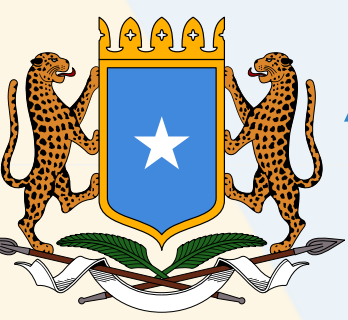


Natural Resource Revenue Sharing International Experience & the Way Forward for Somalia

Financial Governance Committee, October 2017



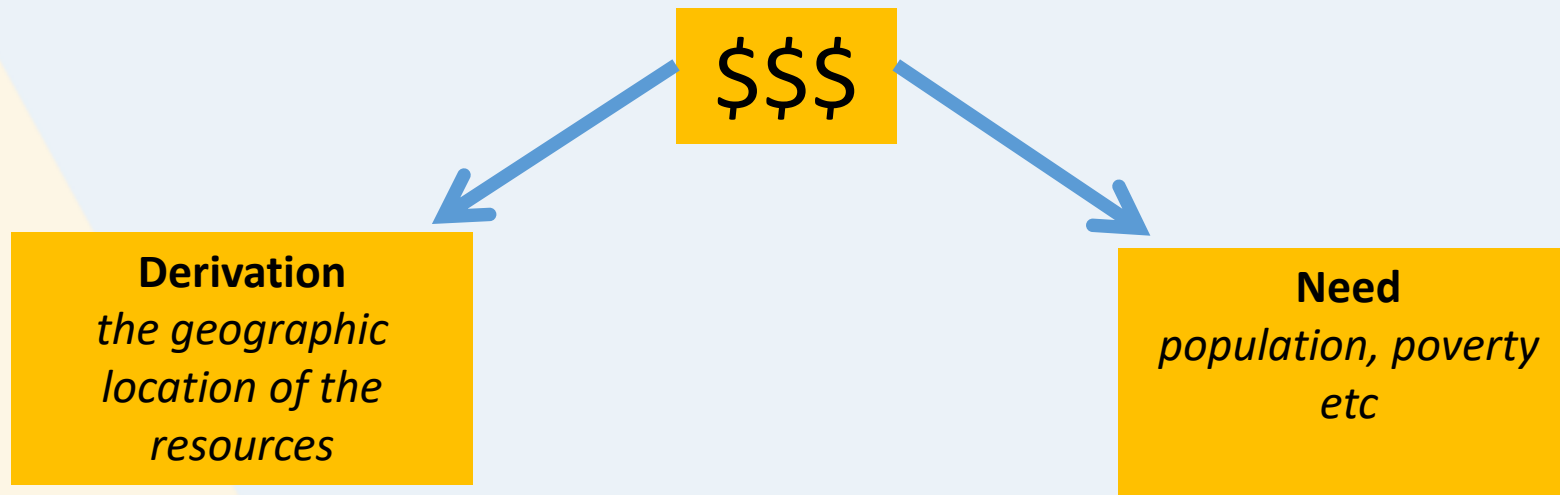


About The Financial Governance Committee (FGC)

- ⇒ Established in 2014, following mutual agreement between the Federal Government (FGS) and international community
- ⇒ Chaired by the Minister of Finance; includes the Governor of the Central Bank of Somalia, representatives from the President's Office, Prime Minister's Office and Cabinet Economic Sub-Committee, the Chair of the Parliamentary Finance Committee and the State Attorney General
- ⇒ Includes international delegates from the International Monetary Fund, the World Bank and Donor partners
- ⇒ Provides advice on Central Bank governance, asset recovery, public procurement and concessions, public financial management reforms and fiscal federalism
- ⇒ In October 2017, in response to a request from the Minister of Fisheries, the FGC's international delegates prepared an advisory note on natural resource revenue sharing

How other countries share natural resource revenues

- ⇒ More than 30 resource-rich countries have specific rules that guide natural resource revenue sharing
- ⇒ There are 2 main ways of sharing natural resource revenues between levels of government



- ⇒ In practice, a number of countries adopt a mix of these two approaches
- ⇒ Derivation-based approaches tend not to be applied to offshore petroleum or fisheries revenues, although investments from fisheries resources can be targeted to fishing communities

Which revenues are shared??

- ⇒ Natural resources can generate a range of revenues for the State, depending on the fiscal arrangements with the producers

**SIGNATURE BONUSES, LICENCE FEES, ROYALTIES, WITHHOLDING TAX
CORPORATE INCOME TAX, CAPITAL GAINS TAX, SHARE OF PETROLEUM
PROFIT, REVENUE FROM PETROLEUM SALES....**

- ⇒ Revenue sharing agreements need to clearly identify which natural resource revenues are being shared
- ⇒ Revenues such as royalties and licence fees are more commonly shared – they tend to be straightforward to collect, and depending on their terms, may be reasonably predictable in nature

Benefits of well-designed sharing arrangements

- ⇒ Recognise local claims on natural resources
- ⇒ Compensate for negative impacts arising from resource extraction
- ⇒ Promote sustainable economic development and raise living standards
- ⇒ Compensate for or mitigate violent conflict over resources



But international experience shows that revenue sharing arrangements can create significant risks and challenges

Particularly when they are:

- ✘ Poorly designed
- ✘ Not subject to sufficient consultation and agreement amongst all affected parties
- ✘ Badly implemented
- ✘ Too inflexible to evolve when circumstances require them to



What are the main risks?

Risk #1: Violent conflict over the terms of an agreement or its implementation (Iraq, Peru, Nigeria)

Risk #2: Volatile revenue flows that destabilise economic management and service delivery (Peru, Nigeria)

Risk #3: Revenue flows that exceed absorptive capacity leading to wastage and corruption (Nigeria, Brazil, Columbia, Peru)

Risk #4: Regional inequality (Brazil, Nigeria)

Risk #5: Inadequate resourcing of core functions of the State (South Sudan).



Somalia's Constitution and natural resources

- ⇒ Somalia's 2012 Interim Constitution articulates a number of important principles with respect to natural resource ownership and revenue sharing
- ⇒ These principles place emphasis on equitable allocation of resources

Article 25 (2). Environment “Every person has the right to have a share of the natural resources of the country, whilst being protected from excessive and damaging exploitation of these natural resources”

Article 44. Natural Resources “The allocation of the natural resources of the Federal Republic of Somalia shall be negotiated by, and agreed upon, by the Federal Government and the Federal Member States in accordance with this Constitution”

Article 50. Principles of Federalism in the Federal Republic of Somalia

The various levels of government, in all interactions between themselves and in the exercise of their legislative functions and other powers, shall observe the principles of federalism, which are:

- (d) Every part of the Federal Republic of Somalia shall enjoy similar levels of services and a similar level of support from the Federal Government;
- (e) Fair distribution of resources;

Revenue sharing discussions to date

- ⇒ During the previous administration, both the Federal Ministry of Petroleum and the Federal Ministry of Fisheries commenced bilateral revenue-sharing discussions with Federal Member States
- ⇒ Both sets of agreements jumped straight into the details of how revenues would be shared, without any reference to the underlying principles and objectives of revenue sharing
- ⇒ As a result, these individually proposed sector agreements lacked mutual coherence, created ad hoc precedents, and risked creating a number of unintended consequences – particularly with regards to inter-regional inequality, the likelihood of volatile revenue flows and allocations that exceeded absorptive capacity

Fisheries Revenue Sharing Proposals 2016	
FGS	25%
Puntland	15%
Galmudug	15%
South West	12%
Jubaland	13%
Hiraan/Middle Shabelle	12%
Banadir	8%

Petroleum Revenue Sharing Proposals (2016)	On-shore and off-shore up to 6 nautical miles	Off-shore beyond 6 nautical miles
FGS	30%	60%
FMS (producing if onshore, adjacent if off shore)	40%	20%
FMS (non-producing, or non-adjacent if off-shore)	30%	20%

Tuna Revenue Sharing Proposals 2017	
FGS	40%
Ministry of Fisheries	10%
Puntland	10%
Galmudug	10%
South West	10%
Jubaland	10%
Hiraan/Middle Shabelle	10%



Macroeconomic management of natural resource revenues

- ⇒ The Federal Public Financial Management (PFM) Bill which has recently been submitted to the National Assembly includes a section on Natural Resource Revenue Management
- ⇒ This section responds to some of the shortcomings identified in the earlier Petroleum and Fisheries revenue sharing proposals, particularly regarding banking of revenues, disbursement and macroeconomic management
- ⇒ Consistent with the Interim Constitution, the Bill states that revenues will be shared in accordance with agreements established between the Federal Government and the Federal Member States
- ⇒ The Bill also includes provisions for introducing a natural resource revenue saving mechanism. The saving mechanism can be used to manage revenue volatility, build up funds for large-scale investments and set aside natural resource revenues for future generations

FGC Recommendations on the Way Forward



1: Ensure revenue sharing discussions are credible

International experience shows that if revenue sharing agreements are badly designed, negotiated or implemented, they can create a range of economic and security risks that could in themselves significantly undermine state-building in Somalia. To address this:

- ⇒ A range of FGS Agencies should be involved in the revenue sharing discussions. These include: the Prime Minister's Office, the Ministry of Finance, the Ministry of Planning, the Ministry of Interior and Federal Affairs, as well as relevant sector Ministries and the Central Bank.
- ⇒ Negotiations need to be subject to adequate discussion and consultation with all concerned stakeholders, including Federal Member states, the private sector and civil society
- ⇒ Negotiations should be managed through a mechanism that is robust and perceived as being credible by all parties
- ⇒ Technical expertise should be drawn on throughout the discussions
- ⇒ Terms of the agreements should leave open the possibility for future adaptation as circumstances require

#2: Agree the overarching principles that will guide revenue sharing

⇒ High-level discussions on revenue sharing principles should precede any discussions on individual, sector-level agreements

Issues that require high-level agreement include:

- ⇒ The desired balance between equitable revenue sharing and compensation to resource-rich areas
- ⇒ Revenue allocations that are consistent with the functional responsibilities of each level of Government
- ⇒ Striking a balance between immediate consumption of natural resource revenues and revenue saving
- ⇒ The social and economic variables that will underpin equity-based allocations.

#3: Ensure sector-level agreements are comprehensive

Individual sector-level agreements will need to identify:

1. which revenues arising from the sector are to be shared
2. how they are to be shared
3. the timeframe of the agreement

Given the ongoing statebuilding process in Somalia, agreements that have defined timeframes and explicit conditions for renegotiation may be preferable, and may generate more willingness amongst all parties to enter into them.

#4: Synchronise with Constitution re-drafting

- ⇒ It is important that the Constitution articulates the principles on which revenue sharing is based, and the process by which revenue sharing agreements should be arrived at
- ⇒ However, it is not advisable that the Constitution defines specific revenue shares or prescribes specific allocation mechanisms
- ⇒ Such an approach limits scope for future adjustment in light of changing circumstances, thus exacerbating risks relating to conflict, inequity and inadequate financing of core functions of the State