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# paper

Negotiating natural  
resources for peace:  
Ownership, control  
and wealth-sharing

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# “hd” Briefing Paper

The Centre for Humanitarian Dialogue (HD Centre) is an independent Swiss Foundation dedicated to helping improve the global response to armed conflict. It attempts to achieve this by mediating between warring parties and providing support to the broader mediation community.

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# 1 | Introduction

Natural resources (such as oil, natural gas, diamonds, minerals, forests and water) are often a major source of national income, and are also a major cause of conflict and instability if mismanaged or shared unfairly. Countries with weak institutions often struggle to handle the potentially destructive force of corruption and attempts by various actors to capture the wealth generated by natural resources. The governance of natural resources is especially important in the context of divided societies because control over the benefits from local natural resources is often a chief motivator of ethnic or identity-based conflicts.

Where the natural-resources debate is particularly sharp is not only in the context of divided societies, but in those cases where the uneven geographic distribution of natural resources corresponds with ethnic, religious or linguistic divides. While these issues are especially important in decentralised nations and are particularly salient in a federal context, they can arise in any state confronted with demands for increased autonomy over local resources from individual communities. Under these circumstances, the framework for the treatment of natural resources can strengthen a national compact or can exacerbate conflict.

Despite this, natural resources have not always been perceived as important enough to require extensive treatment in constitutions or peace agreements. In many countries where natural resources do not constitute a significant sector of the economy, it is not unusual for natural resources to fall under general provisions dealing with the treatment of revenue and fiscal and financial issues (as in most Western states). Similarly, many peace treaties make only passing reference to natural-resource arrangements. In more recent constitutions and legal agreements it is, however, more common to deal with natural resources separately from other elements of the wealth-sharing framework. There are a number of reasons for this. In some developing countries, natural resources are the only or predominant source of wealth. As a result, these resources are very often seen as a national heritage to be shared equitably. However, they often generate strong feelings of local community ownership over their development and the resulting revenues. The challenge is to balance these local interests against the overall importance of natural resources to national development. Constitutions or peace treaties are often called upon to mediate this tension and the conflict that can result from it.

It therefore becomes important to develop conceptual clarity on the categories of issues that can arise in natural-resource negotiations. Our experience in these types of negotiations suggests that arrangements to govern natural resources can be categorised into three broad areas, as follows.

**i) Ownership of natural resources.** The regime governing the property ownership of natural resources is often an emotional issue that requires a balancing of the claims of private ownership, communal and customary rights, and state ownership. The resolution of ownership is often the most contested aspect of constitutional negotiations on natural resources. However, ownership is often misunderstood as resolving the related issues of the management, control and sharing of revenues from natural resources. In fact, the rights and benefits of ownership can vary and are often limited by legislation and the treatment of the issues listed below.

**ii) Allocation of the power to manage and develop natural resources.** Constitutions are often called upon to decide what bodies at the national and provincial levels of government should have the authority to make and administer laws relating to the development and exploitation of natural resources. This amounts to the power to control, regulate and manage natural resources and is potentially more significant than ownership rights in themselves. This allocation can have profound effects on the development of the sector and even on the overall structure of the state when natural resources are a major source of public income. In centralised states this may be less of an issue, but it can be fundamental in resource-rich or federal countries.

**iii) Treatment of natural-resource revenues.** The transparent and fair generation, collection and sharing of natural-resource revenues can be a determining factor of the viability of a peace agreement or constitution. The handling of resource revenues may follow directly from the allocation of management and control over these resources, or it can be undertaken quite differently. The latter is possible because the objectives that motivate how a constitution distributes responsibility for the management of natural resources can be substantially different from the often political goals that underpin how the revenue from those resources should be shared.

This article will elaborate on this conceptual framework for natural-resource negotiations (Sections 3–5), and then presents some initial considerations on the structure of natural-resource negotiations in peace talks and constitutional drafting processes (Section 6). In order to provide a comprehensive treatment of the subject, we present the negotiation of natural resources in terms of a single, all-encompassing event such as a constitutional convention. In reality, the issues identified in this article can and do arise individually in a variety of contexts, including in peace negotiations, autonomy agreements developed in response to provincial autonomy demands or secessionist threats, within the development of resource management or revenue-sharing laws, and even in the design of development and reconstruction programmes.

## 2

# Why enshrine the treatment of natural resources in a constitution?

Before examining the types of natural-resource arrangements that constitutions can be asked to address, it is first necessary to consider why it might be important to include provisions on natural resources in constitutions or (antecedent) peace treaties. In our view, in divided societies or post-conflict settings, these agreements should aim to form the basis for a new social compact. This article is essentially about the place of natural resources in the social contract, and we use the constitution as an expression of this (other forms of a social contract are of course possible).

Here it is worth recalling that many ‘first-generation’ constitutions of the 20th century were largely concerned with proclaiming national sovereignty (as in Papua New Guinea, Indonesia, Nigeria and Venezuela for example). This implied a homogeneity of the formerly colonised. With respect to natural resources, their focus was on establishing these resources as owned and for the benefit of the country, as opposed to their ownership and exploitation by foreign entities or multinational corporations. In contrast, later-generation constitutions, drafted many decades later, have more often been concerned to resolve internal conflicts and are forced to recognise diversity and heterogeneity. As a result, their provisions on natural resources increasingly try to resolve claims by competing internal groups over the ownership, control and sharing of natural resources. Indeed, natural resources have been a major part of several recent peace and constitutional negotiations. While these types of disputes and attempts to resolve them in peace and constitutional negotiations are most prevalent in federal countries (such as Sudan, Iraq and Nigeria), these same sets of issues are also present in unitary states with regions inhabited by ethnic or religious groups claiming autonomy over local resources (such as Indonesia and Aceh, Papua New Guinea and Bougainville).

The political motivations for why disputes over natural resources find constitutional expression is therefore twofold: first, how natural resources are treated has become a foundational element of any new national compact; and second, constitutions themselves are typically intended to protect the core elements of a new national compact by preventing them from being changed except by super-majorities and special procedures. This article will argue that, particularly in situations where natural resources are or may have been a driver of conflict, the handling of natural resources should be a central component of subsequent peace or constitutional negotiations and that relatively greater detail on the handling of natural resources may be required in such agreements to reassure parties of the nature of the compact into which they are entering. Of course we do not mean to imply that the constitution is the only vehicle by

which a lasting agreement on natural resources can be reached. It is possible, and in some cases actually more feasible, to achieve such agreement without giving it constitutional expression. In this event, almost all of the issues raised in the following sections on ownership, control and revenue-sharing are just as pertinent.

# 3

## Ownership of natural resources

### 3.1 General comments

The property-ownership regime for natural resources is a highly emotive issue that is often intertwined with identity-based conflicts. As a result, it is often the case that on the issue of natural-resource ownership, emotional concerns can override fiscal rationality, and the challenge faced by negotiators will be to direct the debate away from political slogans to a technical discussion based on good governance. Natural-resource ownership takes on a dimension of added importance in those countries where resource revenues represent a large portion of the economy and especially where the geographic distribution of natural resources is uneven across ethnic or sectarian groups. Ownership often involves a contest between one or other or all of the following potentially competing claims: private title (individual or corporate ownership), communal or customary land rights, and state ownership. In order to provide the foundation for sound natural-resources management and development, and in some cases social peace, a constitution should clearly establish legal rights to the nation's natural resources.

However, while constitutions frequently pronounce on the ownership of natural or subterranean resources, this issue sometimes punches above its real weight in terms of actually addressing drivers of conflict in divided societies. In homogenous societies constitutional provisions on natural-resource ownership are expected to address national development or how natural resources are shared between governments and private interests. In divided societies, the constitutional treatment of natural resources is more concerned with how natural-resource wealth is shared among often antagonistic communities. Ownership is sometimes mistakenly seen as regulating this in and of itself. However, while ownership is an important element of an overall natural-resources framework, it does not necessarily answer the questions of who manages, regulates and makes money from natural resources. This can be determined separately by other parts of the constitution or through future legislation.

Perhaps the clearest illustration of ownership being distinct from control and the sharing of natural-resource benefits is seen in Sudan's Comprehensive Peace Agreement (CPA), which established a National Petroleum Commission to regulate the oil sector and specified formulae for sharing oil wealth while



explicitly delaying the question of ownership of oil resources to a future process. In other words, it was not necessary for the parties to agree on who owned the resources in order to agree a framework for oil development and revenue-sharing. A brief case study on the Sudanese experience can be found on page 30.

## 3.2 Constitutional practice

Constitutions (or the legal texts that deal with this topic) differ significantly regarding the treatment of property rights in general, and ownership of natural resources in particular. At a fundamental level, constitutions may or may not guarantee private property rights and the extent to which private, and particularly foreign, ownership is permitted in the overall economy and for natural resources in particular. It is increasingly common for constitutions to recognise types of property regimes and how this applies to subterranean resources or natural resources more generally. Various potential property regimes exist, as follows.

- a) *Private title* – absolute ownership is given to a private or legal individual or corporation.
- b) *Communal or customary title* – usually a collective right of access and use without absolute individual title.
- c) *State ownership* – where the central state or local province, in its own name or in the name ‘of the people’, assumes ownership of the resource which it may then utilise itself or rent out.
- d) *A mix, or co-existence* of these different regimes, perhaps making a distinction between those resources which are essential for individual livelihoods and those important to the national economy.

In most instances where constitutions specifically address ownership of natural resources, the sovereign state, or, as it is more commonly expressed, ‘the people’, is designated as the owner of the natural resource.<sup>1</sup> Generally constitutions may also contain provisions relating to the right to be compensated for the deprivation of one’s property (expropriation for development of resources) and regulating the right of the state and the individual by limiting the uses or the ways of exercising one’s property rights (e.g. environmental legislation with respect to various forms of mining). Constitutions also often distinguish between surface rights, which may remain in private or communal hands, and subterranean minerals and resources, which are owned by the state (e.g. Liberia). Some areas also recognise sub-surface mineral rights of indigenous communities and require those communities to be consulted in contracting procedures and the negotiation of local benefit agreements (e.g. Canada’s Yukon Territory and its ‘First Nations’).

The explosiveness of the ownership issue and competing ownership claims should not be underestimated. A tragic example is provided by the autonomy-based conflict on Bougainville Island in Papua New Guinea (PNG) during the 1980s and 1990s. In this case, the PNG constitution gave the national government sovereignty over natural resources throughout this unitary state, which conflicted with customary matrilineal land-ownership rights on

1 International Monetary Fund (2005), *Guide on Resource Revenue Transparency*, June. Resources in the ground are usually the property of the state, except in a few countries (e.g., the USA) where private ownership of minerals in the ground is legal.

Bougainville Island. The construction and operation of a large open-pit copper mine against local wishes on Bougainville was the trigger point for a 14-year civil war that led to approximately 15,000 deaths. The conflict was resolved only in 2001 by transferring ‘high’ autonomy to the regional government (the Autonomous Bougainville Government), including ultimately over its natural resources, and by securing agreement to a future referendum on the island’s independence.

### 3.3 Federations and autonomy settings

In many federal systems, as well as some unitary states responding to demands for local autonomy over natural resources as in Papua New Guinea, an added complication arises regarding how to resolve potentially competing ownership claims between the national governments and state or provincial governments. In these cases, simply declaring state ownership of natural resources does not say anything about the right or duty of different levels of government to develop and share the benefit from those resources.

Older federations, such as the USA, Canada and Australia, have tended to favour private ownership or absolute ownership by state and to leave the control and benefits of natural resources to be determined at the level of the states or provinces. This may have been a function of 19th-century technologies and the historical reality that communication and transport infrastructure did not exist to permit centralised control over the regulation and exploitation of natural resources. Moreover, the USA and Australia, at the time of their creation, consisted of pre-existing states and there was no awareness of the existence or significance of natural resources such as oil.<sup>2</sup>

<sup>2</sup> Cotrell, J. (2005), *Oil Revenues, Distribution and the Constitution of Iraq: An Option Paper*. Unpublished paper commissioned by the United Nations Assistance Mission for Iraq.

During the 20th century however, constitutions began to reflect the view that natural resources should be for the national benefit. This was driven by technological advancement, changes in national economies and the fact that these constitutions were less likely to be drafted among formerly self-governing units choosing to join together. Given the typically significant economic impact of oil and gas in particular, national policy-makers pushed to retain ownership, or ‘sovereignty’, of many natural resources at the national level. Constitutions such as those of South Africa, Nigeria, Indonesia, Papua New Guinea and India have therefore treated natural resources as a national heritage, important in the financing of equal services and development nationwide, rather than as a regional resource. However, as the history of intra-state conflict in the late 20th century indicates, there are often strong political demands to devolve some of the benefits of ownership of natural resources to the local level. The most recent constitutions have therefore attempted a more nuanced treatment of resource ownership. This has resulted from recognition of legitimate regional aspirations for a voice in the development of natural resources within a national standard of rules and regulations (as in Iraq, Sudan, Indonesia and Aceh, Nigeria and the Niger Delta). Examples of different approaches are shown in Table 1.

**Table 1: Ownership of natural resources in selected countries**

<b>Unitary States</b>	
<b>Indonesia</b>	<i>The State</i> [Article 33.2] Sectors of production which are important for the country and affect the life of the people shall be under the powers of the State. (3) The land, the waters and the natural resources within shall be under the powers of the State and shall be used to the greatest benefit of the people.
<b>Papua New Guinea</b>	<i>The State. Ownership of natural resources for Bougainville Island to be determined in the future.</i> [Part I, Article 2.2] The sovereignty of Papua New Guinea over its territory, and over the natural resources of its territory, is and shall remain absolute.
<b>Federal States</b>	
<b>Canada</b>	<i>The Provinces</i> [Article 109] All Lands, Mines, Minerals, and Royalties belonging to the several Provinces of Canada, Nova Scotia, and New Brunswick at the Union, and all Sums then due or payable for such Lands, Mines, Minerals, or Royalties, shall belong to the several Provinces of Ontario, Quebec, Nova Scotia, and New Brunswick in which the same are situate or arise, subject to any Trusts existing in respect thereof, and to any Interest other than that of the Province in the same.
<b>Nigeria</b>	<i>Government of the Federation</i> [Article 44] The entire property in and control of all minerals, mineral oils and natural gas in under or upon any land in Nigeria or in, under or upon the territorial waters and the Exclusive Economic Zone of Nigeria shall vest in the Government of the Federation.
<b>Iraq</b>	<i>The people</i> [Article 111] Oil and gas are owned by all the people of Iraq in the regions and governorates.
<b>Russia</b>	<i>Private, state, municipal or other forms of ownership</i> [Article 9.1] The land and other natural resources shall be used and protected in the Russian Federation as the basis of the life and activity of the peoples living on their respective territories. (2). The land and other natural resources may be in private, state municipal and other forms of ownership.
<b>Sudan</b>	<i>Not designated</i> [Comprehensive Peace Agreement, Wealth Sharing Protocol Article 2.1] Without prejudice to the position of the parties with respect to the ownership of land and subterranean natural resources, including in Southern Sudan, this Agreement is not intended to address the ownership of these resources.
<b>United Arab Emirates</b>	<i>Public Property of the individual Emirates</i> [Article 23] The natural resources and wealth in each Emirate shall be considered to be the public property of that Emirate [...]
<b>Venezuela</b>	<i>The Republic</i> [Article 12] The mining deposits and of hydrocarbons, [...] existing in the national territory, under the bed of the territorial sea, in the exclusive economic zone and the continental platform, belong to the Republic, are goods of the public dominion and, therefore, inalienable and imprescriptible.

### 3.4 Implications

Clarity regarding ownership rights and regulatory authority is critical for political stability and investor confidence. Ambiguity about who owns natural resources can become a source of ongoing dispute between national governments and state or provincial governments. Guaranteeing regional governments or indigenous communities a voice in development plans for natural resources, management (including employment) and a share of revenues may also take some of the sting out of the potentially 'zero-sum' ownership debate.

From an economic standpoint, constitutional provisions on the ownership of natural resources must not only meet the aspirations of domestic actors but also provide the certainty necessary to attract investment. In particular, both local and international investors need to have confidence and clarity about their ownership rights, ability to achieve a return on their investment and how their rights will be balanced against those of other actors, for example in terms of compensation to those local communities adversely affected by the exploitation of natural resources. Ambiguous ownership provisions can be a major source of political risk for potential investors. This can lessen the attractiveness of an investment opportunity in the country's resources, resulting in difficulties in attracting capital. Angola's diamond industry provides an example, where, according to the World Bank, a weak legal and regulatory framework in terms of a lack of clarity on the 'rules of the game' on ownership rights has created a perception of Angola as a high-risk location and continues to deter investors. Despite Angola being the fourth-largest diamond producer in the world, there has been little international investment in the sector and only 40% of the country has been explored using modern geological surveys.<sup>3</sup>

<sup>3</sup> World Bank (2006) Angola Economic Memorandum: Oil, Broad Based Growth, and Equity, 2 October.

## 4 Allocation of control over natural-resource management

### 4.1 General comments

The allocation of legislative and executive authority over natural resources determines who has the ability to make and administer laws relating to the development and exploitation of natural resources. This is potentially much more important than the question of ownership because the power to legislate and regulate natural-resources development determines the rights, and the limits of the rights, of ownership. Very often legislative and executive authorities are coupled with the right to collect revenues from the exploitation of natural resources, but this does not have to be the case (as discussed below).

From a technical standpoint, the allocation of legislative and executive authority with respect to natural-resources management addresses the

questions of who has the authority to pass laws regulating natural resources, who administers the laws, and which court resolves disputes under them. The range of issues covered by the allocation of regulatory authority includes: contracting authority and procedures; licensing, taxation and royalty regimes; employment practices; safety and environmental standards; transportation networks; labour laws, import and export permits and tariffs; and almost any other matter that can affect the development of the natural-resources sector.

In unitary states these functions would typically default to the national government if not explicitly addressed in the constitution, although in some cases secessionist or identity-based conflicts have led to these functions being devolved to individual provinces as part of peace agreements or autonomy legislation (Indonesia and Aceh, Papua New Guinea and Bougainville). In these circumstances and also in many federal or decentralised states, the distribution of these functions is a sharp point of contention precisely because it is often this allocation of power, and not ownership rights in themselves, that determines control over natural resources. In these contexts, constitutions or peace agreements often have explicit provisions allocating management and control between national and provincial governments.

## 4.2 Constitutional practice

In most unitary countries the national legislature sets policy for the sector and specialised agencies of the executive branch, such as a ministry of natural resources, are responsible for applying relevant laws and policies for the natural-resources sector (including granting licences for exploration and production). Specific matters related to natural-resource exploitation, such as taxation, labour standards or environmental protection, may be designated to specific ministries (such as finance, environment or labour) rather than the sector ministry itself. The level of parliamentary oversight of sector ministries varies, with some countries requiring contracts to be ratified by the legislative branch (as in Azerbaijan and Egypt) or the executive (as in Yemen).<sup>4</sup> Examples are shown in Table 2 (page 14).

<sup>4</sup> International Monetary Fund (2005), *Guide on Resource Revenue Transparency*, June.

Similarly, it is usually the courts that are designated as responsible in the resolution of disputes or interpreting and applying the constitutional provisions related to the management and control of natural resources. In some cases, specialised courts, such as land courts and arbitration mechanisms, may be established. Generally however, the constitution will set out a court of final instance on constitutional issues and this court would typically ‘police’ the allocation of natural-resource powers between the legislative and executive branches of government or between national and provincial governments, as well as resolving any arising disputes.

## 4.3 Federations and autonomy settings

### 4.3.1 Criteria for allocation of regulatory authority between levels of government

In federal states or other countries seeking to address local demands for autonomy over natural resources, the choice of which level of government

**Table 2: Allocation of authority for natural resources in selected countries**

National Priority	Regional Priority	Shared/Divided Priority	Asymmetrical
<p><b>Nigeria</b> – National Parliament has exclusive legislative authority over mines and minerals, including hydrocarbons. [Section 39 of the Exclusive Legislative List]</p>	<p><b>Canada</b> – Provincial legislatures and governments are given exclusive authority to make laws related to exploration for non-renewable natural resources; development, conservation and management of non-renewable and forestry resources. [Article 92]</p>	<p><b>Iraq</b> – The federal government, together with the producing regional and provincial governments, are given the responsibility to formulate strategic policies to develop Iraq’s oil and gas wealth to achieve the highest benefit to the Iraqi people. [Article 112.2]</p>	<p><b>Indonesia</b> – Council of Representatives of the Regions (Upper House of Parliament) given exclusive responsibility for legislation related to the management of natural resources and other economic resources. [Chapter VIIA 22D Sections 1 and 2]</p> <p>Law on the Government of Aceh provides for joint management of oil and gas resources between Government of Indonesia and Provincial Government of Aceh. [Section 160 Article 5]</p>
<p><b>Venezuela</b> – National Public Power (Federal Government) has responsibility for the governance and management of mines and hydrocarbons. [Article 156.16]</p>	<p><b>United Arab Emirates</b> – Each emirate has full control over its natural resources and other wealth. [Article 23]</p>	<p><b>Russia</b> – Joint jurisdiction of the Russian Federation and the subjects of the Federation over use and management of land, mineral resources, water resources, and other natural resources as well as protection of the environment. [Article 72.1.C and Article 72.1.E]</p>	
		<p><b>Sudan</b> – National Petroleum Commission (NPC) established with representatives of National Government, Government of Southern Sudan and state governments. NPC given responsibility for formulating public policy, development strategies, and negotiating and approving all oil contracts. [Comprehensive Peace Agreement, Wealth Sharing Protocol, Article 3.2]</p>	<p><b>Papua New Guinea</b> – Natural resources included in the National Legislative Power.</p> <p>Natural resources and land included in powers and functions to be transferred to the Bougainville Autonomous Government when it feels it has the need and capacities. [Article 290.2.zd]</p>

has the legislative and executive authority over the natural-resources sector, including the ability to sign contracts, is often a central component of constitutional negotiations. From a political-economy standpoint, the allocation of contracting authority frequently also implies the control over high-income jobs, a significant and highly contested source of patronage. As with ownership provisions, the allocation of executive and legislative authorities must be sufficiently clear to provide confidence for investment. Uncertainties about whether the national or provincial government has the authority to sign contracts and which level of government's legislation regulates natural resources are a major impediment to the development of natural resources. Without clarity on this issue, investors may be reluctant to commit to long-term engagement or may demand a higher share of profits so as to be compensated for the political risk of conflicts between national and provincial actors regarding jurisdiction over natural resources.

Depending on the importance of natural resources to the economy as a whole, the eventual distribution of powers over natural resources can affect the structure of the state itself. Deciding on the proper allocation of legislative and executive authority over natural resources is a complex question dependent upon a number of sometimes contradictory criteria. These include the following.

- a) *Efficiency and capacity*: Which level of government has the ability and capacity to develop and manage the natural resources most efficiently?
- b) *Equity*: How will a minimum standard of public services be ensured across states or provinces, if resource wealth is trapped in one region only?
- c) *Accountability*: Which level of government provides the greatest accountability to the local population with respect to the exploitation of natural resources?
- d) *National interest*: Is a national regulation over a particular aspect of natural-resource development required? Can a particular function be treated differently in different parts of the country?

It is often the case that an examination of the distribution of powers regarding the control and development of natural resources may suggest different conclusions for different types of authority (production activities that have national environmental consequences versus local labour standards) and for different types of resources. (Resources that cross provincial boundaries are discussed below in Section 4.3.2.)

In general, assigning executive and legislative authority to state or provincial governments is considered likely to improve accountability because regional governments can better determine the needs and preferences of their populations. Provincial authorities also have a direct interest in making the most of their region's resources, whereas if an authority to develop natural resources is given to the national government, dominant groups at the centre may not have an interest in promoting a particular province's development.

However, there are possible efficiency and capacity concerns related to assigning powers to the provincial level. Substantial devolution of authority to state or local governments complicates the development of a consistent national policy on natural resources. In particular, in the absence of national standards, regional governments may engage in a 'race to the bottom' to attract investment to their community by offering investors more favourable contract terms or forgoing environmental and labour standards. From the standpoint of ensuring a minimum level of public services throughout the country, full regional control of natural resources can also be problematic. For example, in Canada, where the provinces are granted control over natural-resource development and revenues, concerns about the ability of oil-poor provinces to offer a comparable standard of services to those in oil-rich provinces have been a longstanding concern.<sup>5</sup>

5 Canada's Constitution seeks to deal with this problem by committing the federal government to 'making Equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services'. Less wealthy provinces in effect receive transfer payments from wealthier provinces via the federal government based on a formula which explicitly takes into account provincial natural resource revenues.

#### 4.3.2 Resources which traverse provincial boundaries

Much of the dispute over ownership, control and benefit from resources assumes that the resource can be cleanly found within a region, province or state. This is not always the case and there are obvious problems in treating a resource that crosses multiple provinces as the right for one province alone to regulate and use as it sees fit. In these cases the general wisdom is to treat these resources nationally, or through an inter-provincial mechanism.

**Water.** This problem is particularly acute when it comes to inter-provincial waters, which are important not only for economic reasons (e.g. industrial production and hydroelectricity generation), but also human survival (drinking water and agriculture). It is clear that where waterways cross provincial boundaries and may even traverse several provinces, despoiling or restricting the flow of water in one state can have dramatic impacts for downstream states. The usual approach is to provide for national regulation of inter-province waters because this is an issue that cannot be managed by one province alone, and one province's treatment of water resources may harm other provinces. However, in order to find an accommodation in cases where provinces assert proprietary right over water sources, it may be possible to split either the functions over which the different levels of government have authority (delivery of drinking water as a provincial function, with guaranteeing nationwide distribution, supervising water flows and pollution controls as national functions). Such a system requires a robust legal framework to manage disputes and separate different elements of control between central and regional governments. South Africa provides an example of a constitutional structure where the courts are asked to apply a logical test to determine which level of government should control what function.

**Marine resources.** These same considerations would for example apply to marine resources in the case where two or more provinces share a coastline. It would be illogical to treat the marine life, which moves back and forth between the off-shore zones adjacent to individual provinces, as belonging to either one or other of the provinces sharing the coastline. Rather it would be worthwhile to consider that adequate conservation and protection of marine resources can better be achieved through a national framework or an inter-province



cooperation agreement rather than by one province alone. This has arisen as an issue of contention in Sri Lanka, where control over marine resources and the regulation of access to them in the north-east of the island of Sri Lanka was claimed by the Liberation Tigers of Tamil Eelam.

**Hydrocarbons.** Finally, resource traversal of provincial boundaries also arises in the case of oil, often one of the most fiercely contested of all natural resources. Oil (as well as natural gas) fields can extend for tens of kilometres and span provincial boundaries. In the absence of any larger cooperative framework, competition between provinces to extract as much oil as possible before a neighbouring province does the same can lower the overall pressure in the field and result in a dramatic loss in total oil recovered. In this context, unitisation refers to the effort to consolidate competing provincial claims to an oil field into a single production plan that encompasses the natural geology of the oil field. This allows reservoir engineers to plan operation of the field to extract oil at the location and production rate which is most efficient (and irrespective of man-made provincial boundaries). If regulation of the oil sector is handled at the provincial level, it may be necessary to give the federal government the power to encourage or force unitisations for the benefit of the state.

The issue of resources which traverse provincial boundaries is highlighted because if these issues are not dealt with in a careful and considered manner in the constitution or subsequent legislation, several pernicious outcomes are possible. These include a tragedy of the commons (e.g. over-exploitation of fish stocks), failure to recover a large part of the resource (e.g. oil fields), and territorial disputes and allegations of theft of resources between provinces (alleged thefts from oil fields that span international borders have been a trigger of conflict between Iraq and Kuwait). An improper or hasty treatment of these issues in the constitution in a federal setting can ultimately therefore exacerbate rather than ameliorate conflict between groups with competing claims to natural resources that span their respective provinces.

#### **4.3.3 Asymmetrical allocation of authority over natural resources**

Complicating matters further, constitutional drafters may well have to consider whether there should be a single scheme for the allocation of authorities over natural resources (symmetrical system) or whether special authorities be given to specific states or provinces (asymmetrical system). In countries with territorially based ethnic or religious groups who see themselves as distinct from the rest of the national population, the asymmetrical allocation of authorities over natural resources may be attempted to deflate secessionist tendencies or to end a civil war.<sup>6</sup> In other words, secessionist-prone areas may be given special abilities to manage their own natural resources as compared to other provinces. In other cases, certain provinces may have higher levels of capacity and be more capable of managing their own affairs and therefore have a higher level of autonomy transferred to them.

The clearest conceptual examples of asymmetrical systems are sometimes provided by unitary states seeking to accommodate the demands of a particular province for control over its natural resources without totally

<sup>6</sup> Bird, R. and Ebel, R. (2005) *Fiscal Federalism and National Unity*. 25 March.

reorganising the existing structure of the state. In Indonesia for example, the oil and gas resources in the province of Aceh are jointly managed between the province and the national government (in contrast to all other provinces where oil and gas management is the domain of the national government). The short study on page 31 provides an overview of the Indonesia and Aceh case.

In fragmented societies, asymmetrical systems are often primarily, or even entirely, motivated by political considerations. It is therefore important to note that there is no conclusive evidence of whether such arrangements help or hurt political stability – efforts to buy the loyalty of one group with a high level of autonomy over natural resources can generate demands for further decentralisation or cause resentment or demands for equal treatment by other groups.<sup>7</sup> The question that constitutional drafters must therefore ask is how who gets what control over natural resources impacts on broader pressures for decentralisation and national stability.

7 Ibid.

#### **4.3.4 Sharing powers to regulate natural-resource issues**

As discussed above, tensions can often exist between the need for a centrally coordinated policy on issues of national concern related to natural-resource management and wealth-sharing and the political reality of demands for power-sharing among political competitors or greater autonomy at the state or provincial level. This dilemma is particularly salient in post-conflict environments where there may be a deficit of trust in the ability of the government to handle natural-resource development and revenue-sharing in a fair and transparent manner. The recent trend is to recognise that more than one level of government can have a legitimate interest in the management of natural resources and needs to be involved in the exercise of most government powers (even including those long considered solely national). Various constitutional and institutional arrangements are possible to reflect these shared interests, including the following.

- Dividing responsibility for specific aspects of authority over natural resources between the national government and the provinces, for example providing states or provinces with a leading role on the exploration and production of natural resources and the national government control over transport networks, refining of natural resources and export and marketing (as in South Africa and Sudan for water).
- Vesting the authority to produce a coordinated natural-resources strategy and reconcile contradictions between national and provincial law in a central coordinating mechanism made up of regional representatives, for example the upper chamber of the federal parliament. (This is the core of the German model of federalism which could be applied to natural-resources issues.)
- Dividing the allocation of legislative and executive powers over natural resources – by allocating a leading role to the national government in setting the standards or framework governing the management of natural resources, and, to the provinces, a leading role in implementation issues.
- Establishing an intergovernmental commission that explicitly integrates regional representatives into policy- and decision-making processes

along with their national counterparts (e.g. Sudan's National Petroleum Commission). In order to provide further reassurance to states or provinces, the safeguard of a super-majority requirement for the rejection of contracts negotiated by provincial governments is often put in place in these commissions.

- Establishing a mechanism that is independent of the political influence of either national or provincial governments but has the confidence of both (i.e. an external independent, auditing or banking institution). This is in essence the mirror image of the option above.

#### 4.3.5 Resolution of disputes over the control of natural resources

Ultimately, it is critical that, whatever allocation of natural-resource authorities occurs, there is a mechanism for the harmonisation of national and provincial laws to ensure efficient and effective planning, administration and execution of natural-resources policy. Without agreement on such mechanisms, conflict between resource-wealthy provinces and the national government, or among provinces themselves, is possible. The hurdle that has to be met in divided societies is that the provincial level should have confidence in the impartiality of the common adjudicatory institution. As stated above, very often it is the courts that are designated to resolve disputes or interpret and apply the constitutional provisions on natural-resource issues in both unitary and federal systems. The problem in certain circumstances is that provinces will not necessarily accept the authority of an institution located in the national capital to adjudicate on 'their' natural resources, unless they have some influence or are represented in it (as in Iraq, Sudan).

## 4.4 Implications

In divided societies, constitutions or peace agreements are often called upon to resolve issues of control over the development of local natural resources that are intimately linked to conflicts based on issues of identity and local autonomy. Clarifying responsibilities for natural resources can also help to reduce the opportunities for corruption and graft by limiting the discretion of government officials to insert themselves into regulatory processes. In both of these types of circumstances, it may be necessary for the constitution to devote greater detail to the allocation of authority over natural resources than is usually the case. This is to reassure and provide clarity to the parties on the nature of the national compact they are entering into, to forestall future conflicts that could result from ambiguous provisions, and to set up a framework to resolve any resulting disputes.<sup>8</sup>

Finally, a clear allocation of responsibility for the control and management of natural resources can provide investors with clarity on which authorities at the national and provincial level they should deal with and who has the right to sign contracts. Once again, ambiguous provisions can reduce the leverage of domestic actors in negotiations with investors, with the consequence of 'money being left on the table' during contract negotiations.

<sup>8</sup> Delays in the passage of national Hydrocarbon and Revenue Sharing laws seen as fundamental to reconciliation in Iraq provide a cautionary example. In this case, breakdowns in negotiations between Iraq's Kurdistan Regional Government and the Federal Ministry of Oil have been partially attributed by some to ambiguous constitutional provisions as to whether the federal state or the regions have ultimate authority to manage oil development, and on the practical significance of the constitution's assignment of ownership over hydrocarbon resources to all of the people of Iraq.

# Treatment of natural-resources revenue

## 5.1 General comments

The raising and sharing of revenue from natural resources constitutes a key issue that may need to be addressed by the constitution in both political terms and with regard to economic stability. This is true in both centralised and decentralised states. As mentioned, revenue-raising and wealth-sharing may naturally follow the allocation of control over regulatory natural resources, but any complex treatment of the issue that involves multiple stakeholders may require a distinct treatment of the financial issues. This is because the raising and sharing of wealth from natural resources may have different objectives and concerns (such as political settlement of a conflict, or equal sharing of national revenue) from the allocation of control over the regulation and development of natural resources (which may be focused on economic efficiency, equity, capacity or accountability).

Despite the often intense focus on provisions related to the ownership of natural resources, in many senses it is the distribution of their revenue benefits that is at the core of the debate. As noted in the Introduction above, the transparent and fair generation, collection and sharing of natural-resources revenues can be a determining factor of the viability of a peace agreement or constitution. Here the fundamental questions which must be addressed are: who collects natural-resources revenues, and how are the revenues distributed?

## 5.2 Constitutional practice

Natural-resource revenues are particularly problematic, as they are prone to capture by ruling groups or communities, exacerbating social divisions and even leading to direct conflict over the resource itself. Indeed, research by the World Bank points to resource dependence as one of the most important causes of civil wars.<sup>9</sup> Given the lack of trust that often permeates post-conflict environments, the constitutional enshrinement of revenue collection and distribution principles and implementation mechanisms may be critical in finding an overall constitutional consensus on the sharing of power and resources. As will be seen, addressing these issues can be so challenging that radical solutions such as contracting these functions to private or international actors is in some cases being attempted (e.g. in Liberia, with natural-resource revenue collection) or have been actively considered (in Sudan, Indonesia and Iraq, with respect to natural-resource revenue handling and distribution).

The challenges inherent in the transparent collection of natural-resource revenues in both centralised and decentralised countries are substantial. The 'leakage' of natural-resources revenues through the selling and marketing of

<sup>9</sup> Busby, G., Isham, J., Pritchett, L. and M. Woolcock (2002) 'Natural Resources and Conflict: What Can We Do?', in Bannon, I. and P. Collier (eds), *Natural Resources and Violent Conflict*, Washington DC, World Bank.

- 10 International Crisis Group (2004) *Liberia and Sierra Leone: Rebuilding Failed States*, December.
- 11 International Monetary Fund (2005), *Guide on Resource Revenue Transparency*, June.
- 12 In Angola, Sonangol, the national oil company, has sole authority to grant oil exploration and production contracts in Angola and among other purposes uses its revenues to manage and service Angola's sovereign debt. Sonangol is subject to the taxes and other payment obligations to the Government but has a record of underpayment of taxes and substantial arrears. The World Bank describes these arrangements as giving the company a 'largely independent role in the economy'. See World Bank (2006) *Angola Economic Memorandum: Oil, Broad Based Growth, and Equity*, 2 October.
- 13 Liberia's multi-decade civil war was in part financed by trade in its timber and diamond resources. The 2003 Accra Comprehensive Peace Agreement which ended Liberia's conflict does not directly address natural resources and the constitution contains only a limited treatment of the natural-resources sector. However, many donors felt that the transitional Liberian government, after assuming office in 2003, failed to generate adequate revenues or utilise the country's resources in a transparent manner, resulting in renewed concerns of a resumption of conflict. The resulting pressure from the international community to address the situation led to GEMAP which, among other measures, targets the collection of revenues from key natural resources (export of timber, gold and diamonds) at key sites (ports, airports, borders). GEMAP includes international management contracts for key Liberian institutions concerned with natural resources and revenue collection, and the placement of international experts with co-signature authority in selected ministries and state-owned enterprises (including national-resource companies). See Gilpin, R., and Hsu, E. (2008), *USIP Peace Briefing: Is Liberia's Governance and Economic Management Assistance Program a Necessary Intrusion?* May.
- 14 Bird, R. and Ebel, R. (2005) *Fiscal Federalism and National Unity*. 25 March.

natural resources outside agreed-upon systems can undermine state institutions and even provide financing for non-state actors. The diamond trade provides a powerful example of this problem. For example, prior to 2003 it was estimated that the Sierra Leone Government collected customs duties on no more than 5% of diamonds exported from its territory.<sup>10</sup> Given the role that diamonds and other natural resources have played in hollowing out the state through corruption and the financing of civil wars (e.g. in Sierra Leone, Liberia and Angola), constitutional framers may in certain circumstances wish to directly consider principles and institutional arrangements for the transparent collection of revenues from key natural-resources.

In unitary states the responsibility for collecting and distributing resource revenues typically falls to the central government, as represented by the Ministry of Finance, or to the relevant sector ministry.<sup>11</sup> In centralised countries recovering from civil conflicts in part fueled by natural resources revenues, or which face significant corruption issues, a constitutional principle on the centralisation of the collection of all natural resource revenues into a single account under the authority of the Ministry of Finance may be an important step in establishing a transparent resource-revenue system. In the absence of such a principle, the capture of resource revenues by various ministries, state-owned entities and national-resource companies can have significant negative implications for transparency and the ability of the state to generate sufficient revenues to fulfil its functions. It is sometimes argued that this can lead to the establishment of a 'state within a state' (e.g. as in Angola).<sup>12</sup> Liberia's Governance and Economic Management Assistance Programme (GEMAP) provides an example of the persistence of the challenges inherent in the transparent collection of resource revenues and the radical nature of the solutions that are being attempted, including international management contracts for normally sovereign revenue-collection institutions.<sup>13</sup>

In federal systems and unitary states devolving autonomy over natural resources to certain regions, a more complex treatment of revenue collection and distribution may be required in order to accommodate provincial demands for a direct share of locally generated resource revenues and role in overseeing their collection. Examples of different approaches to resource revenue collection and sharing are shown in Table 3 (page 22).

## 5.3 Federations and autonomy settings

### 5.3.1 General comments

In federal systems, and in unitary states responding to local-autonomy demands or secessionist conflicts, political rationales rather than economic best practice are often dominant in determining how revenues are raised, collected and shared. In these cases, constitutions may be called upon to balance the competing feelings of community ownership over local resources against equally strong assertions that the wealth of the country should belong to all. This will often require some compromise or reflection of the communities' interest in receiving part of the wealth produced from local resources. This has been described as 'buying' the loyalty of territorial dissidents if it is involved in the resolution of a secessionist conflict.<sup>14</sup>

**Table 3: Treatment of natural-resource revenue-sharing in selected countries**

National Revenue-Sharing	Power of Taxation	Regional Control
<p><b>Indonesia</b> – Requires implementing legislation [Article 18.A.2].</p> <p>Legislation requires 15% of oil revenues and 30% of gas revenues to be transferred to the originating provinces.</p> <p>Special arrangements for Aceh that allow it to receive 70% of its oil and gas revenues. [Section 181 Article 1.B of the Law on the Governing of Aceh]<sup>1</sup></p>	<p><b>Canada</b> – Provinces have the exclusive right to levy a range of taxes and royalties on earnings from natural resources. [Article 92.A.4] Federal government is able to levy corporate income taxes. [Article 91.3]</p>	<p><b>United Arab Emirates</b> – Emirates required to contribute a negotiated portion of their annual revenues to the Union Budget. [Article 127]</p>
<p><b>Iraq</b> – Federal government, together with producing provinces and regions, is given the authority to manage oil and gas extracted from present oil and gas fields, provided that it distributes these revenues in proportion to the population distribution and specifying an allotment for previously disadvantaged areas. [Article 112.1]</p>	<p><b>Iraq</b> – Constitution does not specify a power of taxation, but states that non-enumerated authorities revert to regions and provinces. Local governments could therefore theoretically tax oil and gas operations. [Article 115]</p>	<p><b>Iraq</b> – Constitution is silent on future oil and gas fields, potentially implying regional control of these revenues. [Article 115]</p>
<p><b>Nigeria</b> – Formula for distribution of oil revenues is decided by Parliament every five years. Constitution requires that population, equality of States, internal revenue generation, and land mass be taken into account in allocation formula with a minimum of 13% reserved for oil-producing states. [Article 162.2]</p>	<p><b>Russia</b> – Russian Federation and states jointly establish of common principles of taxation [Article 72.1.i], with this to be regulated by federal law [Article 75.3]. In practice, states able to levy corporate profit taxes on oil and gas companies.</p>	
<p><b>Sudan</b> – Net oil revenues split equally between Government of Sudan and Government of Southern Sudan with 2% of oil revenue reserved for producing states in accordance with their proportion of production. [Comprehensive Peace Agreement, Wealth Sharing Protocol Articles 5.5–5.6]</p>	<p><b>Sudan</b> – National government is able to levy business-profit taxes and states are able to levy land-property taxes, royalties and excise taxes. [Comprehensive Peace Agreement, Power Sharing Protocol, Schedule A.35, Schedule B.12 and Schedule C.39]</p>	
<p><b>Venezuela</b> – Requires 15–20% of national budget to be transferred to the states. [Article 167.4] and envisions special allotments for states with hydrocarbon and mining activities [Article 156.16]</p>	<p><b>Papua New Guinea</b> – National government will support Bougainville in the goal of becoming financially self-reliant; once this occurs the two governments will establish a revenue-sharing formula. [Article 324]</p>	

<sup>1</sup> Drafters considered giving Aceh the right to collect natural-resource revenues directly, keep its 70% share, and to forward the remainder to the central government but ultimately chose to provide for greater transparency on the handling of revenues originating in Aceh (use of an external auditor on the collection and allocation of revenues originating in Aceh). [Sections 181 and 194 of the Law on Governing Aceh]

As much as possible, it is important for the financial health of both national and provincial governments that clear and specific rules govern the process of wealth-sharing. Particularly when the natural-resources sector represents a major sector of the economy, the extent to which the constitution centralises or decentralises the collection and distribution of resource wealth should be informed by the rights and duties assigned to the national government and state or provincial governments respectively. For example, if either the national government or the provinces are responsible under the constitution for funding a large social safety net (e.g. pensions, medical care, unemployment insurance) or subsidies on basic commodities, the need to fund these obligations should be reflected in the distribution of the benefits from natural resources.

There are three possible broad approaches to revenue collection and distribution: allocation of the right to directly collect certain types of revenues to state or provincial governments and certain types to national governments (as in Canada and Sudan); collection of revenues into a single account and then sharing them between different levels of government in accordance with an agreed formula (as in Nigeria, Venezuela, Indonesia and Aceh); and any number of combinations these alternatives (e.g. as in Iraq).<sup>15</sup> In the absence of clear assignment and subsequent monitoring of these authorities, there is the possibility of excessive and overlapping application of taxes and charges by both the national and provincial governments, diminishing the competitiveness of national resources and preventing a mutually beneficial growing of the revenue pie. The three options are discussed in the following three sections.

15 For a detailed treatment of these possible alternatives for oil resources, see: Ahmed, E. and Mottu, E. (2002) *Oil Revenue Assignments: Country Experiences and Issues*, International Monetary Fund.

### 5.3.2 Distinguishing between taxation and other methods of raising revenues

The first option involves a constitutional allocation of the authority to collect different types of revenues to different levels of governments. If, for example, the constitution allocates contracting authority or certain powers of taxation to the provinces, an automatic form of wealth-sharing can occur whereby provincial authorities can raise revenues through the collection of royalties, contract licence-fees bonuses and excise or production taxes, while corporate income taxes, export charges and other types of fees are maintained at the national level (e.g. as in Sudan).

The advantage of this kind of system, particularly in relation to divided societies, is that it can circumvent the distrust between regions and the national government by giving provincial governments the power to raise revenues directly from natural resources. On the other hand, because local collection of natural-resource revenues takes away revenues from the national government, decentralised systems can complicate the management of the national economy.<sup>16</sup> Furthermore, given the often uneven geographic distribution of natural resources, heavily decentralised systems have the potential to lead to wide income gaps between provinces (for example, Abu Dhabi and Dubai as compared to the other emirates in the decentralised system of the United Arab Emirates). Constitutional drafters therefore often consider a certain degree of redistribution of natural-resource revenue in decentralised systems. If this does not occur, the unequal distribution of natural-resources wealth can lead to concerns regarding the unequal

16 Ibid.

provision of public services between provinces (as in Canada), disparate levels of development (as in the United Arab Emirates) or may even spark the resentments which could provoke new sources of conflict in divided societies.

### 5.3.3 Formula-based revenue-sharing

The second option is a formula-based revenue-sharing system, whereby all types of revenues from the exploitation of a natural resource are collected into a single account and then distributed between the national government, different provinces or local governments based upon some agreed formula (e.g. in Sudan, Iraq for currently producing oil fields, Nigeria, Indonesia and Aceh). This formula can be based on a number of possible criteria, including: population ratios, land mass, ensuring an equal standard of public services between provinces, distinguishing between presently producing resources and future resources, provincial and national expenditure needs, derivation (payments to producing areas), and compensating the provinces, districts and indigenous peoples for the exploitation of resources from their land and associated environmental damage.<sup>17</sup> Nigeria provides perhaps the best-known example of such a system, with its constitution requiring the Nigerian Parliament to take into account several of the above criteria in approving a revenue-sharing formula every five years.

17 Ahmed and Mottu consider revenue-sharing systems to be less fiscally sound than the allocation of taxation authorities because they fully transmit volatility in commodity prices to provinces in a way that the allocation of tax bases or bonuses linked to production (rather than revenues) do not (Ahmed, E. and Mottu, E. (2002) *Oil Revenue Assignments: Country Experiences and Issues*, International Monetary Fund). This is a concern because of the generally limited alternative sources of revenues at the local level.

The greatest stumbling block in obtaining agreement of regional actors to formula-based revenue-sharing systems is often the ‘cheque is in the post’ syndrome. That is, the often-well-founded fear of provincial governments that the transfer of their fair share of natural-resource revenues from a central account will not be timely, transparent or free from political interference. Indeed it may have been past discrimination in the sharing of natural-resource wealth that served as the root source of conflict. This lack of trust has manifested itself in the context of negotiations in Sudan, Iraq and Indonesia. In these circumstances it is possible for the constitution to contain extraordinary guarantees on the automatic distribution of revenues and require implementing legislation to set forth the mechanisms and rules for doing this. For example, in the unitary state of Indonesia, drafters of the Law on the Autonomy of Aceh considered giving Aceh province the right to directly collect oil and gas revenues generated in the province, retain its agreed share of 70% (compared to less than 30% for other provinces), and forward the remainder to the central government.<sup>18</sup>

18 Ultimately the drafters chose to provide for greater transparency on the handling revenues originating in Aceh through the use of an external auditor that submits reports on the collecting and allocating of revenues originating in Aceh to both the Government of Indonesia and the Government of Aceh.

Recent negotiations have also seen the parties exploring outsourcing of the handling of natural-resource revenues to third parties, although central governments are naturally resistant to contracting outside parties to undertake functions that are normally reserved for central banks. For example, in negotiating drafts of Iraq’s Financial Resources Law, the Regional Government of the Iraqi Kurdistan Region proposed creating an Intergovernmental Petroleum Revenue Fund for Iraq in the Federal Reserve Bank of New York or a single international custodial institution of high financial standing. A brief case study outlining Iraq’s ongoing debate on oil and federalism is presented on page 32.



### 5.3.4 Mixed systems

Many systems embody some combination of these options. For example, Iraq's constitution envisages national collection and a population-based distribution of revenues from currently producing oil fields while seemingly allowing for separate regional-led arrangements for future oil fields. It is also possible to have asymmetrical revenue-sharing arrangements, where the rules or formulae for revenue-sharing for certain provinces are more favourable for oil-rich or secessionist-prone provinces (e.g. Indonesia and Aceh). The economic inefficiencies sometimes associated with asymmetrical natural-resource revenue-sharing arrangements can be interpreted as an effort to buy the loyalty of territorial dissidents.<sup>19</sup>

<sup>19</sup> Bird, R. and Ebel, R. (2005) *Fiscal Federalism and National Unity*. 25 March.

Assuming that the necessary political will is present, the shares accruing to various regional and national actors can be agreed and delivered through a variety of means. A certain level of creativity may be required in order to allow the parties to save face on the heated political issues of ownership and collection of revenues. For example, with hydrocarbons, political stalemate over the sharing of oil and gas revenues can be addressed through allowing the provinces to maintain revenues from regional production but utilising national refinery, pipeline charges or export duties for the transport of hydrocarbons as a means of transferring a share of the revenues to the central government or hydrocarbon-poor provinces through which pipelines pass (as with the Russian Federation during the 1990s).

## 5.4 Implications

The constitution has an important role to play in setting up the wealth-sharing system by clearly assigning revenue bases to various levels of government and setting out stable principles and agreed formulae for any revenue-transfer system. Particularly when natural resources have been a source of conflict, the constitution may also need to require enabling legislation and institutions to monitor production to ensure that national or local actors are not exceeding their production quotas or marketing illicit production outside agreed systems for the collection and distribution of natural-resources wealth. In federal systems, this will typically involve some balance between ensuring that all citizens enjoy at least a minimum standard of public services and the recognition of legitimate local desires for a share of production in their area and compensation for any damage incurred during the extraction process.

Ultimately, whatever mix of revenue-raising, collection and distribution systems is chosen, the overriding concern must be to ensure that there is a transparent and automatic collection and sharing of the national-resource wealth of a country in accordance with whatever wealth-sharing principles have been agreed. In some cases, given the importance of this issue and internal challenges related to both a deficit of trust and institutional weaknesses, parties have considered contracting out some of these sensitive and sovereign functions (e.g. those normally undertaken by the central bank) to outside actors. The willingness to consider such radical alternatives underscores the importance of this issue to preventing state failure.

# 6 | Initial thoughts on process

We have undertaken to develop a conceptual framework for natural-resource negotiations because there is possibly no other area in which parties to conflict (and sometimes mediators) can benefit from additional exposure to an issue than in the case of natural resources. As a vital first step, it is important that the parties have conceptual clarity of the different issues, especially the difference between ownership issues, regulatory-authority control issues, and issues relating to the treatment of natural-resource revenues. While it is beyond the remit of this article to traverse comprehensively the management of the process of natural-resource negotiations, there are four pertinent process considerations worth introducing here. These are how to: technicise the natural-resource debate, equalise the knowledge base of the parties, decide when and in what detail to address natural resources in the negotiating process, and identify the stakeholders to involve in the process. There are no simple answers to these questions, but they are important to consider because it has been our experience that the right answers arrived at through the wrong process may never see the light of day.

## 6.1 Technicising the debate

From a procedural standpoint, and especially given the heightened emotion that often surrounds natural-resource issues, an important success factor in resource negotiations may lie in being able to direct talks away from political slogans and towards technical issues of governance. For example, secessionist movements may have a visceral opposition to resource contracts signed by the existing or past governments (as in Sudan, Liberia and the Democratic Republic of Congo). A dispassionate expert assessment of this potentially inflammatory issue may help in establishing procedures for reviewing the validity of such contracts and processing claims for damages incurred by local populations.

In general therefore, making industry and finance experts on issues such as ownership, contracts and finance available to the parties at an early stage can be of great benefit. Technical experts can make presentations to the parties on possible outcomes under various scenarios to illuminate the range of potential trade-offs and mutually beneficial growing of the pie that can be enabled by moving beyond the zero-sum contestation of topics such as ownership. Experts can also give stakeholders a more realistic assessment of the issues involved, and can level wild and unfounded expectations (especially regarding money) that have the potential to bedevil negotiations. Finally, neutral technical briefings can also be used to establish jointly agreed objective criteria for the identification of solutions prior to engaging on the substantive choices. Thus if 'maximum return' on a natural resource is consensually agreed as such a criterion, this can be used to establish the best solution. In some cases, industry concerns can be important when considering various regulatory issues, and naturally point towards particular arrangements.

The employment of mutually agreed on experts can also have useful ancillary benefits. Putting the parties together on one side of the conference room to listen to and question industry experts and international advisors can create a positive ‘we are in this together’ dynamic among the parties. Even more importantly, if the parties respect their expertise, they might be willing to accept proposals from neutral experts which they would reject if they had come from each other. This is because the same proposal presented by one of the parties would be viewed as ‘their’ proposal, and its acceptance by another party could entail loss of face or be viewed as a concession.

## **6.2 Equalising the knowledge base**

Mutually beneficial solutions to conflicts are often held captive by the experiences and knowledge of the parties. In the case of natural resources, actors frequently have highly fixed and symbolic ideas such as a determination to establish ownership over a resource without recognising that regulatory authority is at least as important. Or there may be demands for a set percentage of resource revenues without full understanding of what exactly is being shared. This can be the case especially when a regionalist or secessionist movement, which may have limited experience in government, comes to the bargaining table for peace or constitutional negotiations.

In these cases, but also in general, it is important that there is some attempt to equalise the knowledge base of the parties. If this does not occur, talks can be non-productive because one side may not be confident in what it is committing to, and consequently continually prevaricate for fear of being seen as ‘selling out’. Natural-resource negotiations are often a high-stakes, high-risk game, and one important role the mediator can therefore play is to empower the parties by providing them with the knowledge to have the confidence to negotiate.

## **6.3 When and in what detail?**

A third procedural challenge is when to address natural resources in the overall constitutional or peace-treaty negotiations, and in what detail. There is no formulaic answer to this complicated question and the choices made will depend on the nature of the conflict and the importance of natural resources to it. With respect to timing, the decision of when to address natural resources is typically between early on (because of their importance) or at the end (in the hope that agreement on the allocation of other government authorities will provide a framework for the allocation of natural-resources authorities). While there is no ‘right way’ to proceed, timing can be a consequential decision which should receive special attention. In the case of Indonesia and Aceh, oil and gas was such an important factor in driving the conflict that wealth-sharing was one of the first issues dealt with in the various rounds of negotiations. In Sudan, oil was a similarly important issue but was postponed until all other fundamental issues were resolved because it was feared that disagreement on the matter could derail the talks in their entirety. As these examples demonstrate, failure to consider proper sequencing of natural-resource negotiations in relation to other issues can affect the overall chances of success of the talks.

Upon actually taking up the natural-resource issue, the subsequent challenge may be jointly to decide on the level of detail with which the constitution should address natural resources. Particularly in situations where the issue of natural resources has been a driver of conflict, relatively greater constitutional detail may be required to reassure parties of the nature of the compact into which they are entering. Typically it is the weaker or more vulnerable party in the negotiation that will argue for greater detail. On the other hand, the difficulty of amending constitutional provisions may suggest that the constitution should protect the procedures and mechanism for decision-making on natural-resource governance and allow specific laws or regulations to deal with complex details.

## **6.4 Which stakeholders and how?**

The fourth obvious challenge in natural-resources negotiations concerns identifying which interest groups (for example, national government, provincial governments, local government, communities or workers) should be regarded as stakeholders in the allocation of resources and the extent of their respective rewards against the overall importance of natural resources to financing national development. To be successful, a process will need to engage a broad range of actors, including not only those who have legitimate claims to ownership of the resource, but also those who could be affected by the allocation of authorities over the resource or the distribution of its revenues. In other words, the arrangements for governing resources cannot be determined unilaterally or often even just between the national government and the community or province in which the resource is located. On the other hand, the handling of the resource clearly cannot be resolved over the heads of local stakeholders or authorities by a group of non-resourced provinces.

In real conflicts, peace negotiations over core issues such as the sharing of resources often take place between the principal protagonists to a conflict on a bilateral basis (e.g. the Government of Sudan/Sudan People's Liberation Movement, and the National Party/African National Congress in South Africa). While this is undoubtedly necessary for peace talks to succeed, when such negotiations begin to touch upon fundamental issues related to the structure of the state they also require some form of broader consultation if a sustainable resolution to the conflict is to be achieved. This is because, apart from basic notions of fairness and equity, natural-resource negotiations that are concluded between only two parties are subject to being undermined by spoilers not included in the process. One possible path out of this conundrum is to accept the necessity for the parties to negotiate natural resources (especially where they represent a key driver of the conflict), but to have the peace agreement explicitly envisage a subsequent process either to broaden the debate or to result in a wider validation of the agreement reached.

Finally, it is also worthwhile to note that consultative processes need not be confined to constitutional assemblies or the parties to a formal negotiation, but rather can and should involve engagement with local communities, tribes, civil society and workers or unions. This is true for all issues in constitutional negotiations, but particularly important in the case of natural resources given the strong proprietary feelings of local communities over local resources and the likely significant local environmental and social impacts from their exploitation.

Deciding how to develop, manage and share the natural resources of a state has recently become one of the most difficult and contentious components of a peace agreement or constitution. This is especially the case when natural resources represent a significant proportion of national income or when the geographic distribution of natural resources is overlaid upon existing ethnic or religious divisions. While constitutions have not necessarily been called upon to do so in the past, in this context a constitution or peace treaty can perform three important tasks: it can set out the promises regarding natural-resource management and wealth-sharing within a national compact; it can establish the framework for the laws and appropriate institutions to deliver on these promises; and it has to provide guarantees to ensure that these promises are not amended or undermined by transient political majorities or dominant groups.

This article has sought to diagnose and provide conceptual clarity on the broad categories of issues important in the negotiation and management of natural resources in these types of situations, whether they arise in federal states or in unitary states facing local demands for autonomy and control over 'their' local resources. While they are inter-related, the ownership of natural resources, the allocation of power to manage and control natural resources, and the treatment of natural-resource revenues are three distinct concepts that can receive separate treatments depending upon the overall political and economic objectives of constitutional framers.

In certain circumstances, failing to distinguish between these different categories of issues, or simply limiting constitutional principles to a general statement of ownership of natural resources may reduce constitutional drafters' options and room for manoeuvre. Sudan provides perhaps the clearest example of this, where if the parties had not been able to agree to table the ownership issue to a future process and move on to discuss separately the issues of management and revenue-sharing, the peace negotiations in their entirety may have been jeopardised.<sup>20</sup>

<sup>20</sup> See, for example: Wennmann, Achim (2009) 'Wealth Sharing Beyond 2011: Economic Issues in Sudan's North-South Peace Process', Draft, 5 February.

The two overriding impressions which emerge from a review of natural-resource governance are: first, the emotions that natural resources generate; and second, the complexity of possible arrangements to govern their use and exploitation. There are no one-size-fits-all solutions to the handling of natural resources, and various potential systems are possible depending upon the specific country context. The task faced by negotiators is to direct the debate and process away from emotional claims and political slogans towards a technical discussion based on good governance and maximising the use of a resource for the shared benefit of all groups. This article has set out to provide a three-part analytical framework (ownership, management and control, and wealth-sharing) around which such a technical discussion can be structured – and to provide some initial thoughts on process design for accomplishing this. In identifying the concerns and sets of issues typically at play, we have sought to illuminate the range of potential trade-offs and mutually beneficial outcomes that can be achieved in resource negotiations. We hope that this can be a practical addition to the mediators' toolkit.

# Case studies

1 Adapted from: Wennmann, A. (2009), "Wealth Sharing Beyond 2011: Economic Issues in Sudan's North-South Peace Process", 5 February Draft.

## Sudan<sup>1</sup>

The 2005 Comprehensive Peace Agreement (CPA) in Sudan was a landmark deal to settle one of Africa's longest civil wars between the Government of Sudan (GoS) and the Sudan People's Liberation Movement/Army (SPLM/A). It contains interim arrangements for the structure of the state until a 2011 referendum on independence in southern Sudan.

The North-South conflict in Sudan has been driven by competing claims of various groups over political power, cultural identity and natural resources. Oil has been a particular driver of the conflict, fostering grievances in the South and was used as a rallying cry by the SPLM, which charged the Sudanese Government with exploiting the resource without providing tangible benefits to local populations. The majority of current oil production occurs in the disputed border area between the North and the South, elevating the strategic significance of these areas and severely complicating efforts at border demarcation. In addition, the majority of the country's unexploited reserves lie in the South, while the sole export pipeline runs through the North.

The Agreement on Wealth Sharing (AWS) is one of six protocols constituting the CPA, and sets out principles for the sharing of resources and institutional arrangements for governing Sudan's economy. Despite the importance of natural-resource issues to the conflict, detailed discussions on the AWS were possible only after fundamental principles on self-determination, state and religion, and security had been agreed. The AWS, in a compromise, does not address the issues of ownership of natural resources, but explicitly defers this to a future process.

Since 2005 the AWS has faced implementation challenges. The National Petroleum Commission which it established has not met regularly and there are problems in the transparency of oil exploitation and the distribution of oil payments to the Government of Southern Sudan. In May 2008 significant fighting occurred between the Sudanese Armed Forces (SAF) and the Sudan People's Liberation Army (SPLA) in the disputed oil-rich Abeyei region. Looking forward, there is the likely need to negotiate a long-term wealth-sharing agreement beyond 2011 regardless of whether the verdict of the referendum in Southern Sudan is unity or separation.

1 Adapted from: Krausa, J. and Wennmann, A. (2009), "Resource, Wealth, Autonomy and Peace in Aceh: Managing the Economic Dimensions of Conflict in Peace Processes", 4 February Draft.

## Indonesia<sup>1</sup>

The Aceh conflict involved a relatively homogenous population that took up arms in response to military oppression and economic exploitation. It is considered a classic resource conflict in which natural-resource exploitation paralleled by local impoverishment created grievances that fuelled a pre-existing conflict on self-determination. In particular, the discovery and exploitation of oil and gas in north-eastern Aceh beginning in 1974 framed Acehnese resistance against centralisation and military repression. Gas extraction augmented the Government's revenues, had significant local environmental and social effects, and resulted in an increased military presence in protection of the gas fields.

The Memorandum of Understanding (MoU) of 15 August 2005 closed one of Asia's longest civil wars and was in part motivated by the destruction in Aceh caused by the tsunami of late 2004. Natural resources were such a core motivator of the conflict that the principles, if not the details, of special wealth-sharing and joint control over natural resources for Aceh had previously been proposed by the Government of Indonesia in 2001. In contrast to the other case studies presented here, Indonesia is a unitary state and the arrangements contained in the MoU applied specifically to autonomy in Aceh rather than implying a reordering of the overall state structure. Under the MoU, Aceh was given the right to retain 70% of its oil and gas revenues (compared to 15% and 30% respectively in other provinces), greater transparency over the collection and distribution of natural-resource revenues, and joint management rights of oil and gas resources with the national government (as opposed to all provinces where oil and gas management is the domain of the national government).

While the MoU and subsequent Law on Governing Aceh have resulted in billions of dollars flowing into the province, Aceh's oil and gas reserves are nearly depleted and differences remain between Jakarta and Aceh on the concept of self-governance.

## Iraq

Iraq is perhaps uniquely dependent upon oil, which accounts for over two-thirds of GDP and generates 95% of government revenues. This resource bounty is however unevenly distributed throughout the country, with most deposits mainly found in the Kurdish North and even more extensively Shiite Arab South, with relatively little confirmed reserves located in areas with Sunni Arab majorities.

After decades of a highly centralised state and oil sector, which under Ba'athist governments undertook severely repressive actions against both Iraq's Shiite majority and Kurds struggling for autonomy, Iraq adopted a federal Constitution in 2005. Federalism and the handling of natural resources were among some of the most controversial elements in the compressed 2005 constitutional drafting process. The Constitution ultimately provided the autonomous Kurdistan Region and possible future regions substantial control over oil management and revenues, including an apparent ability to override national law on these matters. In particular, the charter is silent on the key issues of taxation and the handling of future oil and gas discoveries, possibly implying regional control over these authorities. Joint national and regional control is designated for current oil and gas fields, provided that the national government distributes their revenues in a fair manner according to population ratios and compensation is given to previously damaged areas.

The Constitution was endorsed by referendum but remains controversial with Sunni Arabs, and increasingly so with Shiite Arabs, who fear what its high levels of decentralisation will signify for the fair sharing of hydrocarbon wealth, and even national unity. Continuing disputes over the nature of federalism in Iraq and the drafting of the Hydrocarbon and Revenue Sharing Laws have hindered efforts to foster national reconciliation. Achieving a consensual agreement on oil is seen as important in addressing a key political driver of Iraq's insurgency as well as in resolving tensions between Arabs and Kurds over oil-rich disputed areas in north-central Iraq.









