- Nigeria
 - "Cash calls" are a major drain on taxpayers (\$7 billion in 2010)
 - Petrol subsidies cost \$11 billion in 2008-09
 - Refineries lose hundreds of millions of dollars per year



Good Governance of SOEs

- 1. Define mandate clearly**
- 2. Develop a workable revenue retention model**
- 3. Publicly list SOE shares where feasible, allow private participation**
- 4. Independent and professional boards**
- 5. Invest in staff integrity and capacity**
- 6. Audits, transparency and legislative oversight**

Objectives of resource revenue sharing (subnational)

- **Compensation for the negative impacts from extraction**
- **Conflict mitigation and prevention**
- **Local claims for benefits based on idea of local ownership**
- **Regional income inequality between producing and non-producing regions**
- **Balancing Objectives**



Key points on resource revenue sharing

- A** No 'best practice' in fiscal decentralization except rules, transparency and oversight
- B** Fiscal transfers should be linked to expenditure responsibilities
- C** To reduce conflict and ensure stability, any specific allocation regime for oil, gas or mineral revenues should serve one or several nationally-agreed objectives

Complementary Reform Measures to Improve Revenue Management:

1. Tax Reform

- Simplification of the Tax Code Regime
- Closing extensive tax loopholes
- Tax Rates consistent with major deficit reduction (*cannot be lowered now*)
- Reformed tax code for natural resources/gas, shifting from royalties to profit tax in gas: better incentives for investment (but ensure tax collection and No transfer pricing/tax loopholes)

Complementary Reform Measures to Revenue Management: 2. Anti-corruption measures

- **Rules-based: i) budgeting; ii) project appraisals; iii) procurement, & iv) monitoring, for all budget expenditures (national & subnational) and SOEs**
- **Strong conflict of interest rules: *business out of gov't***
- **Independent external audits for capital projects, special funds and state-owned enterprises**
- **Parliamentary oversight and independent boards of state-owned enterprises**
- **Transparency of all resource revenue flows – online and easy-to-read format -- & working towards Ukraine compliance in EITI; Contracts/B.O.**

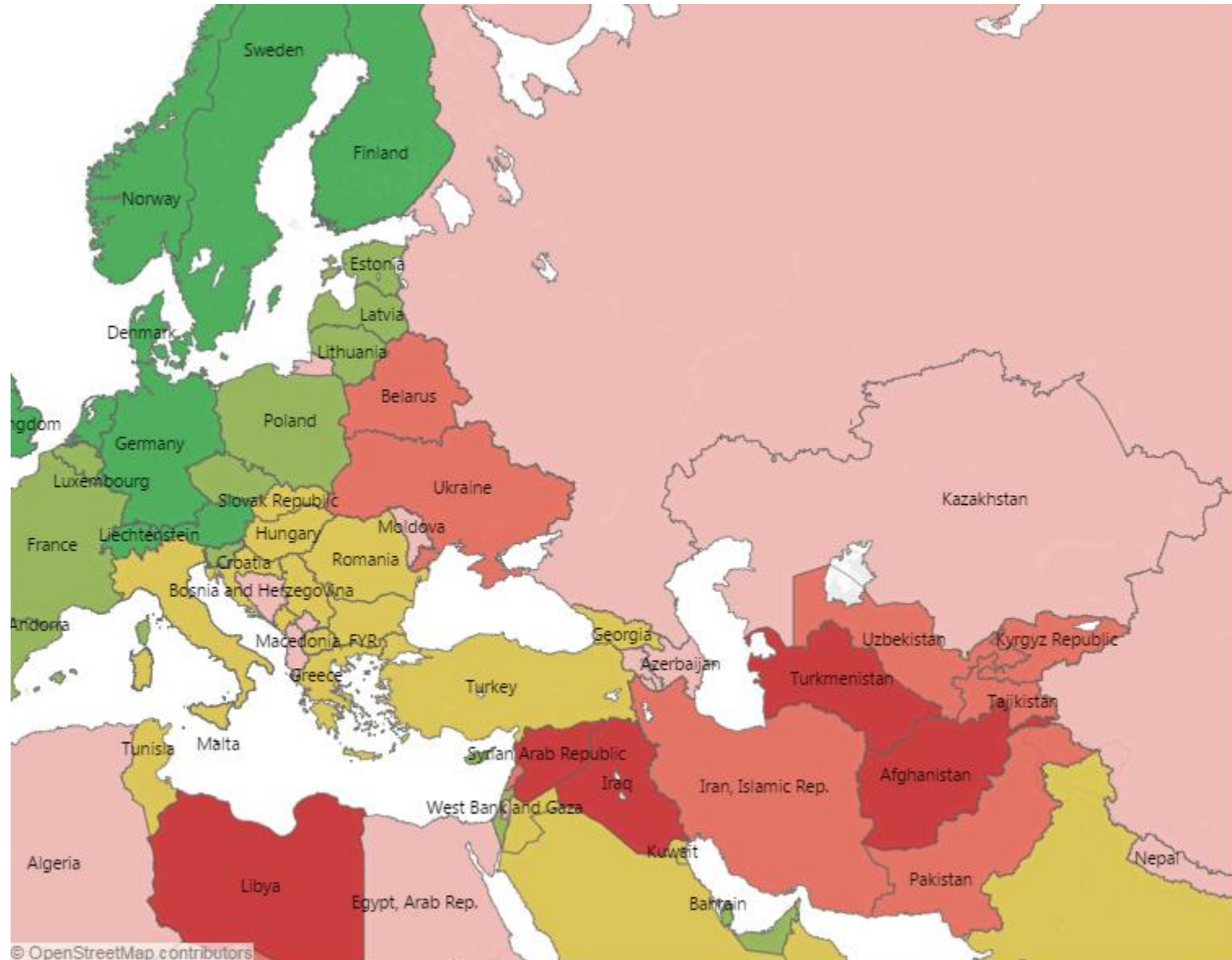
Extractives Industry Transparency Initiative (EITI): Ukraine is in it, and progressing!

- **Commendable that the 1st Ukraine EITI Report was produced**
 - **Serious work by Multi-Stakeholder Group (MSG)–model?**
- Improvements Needed regarding standards of Transparency:**
- **Disaggregate by company; Report acknowledges this & recommends fix..**
 - **Recommends addressing confidentiality obstacles for info:**
 - **technical information about mineral resource reserves;**
 - **some license allocation information; special resource use permits; financial & technical criteria**
 - **recipients of special permits & deviations from legal/regulatory provisions governing these special permits**
 - **list of participants of auctions for purchase of special resource use permits & conditions of such auctions**
 - **contracts, agreements and any other documents concluded between the Government (incl SOEs) & any legal entity (related to mineral resources)**
 - **Report should not interpret fact that legislation does not *require* disclosure means *barring* disclosure**

Yet much more is needed on anticorruption...beyond natural resources

- An important start...
- But deeper, and implementation...

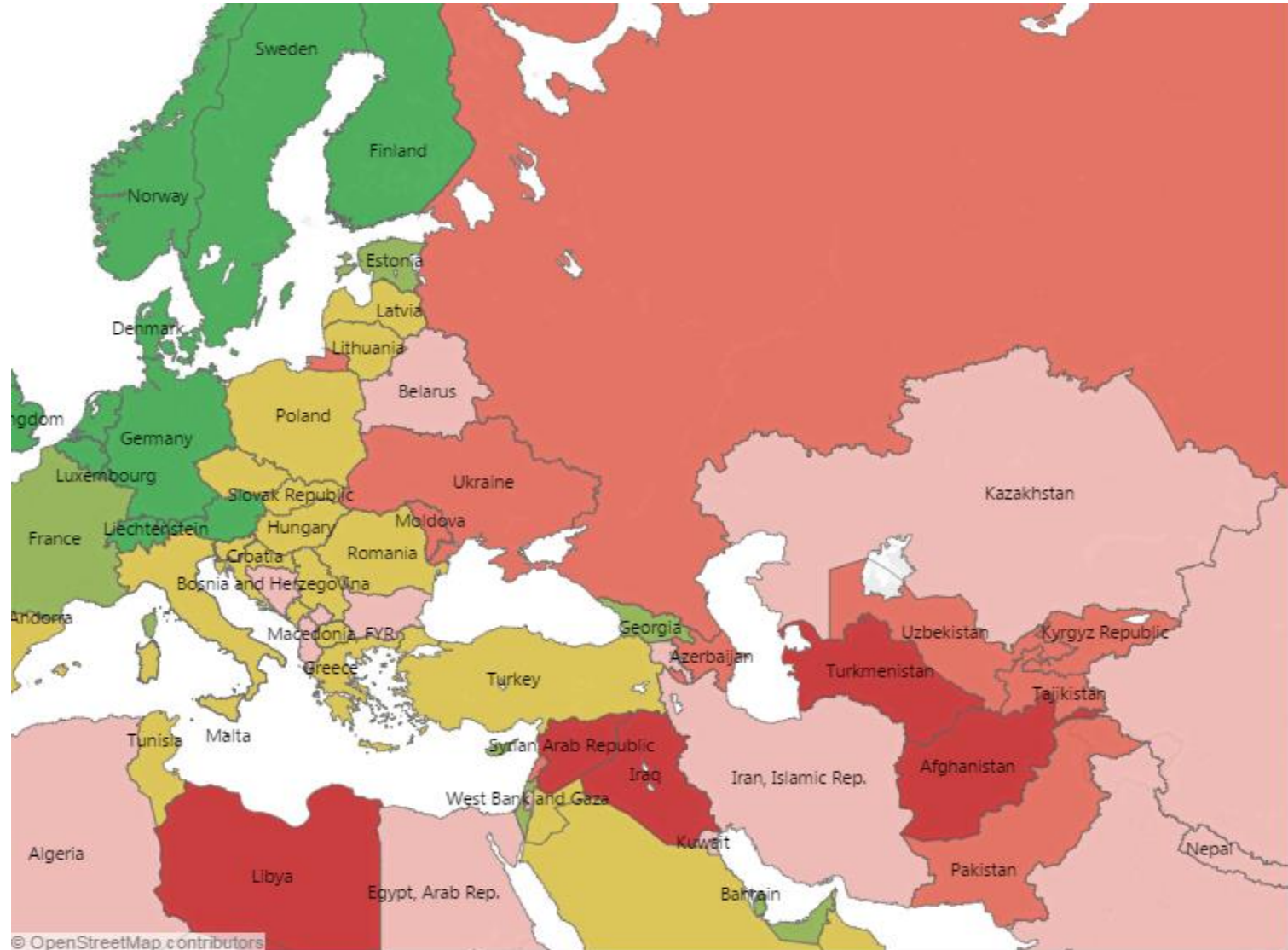
2014 Rule of Law



Percentile Range

□ No Data for Country ■ 0-10th ■ 10-25th ■ 25-50th ■ 50-75th ■ 75-90th ■ 90-100th

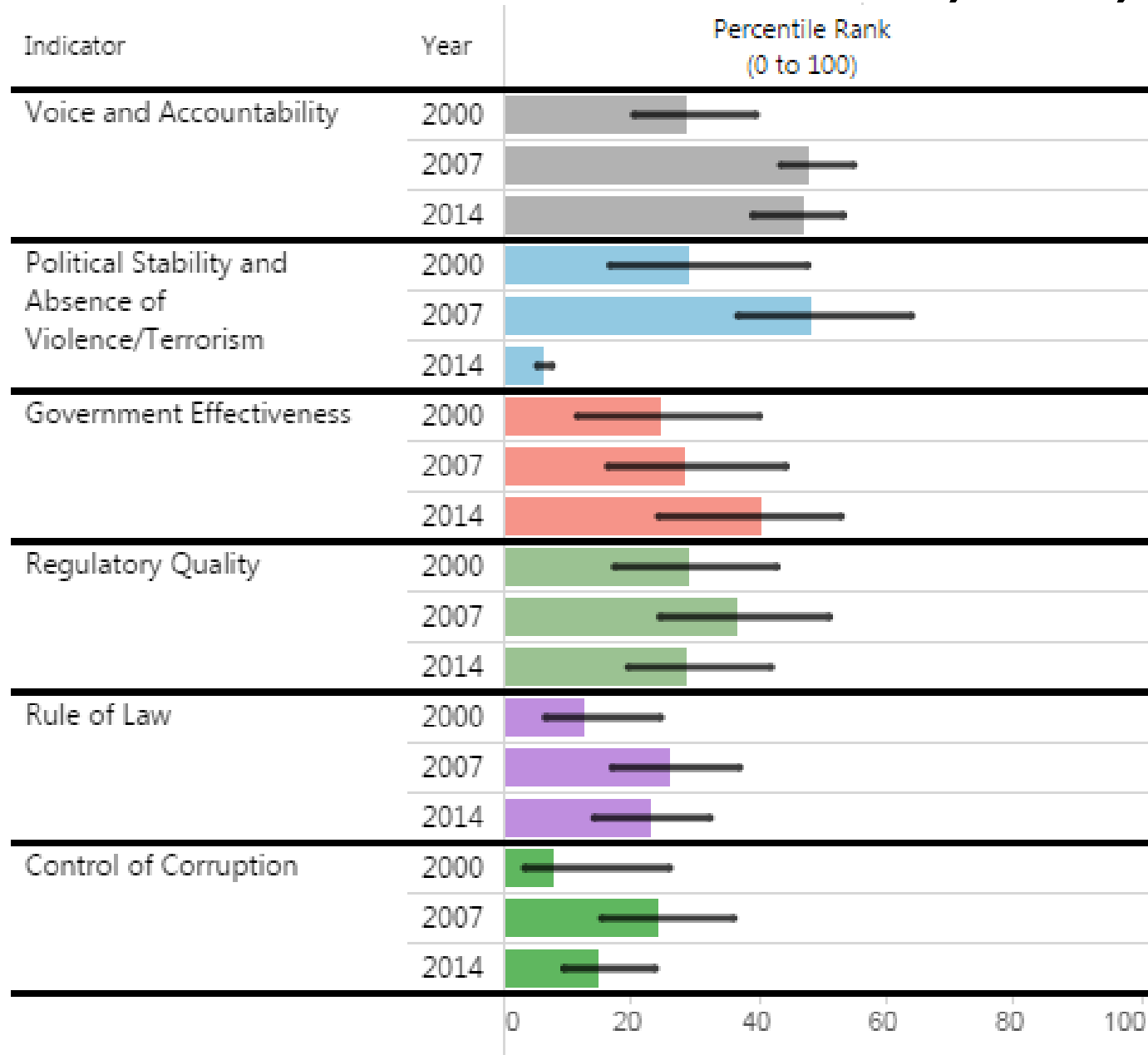
2014 Control of Corruption



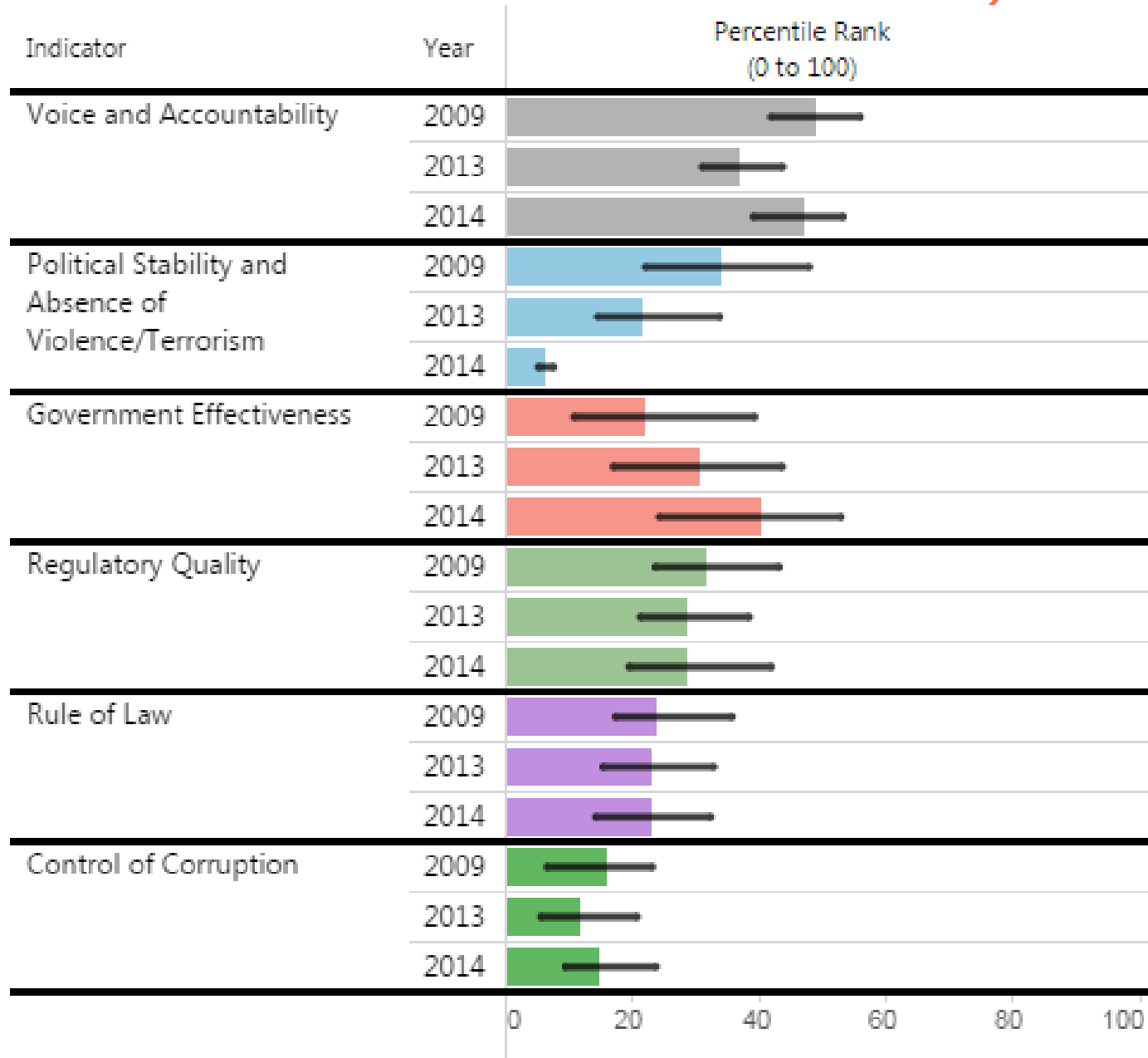
Percentile Range

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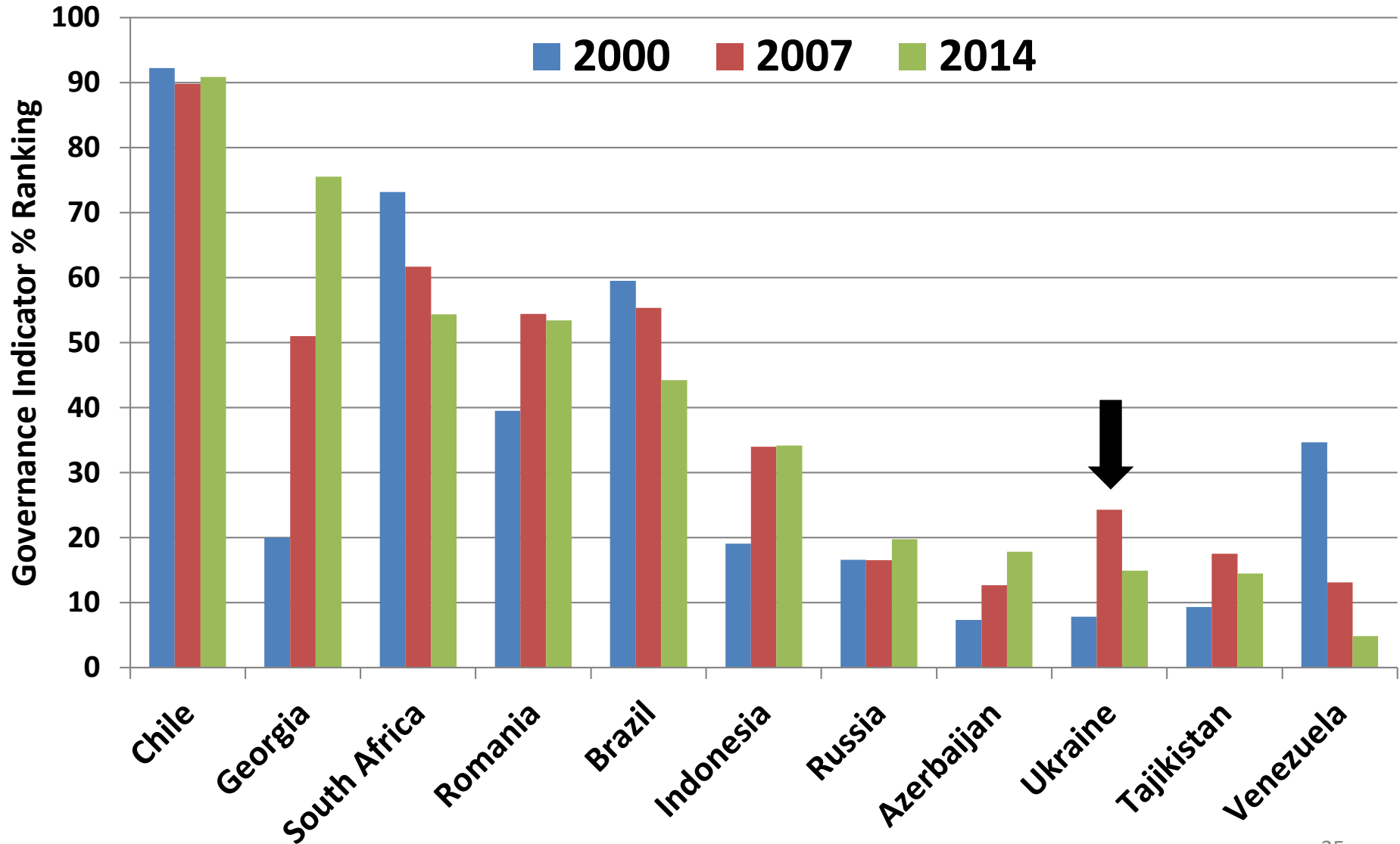
Ukraine Governance Indicators: 2000, 2007, 2014



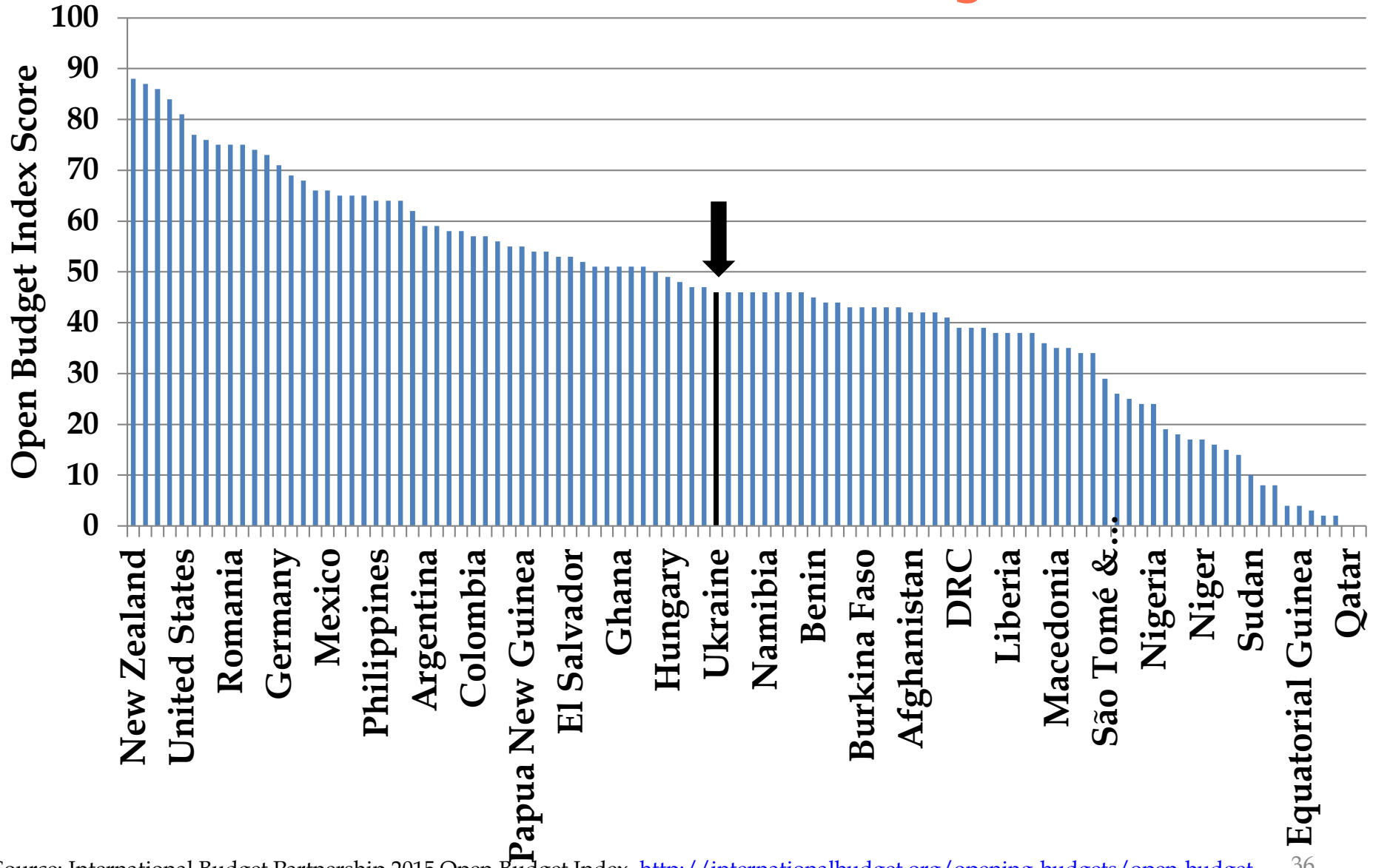
Ukraine Governance Indicators: 2009, 2013, 2014



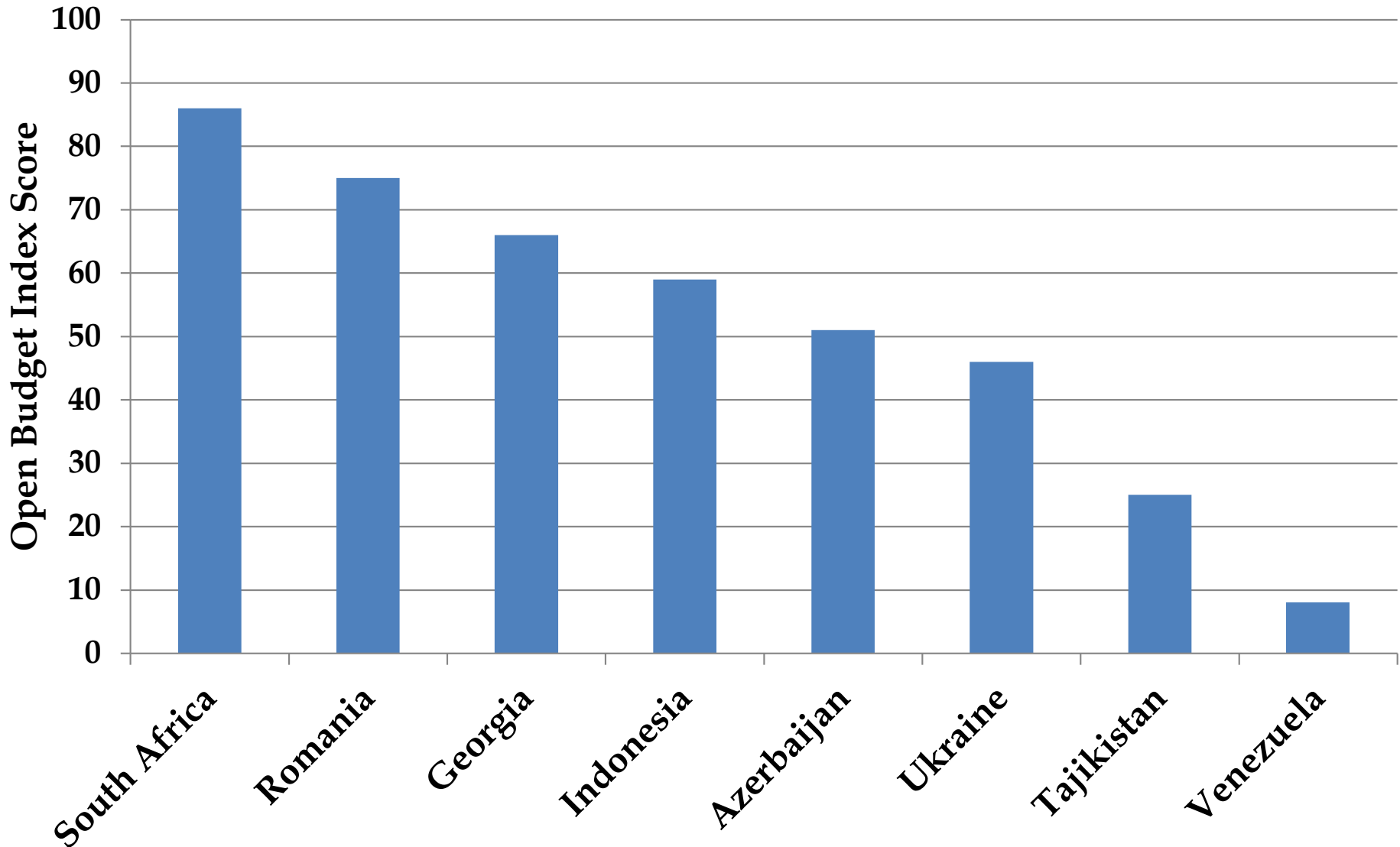
Worldwide Governance Indicator Trends: Control of Corruption in Select Countries



2015 Open Budget Index: Ukraine score: 46. It ranks 49th among 102 countries



2015 Open Budget Index: Select Countries



How good revenue management can reduce corruption

- **Smooth budget spending focuses government on social services rather than infrastructure projects, the largest sources of corruption**
- **Sovereign wealth funds can be huge sources of corruption, especially via asset allocation and patronage positions – strong rules on asset allocation and conflict of interest, along with transparency and independent oversight, can prevent mismanagement**
- **State-owned enterprises can also be huge sources of corruption, especially via procurement and patronage positions – strong financing and procurement rules, audits, independent boards, transparency and parliamentary oversight can help reduce incidences**

Snapshot of Corruption in Ukraine

- Judiciary: widespread corruption, nepotism and vulnerable to political influence; questionable and opaque court decisions
- Police: pervasive corruption, extortion and abuse of power; subject to political control as enforcement agencies lack autonomy
- Public Services: bribes are often needed to get even basic services, increasing costs of getting permits and licenses
- Public Procurement: no transparency or effective regulation, bribes are needed to win government contracts and legislation exempts tenders by government agencies and SOEs from transparency and competition requirements
- Natural Resources: endemic graft, corruption and lack of transparency; extraction and transportation of oil and gas controlled by SOE Naftogaz; regulations and pricing adjusted to benefit business elites close to politicians

Anti-Corruption Reforms in Ukraine

- Proposed International Anti-Corruption Mission to bring in outside investigators from the U.S. and elsewhere to assist in corruption cases
- Establishment of National Anti-Corruption Bureau, National Agency for Prevention of Corruption, and Specialized Anti-Corruption Prosecutor's Office
- Political reform to deoligarchize government (no tycoons in the Cabinet) and legislation to provide public financing of political parties to further reduce influence of oligarchs
- Oil and gas sector reform to break up monopoly of Naftogas, take out intermediaries, impose fees on distributors for access to gas networks, and oblige companies to publish reports to increase transparency
- Judicial reform package designed to shield judges from political interference
- Legislation on open data and access to public information

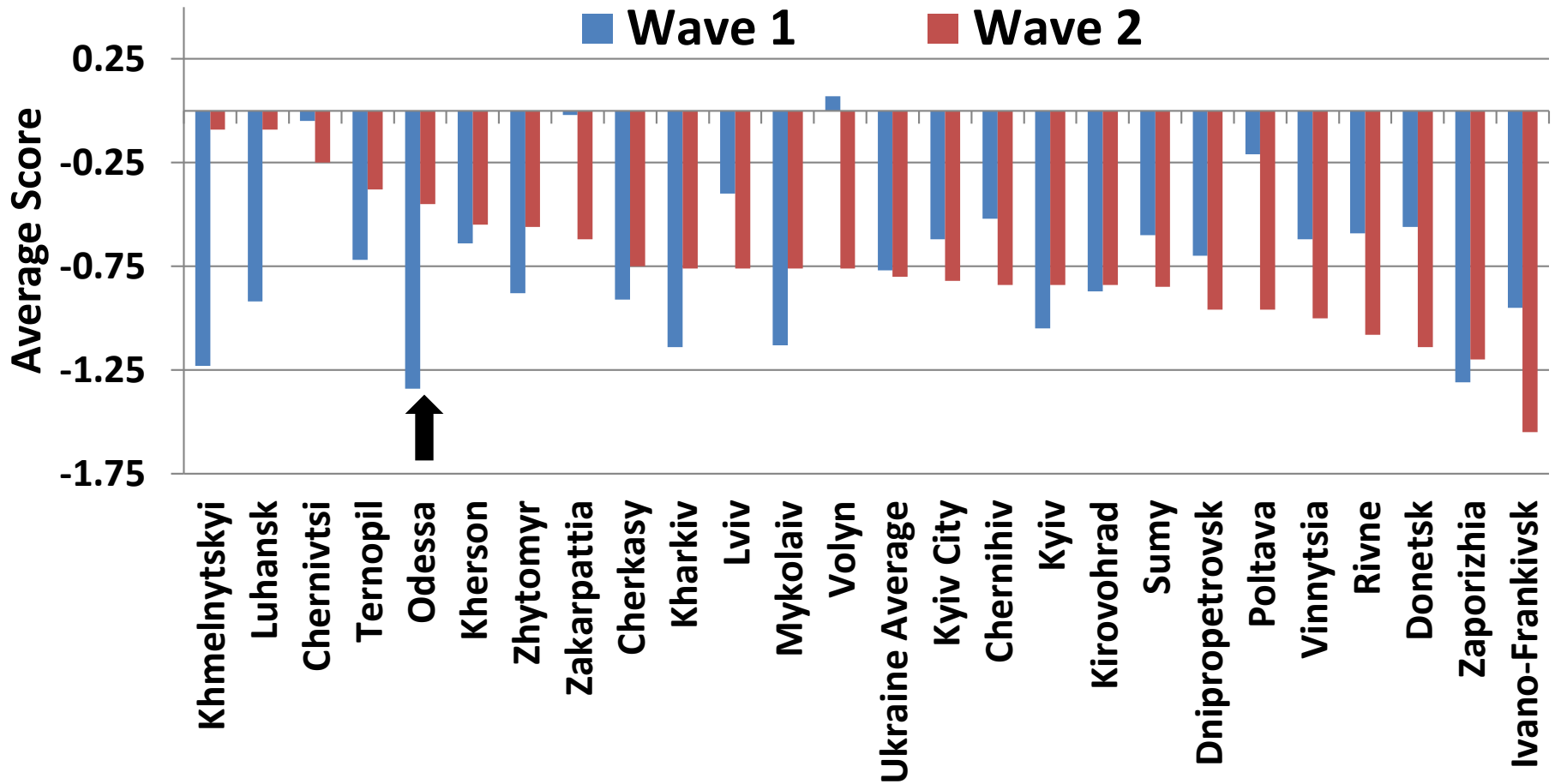
CONCLUDING, 1: IMPROVING GOVERNANCE

- 1. Adoption of macroeconomic framework with rules to improve fiscal sustainability and lower budget volatility**
- 2. Transparency and oversight of natural resource revenues (as key for effective revenue management), with EITI**
- 3. Major Reforms of State enterprises in extractives**
- 4. Governance & Accountability in Subnational transfers**
- 5. Tax Reform that simplifies, no loopholes, & improves fiscal sustainability**
- 6. Effective implementation of Anti-corruption program with: i) support from the top; ii) tax reform; iii) subnational anticorruption; iv) civil society & accountability; & v) focus on enforcement: No impunity**

General Global Lessons from evidence and experience on Anti-Corruption & lessons from experience

- **Central government efforts need to be backed by top leadership, and complemented by: i) Subnational Reforms, & ii) Ukraine Citizens/NGO/MPs/media**
- **Competition across oblasts/cities + data + citizens: an Anticorruption Observatory, with public data on: i) corruption; ii) Impunity Index & iii) implementation of anticorruption reforms**
- **Transparency: economic, financial, institutional, political**
- **Reform SOEs, & Judiciary (No to Impunity – Guatemala?)**
- ***Tax Reform: Simple, No discretion, No loopholes. Enforce***

Perceived Trends in Corruption by Oblast (Early vs Late 2015): *Survey of Companies, Perceived Changes prior 6 months)* *[Source: TI, Gfk, PrvtBnk, PWC, see footnote, Preliminary chart]*



Note: Scale is from -5 to +5 where -5 is significant deterioration, +5 is significant improvement, and 0 is no change. Columns pointing downwards below zero means deterioration. Wave 1 conducted in early 2015 (?); Wave 2 in late summer 2015. Preliminary, caution in interpretation is warranted. Source: Transparency International, Gfk, Privatbank, and PricewaterhouseCoopers, survey of company directors (2471 respondents) http://www.corruption-index.org.ua/index_en.html



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