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São Tomé and Príncipe – Maximizing Oil Wealth for Equitable Growth and Sustainable Socio-Economic Development

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Acronyms and Abbreviations

ADF	African Development Fund
ANP	National Petroleum Agency
CPIA	Country Policy and Institutional Assessment
CSP	Country Strategy Paper
DSA	Debt Sustainability Analysis
EEZ	Exclusive Economic Zone
EITI	Extractive Industry Transparency Initiative
ERHC	Environmental Remedial Holding Company
FDI	Foreign Direct Investment
GAPP	Generally Accepted Principles and Practices
GDP	Gross Domestic Product
GPF	Government Petroleum Fund
HIPC	Highly Indebted Poor Country
HR	Hartwick Rule
HRDP	Human Resource Development Project
I-CSP	Interim Country Strategy Paper
IMF	International Monetary Fund
IWG	International Working Group
JDA	Joint Development Assessment
JDZ	Joint Development Zone
LDP	Livestock Development Project
NPP	Non-Problematic Project
NTF	Nigerian Trust Fund
ORML	Oil Revenue Management Law
PFFG	Permanent Fund for Future Generation
PIH	Permanent Income Hypothesis
PRSP	Poverty Reduction Strategy Paper
STP	Sao Tome and Principe
SBI	Sustainable Budget Index
SSA	Sub Sahara Africa
SWF	Sovereign Wealth Fund
UA	Unit of Account
UNCTAD	United Nations Conference on Trade and Development

EXECUTIVE SUMMARY

1. The Democratic Republic of São Tomé and Príncipe (STP) is an archipelago of just over 1000 sq km in the Gulf of Guinea and consist of two islands: São Tomé and Príncipe. The country has a harmonized WB/AfDB Country Policy and Institutional Assessment (CPIA) rating of 3.154 in 2010, which falls below the cut-off score of 3.2 or more for non-fragile states.

2. STP is on the verge of becoming an oil producing country, with oil production expected to start flowing in 2016. Good governance and prudent management of the oil resources will provide an unparalleled opportunity to structurally transform the economy. Efficient and transparent public financial management of oil revenues will have significant impact on economic growth and development and this will have operational implications for the Bank's strategic engagement in STP.

3. The main objective of this study is to inform the Bank's policy engagement and dialogue in STP. The Bank's operational experiences in Africa have sufficiently demonstrated that natural resource curse which occurs in resource rich economies, has the potential amongst other issues to generate impressive economic growth without impacting positively on poverty reduction in the country. Such developments have normally translated to socio-economic unrest and conflict in Africa. It is on account of such occurrences that the Bank and other development partners have pursued dialogue that is aimed at ensuring that the benefits of economic growth and development is inclusive and widely shared by the country's citizenry[1].

4. It is envisaged that growth in STP will be largely driven by the oil-sector. STP will need to avoid the negative experiences of other oil producing natural resources African countries, where the non-oil sector displays low growth and high unemployment.

5. The paper recommends that the Government of STP come up with strategic decisions regarding saving and investment of its potential oil wealth and learn from the successful experiences of Botswana and Timor-Leste where strong institutions have been critical in monitoring and enforcing government adherence to set rules and practices. Becoming an EITI candidate country will help institutionalizing more transparency and accountability of the oil revenues.

6. For the Bank, engaging with resource-rich countries not only requires technically sound practical advice, but also an appreciation of the political economy. The Bank's support can foster multi-stakeholder capacity building of both state and non-state actors (including civil society, private sector, parliamentarians and the media), to build credibility, trust, and transparency throughout the value chain.

7. With good governance and prudent management of the oil resources, accompanied by a strong, dedicated and accountable political leadership and citizen participation, Sao Tome and Principle can emulate Cape Verde, another Lusophone Island nation, in transitioning from a low income to upper middle income country.

[1] As reiterated in the opening Statement of the AfDB President at the Bank's 2011 Annual Meeting in Lisbon, Portugal.

1. INTRODUCTION

1.1 The Democratic Republic of São Tomé and Príncipe (STP) is an archipelago of just over 1000 sq km in the Gulf of Guinea and consists of two islands: São Tomé is 50 km long and 32 km wide and the more mountainous of the two islands. Its peaks reach 2,024 meters. Príncipe is about 30 km long and 6 km wide. The country's economy is highly undiversified, with cocoa production as the main, albeit small, commercial crop and the tourism sector still in its infant years, however the country has significant agriculture and tourism potential.

1.2 STP is a fragile state as assessed using the Multilateral Development Bank's definition of fragility. The country has a harmonized WB/AfDB Country Policy and Institutional Assessment (CPIA) rating of 3.154 in 2010, which falls below the cut-off score of 3.2 or more for non-fragile states. Unlike the majority of fragile states in Africa that are post conflict countries, fragility in STP is driven mainly by economic vulnerability and insularity. Natural resources have the potential to make STP more fragile and conflict prone. STP therefore qualifies for the Technical Assistance and Capacity Building Support Window (Pillar III) of the Fragile States Facility.

1.3 The specific objectives of this paper are to (i) illustrate how STP can structurally transform its economy from a poor underdeveloped economy to a middle income economy using its natural resources and oil in particular; (ii) to inform the new CSP for STP and to enhance policy dialogue between the Bank and the Government of STP; and (iii) elaborate lessons learnt from countries that have made some progress in avoiding the natural resource curse.

2. RECENT SOCIO-POLITICAL DEVELOPMENTS

2.1 STP is one of the smallest economies in Africa with a gross national income (GNI) per capita of US$1,918 in 2010. Approximately 54 percent of its population of 166,000 is poor and 15 percent live in extreme poverty[2]. The country ranks 127 out of 169 countries in the 2010 UNDP Human Development Index (HDI) with an index of 0.488 placing STP in the group of countries with medium HDI. Life expectancy is 67 years and adult literacy rate is estimated at 83 percent. As a small Island State, STP is faced with geographic characteristics that constraints its economic development challenges. The country is insular and combined with weak infrastructure making the structural costs related to doing business as well as the competitiveness of all sectors of the economy very high[3].

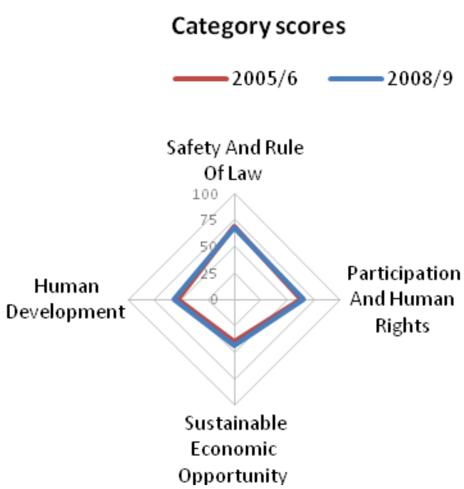
2.2 Politically, STP has a multi party system that has been punctuated by changes in government, through peaceful and transparent elections on several occasions Changes to the constitution, including the legalization of opposition political parties, led to nonviolent, free, and transparent elections in 1991.

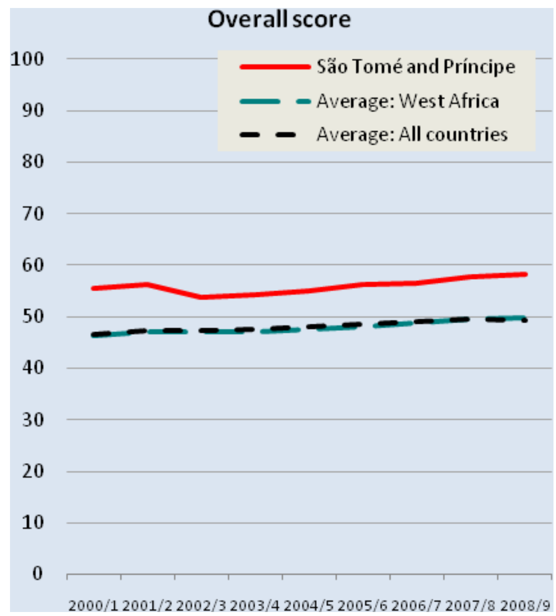
2.3 Sao Tome and Principe has made great strides toward developing its democratic institutions and further guaranteeing the civil and human rights of its citizens. Debates in the National Assembly have been carried out in an open, democratic, and legal manner, and the Sao Tomean law has been properly applied. A number of political parties actively participate in government and openly express their views. Overall, the government's respect for human rights is

[2] WB- Sao Tome and Principe: Country Brief
[3] ADB/BD/IF/2011/134; ADB/BD/IF/2011/108

strong. Freedom of the press is respected, and there are several independent newspapers in addition to the government bulletin. Further, there is no evidence of the government engaging in repressive measures against its citizens, and respect for individuals' rights to due process and protection from government abuses is widely honored. Freedom of expression is accepted. The 2010 edition of the Ibrahim index of African Governance ranks STP in 11th out of 53 countries in terms of civil liberties and political rights (see Figure 1).

Figure 1: 2010 Ibrahim Index of African Governance: Sao Tome and Principe





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3. RECENT ECONOMIC DEVELOPMENTS

3.1 Years of robust economic growth averaging 6.0 percent per year were followed by decline in 2009, when real GDP growth was 4.0 percent as a result of the global economic and financial crises. This resulted in a decline in Foreign Direct Investment (FDI) and took a toll on construction and trade related activities. The envisaged increase in external sources for financing the government's public investment program also fell short of expectations. In 2010, GDP growth picked up to 4.5 percent.

3.2 Inflation has been declining steadily since mid 2008, mainly reflecting lower food and oil prices. The annual average rate of inflation has trended down from 26.0 percent in 2008 to 14.0 percent in 2010.The deceleration in inflation was also as a result of tighter fiscal and monetary policies since 2008, which stabilized the exchange rate.

3.3 On the fiscal front, performance has improved and the overall fiscal balance (including grant as a percentage of GDP) was in surplus in 2007 and 2008. In 2009, the fiscal balance recorded a deficit of 19.2 percent and gradually reducing to a deficit of 7.9 percent in 2010 as a result of a decline in expenditure. Expenditure is dominated by personnel cost and capital expenditure, the bulk of which is financed by external loans and grants.

3.4 Prior to 2009, the exchange rate of the Dobra was stable against the US dollar as the banking system was highly dollarized. However in 2009, the authorities decided to shift management of the exchange rate from a managed float to a fixed exchange rate pegged to the Euro[4]. Pegging the exchange rate to the Euro meant that fiscal policy bears the burden of adjustment, as the central bank loses monetary policy autonomy. Liquidity management will require careful coordination with government fiscal operations.

3.5 Projections for 2011 are: (i) real GDP growth of 5.0 percent a year; (ii) reducing inflation further to 10.0 percent; and, (iii) reducing the fiscal deficit and making progress towards fiscal and external sustainability.

Table 1: Sao Tome and Principe Selected Economic Indicators 2007-2012

	2007	2008	2009	2010	2011(e)	2012(e)
GDP at constant prices (%)	6.0	5.8	4.0	4.5	5.0	6.0
Fiscal balance including grant (% of GDP)	121.6	14.9	-19.2	-7.9	-7.4	-10.9
Reserves (end Dec - in months of imports)	4.1	6.4	5.8	3.7	5.4	5.1
Trade Balance (% of GDP)	-41.8	-47.6	-39.6	-44.2	-50.3	-58.6
Consumer Prices annual average (%)	18.5	26.0	17.0	14.4	10.6	6.7

Source: IMF Regional Economic Outlook – Sub Saharan Africa, April 2011

3.6 STP is one of the 17 emerging African countries that posted per capita income growth of more than 3.2 percent annually over the last decade (Radelet, 2010). Debt relief under the enhanced Heavily Indebted Poor Countries Initiative (HIPC) and Multilateral Debt Relief Initiatives reduced the burden of the country's external debt substantially, however a narrow export base and high reliance on external financing makes it highly vulnerable to external shocks. Notwithstanding the HIPC relief, the debt burden is still high: São Tomé and Príncipe's debt ratios to exports and government revenues remain among the highest in the world. The external debt to GDP ratio in 2008 is estimated at 69.7 percent and is projected to fall to 52.2 percent in 2009, as the authorities conclude debt relief negotiations with non-Paris club members. Debt Sustainability Analysis (DSA) in 2010 classified the country as "high risk of debt distress".

4. THE OIL SECTOR IN STP

4.1 Potential for Structural Transformation of the Economy

4.1.1 STP is on the verge of becoming an oil producing country, with oil production expected to start flowing in 2016. Good governance and prudent management of the oil resources will provide an unparalleled opportunity to structurally transform the economy. Efficient and transparent public

134; ADB/BD/IF/2011/108

[4] World Bank (2008) –ID

financial management of oil revenues will have significant impact on economic growth and development and this will have operational implications for the Bank's strategic engagement in STP. With good financial governance, STP can use the fiscal space from the oil resources to generate large revenue for the government. This in turn, can finance public goods and services such as investment in education, health, and physical infrastructure for sustainable socio economic development and poverty reduction.

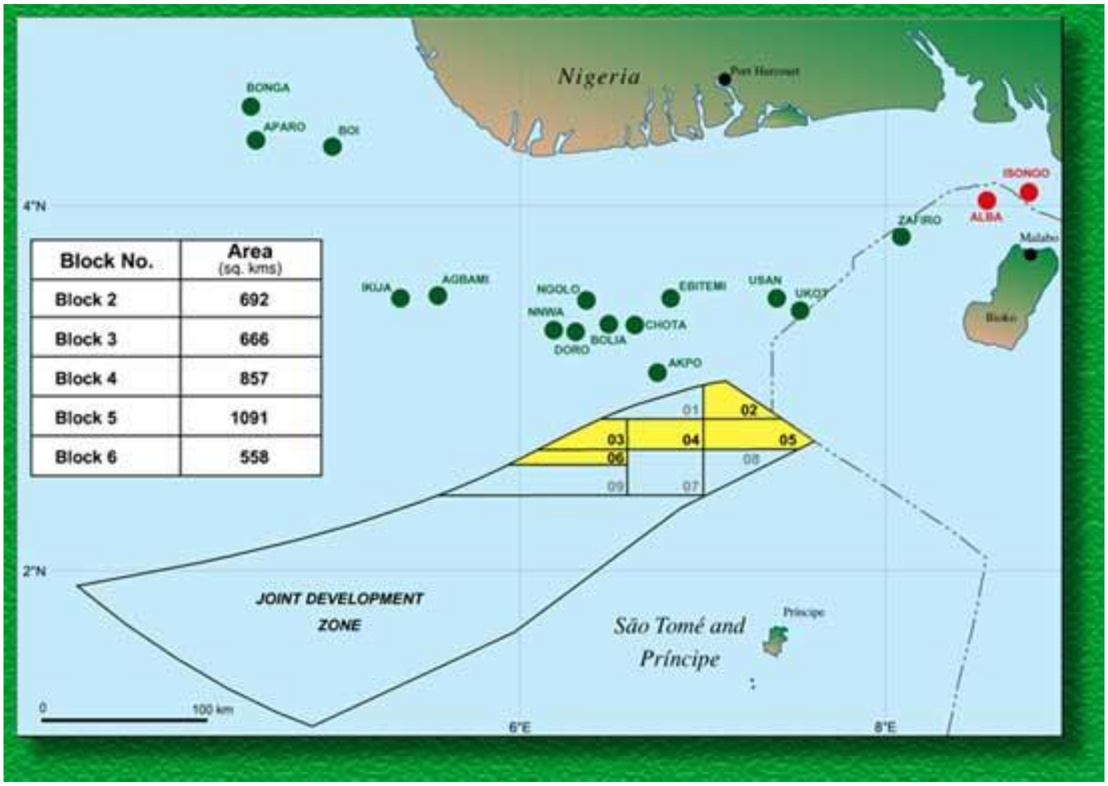
4.1.2 Baseline study conducted by Segura (2006) has shown that oil wealth accruing to STP would be significant, amounting to US$91.9 million annually. By 2032 the Permanent Fund for Future Generations would stabilize at slightly above US$3 billion or 43 times the 2006 GDP. Compared to the current level of donor support, the annual funding would be substantially higher and should in principle substitute for any decline in foreign aid once oil production takes off.

4.2 Joint Development Zone with Nigeria

4.2.1 In 2001, Nigeria and STP signed a Treaty to establish a Joint Development Zone (JDZ) in an area of overlapping maritime boundary claims (Figure 2). The treaty set up the Joint Development Agency (JDA) to jointly manage the resources of the zone. The latter also granted 60 percent to Nigeria and 40 percent to STP of the benefits and obligations arising from development activities in the JDZ. In 2004, the JDZ undertook a licensing round and a consortium comprising Chevron, Exxon Mobil and the Nigerian company Dangote Energy Equity Resources paid a signature bonus of US $123 million for the right to sign a Production Sharing Contract and explore Block 1. The baseline estimates of Block 1 prospective oil wealth for São Tomé and Príncipe are rather conservative and assumes the discovery of only one commercially exploitable block in the JDZ of 500 million barrels of oil in reserves, translating into the production of 70,000 barrels per day for twenty years, of which 28,000 barrels/day would be the Sãotomean share. This level of daily production is roughly that of an average-sized block in the Gulf of Guinea, (Segura, 2006).

4.2.2 In a second licensing round three other blocks were awarded and their licensees have also concluded Production Sharing Contracts: Sinopec (Block 2), Anadarko (Block 3) and Addax (Block 4) are their main operators. In addition to these, there is a contract with Environment Remedial Holding Company (ERHC), signed in 1997 giving extensive rights for oil exploration in STP's offshore waters for a very modest price. These rights have since been scaled back in two successive rounds of negotiations, but are still considered extremely generous, including pre-emption rights to blocks 2-6 in the JDZ and an exemption from paying any "signature bonus" on its entitlements. As a consequence of this prior rights agreement, STP has foregone US $ 51.8 million in signature bonus for blocks 2-4.

Figure 2 : Joint Development Zone (JDZ)



Source: http://www.nigeriasaotomejda.com/

4.2.3 STP also has its own Exclusive Economic Zone (EEZ) that may have the potential for considerable petroleum discoveries. A first bidding round was launched in 2008[5]. The authorities are also developing the country's legislation and strengthening their technical and economic capacity to make the best use of its resources. The joint development zone initiative with Nigeria can provide valuable experience to STP in its own EEZ.

4.3 Potential for Growth

4.3.1 In Africa, many resource-rich countries have failed to realize the full growth and development potential of their natural resources; instead they have been mired in conflict, fragility and underdevelopment. This is especially acute in the case of oil, gas, and mineral resources. It will be critical for STP to "get it right" and therefore gain from the

Box 1: Managing Natural Resources in Botswana.

The case of Botswana is widely cited as an example of responsible management of resource revenues. It is also where the link to improvements in infrastructure, human capital and basic service delivery is most apparent. In Botswana's case key factors for success included cautious macro-economic policy, low volatility in the global price of the resource (diamonds), good governance and the control of rent-seeking, a broad consultative process, domestic ownership of the reform process, separation of state powers, social and political stability, and multiparty parliamentary democracy. Botswana's success is qualified by its slow progress with economic diversification.

[5] World Bank (2008) –IDA report No. 42157 - STP

positive experience of Botswana as a good example of an African country that has managed its natural resource wealth well as well as avoid the negative experiences of other African countries where extraction of natural resource endowments has resulted in increased poverty, conflicts and social exclusion (Box 1).

4.3.2 In a country with weak macroeconomic management capacity, the abundance of oil resources will pose a serious challenge for macroeconomic policies. The government will need to balance funding public spending to reduce poverty and improve basic public services and the intergenerational consideration because oil resources are exhaustible. Policymakers in STP must find the right balance between public consumption and future investment and linking spending to a strategic vision as well as prioritizing poverty alleviation spending programs.

4.3.3 STP can also learn from experiences outside of the region where the extractive hydrocarbon sector has been well-managed, i.e. Malaysia, Norway, Brazil and more recently Timor-Leste have managed their oil revenues and avoided undesirable outcomes and achieved higher growth. These countries have built strong institutions that prevented the large and volatile rents from oil which usually influence a transparent political process, leading to patronage, rent seeking, and at the extreme political instability and violent conflict. They have also made a credible commitment to citizens to use these endowments well over time.

4.4 Potential for Extractive Industry Transparency Compliance.

4.4.1 Transparency, accountability and strong institutions are needed to complement economic prescription of sustainable management of natural resources. STP was a candidate country for the Extractive Industry Transparency Initiative (EITI) which aims to strengthen governance by improving transparency and accountability in the extractives sector. The benefits of being part of this initiative include an improved investment climate by providing a clear signal to investors and international financial institutions that the government is committed to greater transparency. EITI also assists in strengthening accountability and good governance, as well as promoting greater economic and political stability. This, in turn, can contribute to the prevention of conflict based around the oil, mining and gas sectors.

4.4.2 In 2010, the Government of STP requested to the EITI Board for voluntary suspension of the implementation of EITI in STP[6]. The Board decided not to grant the request and therefore STP is no longer considered to be an EITI implementing country. The EITI rules allow voluntary suspension in countries that are experiencing exceptional political instability and conflict. In the case of STP the Board did not consider that such circumstances existed. The Board concluded that implementation has been stalled due to circumstances related to the joint management with Nigeria of the Joint Development Zone and STP should re-apply when circumstances for rapid implementation were more favorable.

[6] The EITI Board concluded implementation was stalled mainly due to the circumstances related to the joint management with Nigeria of the Joint Development Zone.

5. THE DEBATE ON RESOURCE CURSE

5.1 There is ample existing evidence that African countries rich in extractible natural resources, especially oil, often suffer from high poverty, frequent conflict, poor governance and endemic corruption. Current policy prescriptions for countries hoping to evade the curse often fall short, partly because they do not address the internal political economy effects of the massive unearned income – the so called "rents" generated by natural resource extraction. When governments can survive on natural resource rents, they do not usually seem to systematically tax their citizens. Moreover, these resource rich governments commonly suffer from weak revenue management systems which can equally sustain basic social services. As a result, these services gap is more and more filled by non state actors while citizens do not have the platform to demand accountability for the poor revenue and expenditure reporting Citizens do not expect or demand public services, clean government, or even basic accountability

5.2 Various views have been postulated to explain the manifestation and symptoms of the "resource curse" phenomenon with post boom economic collapse of natural resource-rich countries (Gylfason, 2001; Sala-i- Martin and Subramanian, 2003; and Humphreys et. al., 2007). These include the 'Dutch disease', crowding-out effect (inefficient specialization), rent seeking, volatility, and institutional and policy environment (Elbadawi and Kaltani, 2008; and Gelb, 2010). Collier and Hoffler (2002) have shown that natural resources considerably increase the chances of civil conflict in a country and estimated that the effect of natural resources on conflict is strong and non-linear and showed that a country that has no natural resources faces a probability of civil conflict of 0.5 percent, whereas a country with natural resources-to-GDP share of 26 percent faces a probability of 23 percent.

5.3 Evidence from many resource-rich countries in Africa show their performance on human development indicators compare unfavorably to less-endowed countries (Box 2) and poverty is falling at a faster rate in mineral poor countries compared to mineral rich countries.[7] These countries in general have weaker long run growth, higher rates of poverty, and higher inequality than non mineral-dependent economies at similar level of income (Arbache and Page, 2008). At the root of this underperformance is the failure by governments to properly address the institutional, policy and macroeconomic challenges that come with natural resources wealth. This is because national administrations are weak, laws and regulations are defective, and policies inadequate. Governments are often badly equipped to deal with large, international Extractive Industries companies. Moreover, the overall governance environment is often poor, compounded by a tendency towards secrecy in natural resource matters. As a result, countries often do not receive fair compensation for their resources, and what they do receive once spent does not produce the desired benefits[8].

[7] Resource rich countries in Europe, Americas and Asia have HDIs that are very high and high compared to most African resource rich countries that have low HDIs.

[8] Transnational extractive sector industries are aware of the institutional weaknesses in low income countries and exploit them in addition to the resources. Shell has admitted to paying bribes in Nigeria; Enron was involved in bad deals in India.

Box 2: Equatorial Guinea: High natural resource driven growth, low human development.

Equatorial Guinea is one of the fastest growing economies in Africa. After the discovery of massive oil reserves in the 1990s, it has become the third-largest producer of oil in Sub Saharan Africa, after Nigeria and Angola. Oil revenue increased dramatically in value from US$190 million in 2000 to an estimated US$8.4 billion in 2009.

Massive foreign investments in the oil and gas sector, together with a sharp rise in oil exports and favorable terms of trade, have contributed to the country's impressive GDP growth since 1996 with an average real annual growth of 26.2 percent from 2001 to 2005. However, a slowdown in hydrocarbon production has caused the overall GDP growth to decelerate to 9.7 percent between 2006 and 2009. In 2008, Atlas GNI per capita was estimated at US$14,980. Oil contributes to around 73 percent of GDP, while the non-oil primary sector accounts for 3 percent of GDP.

The oil boom has not yet been translated into positive human development outcomes, which remain poor, as evidenced by the low human development index ranking (136 out of 187 countries in 2011 compared to Sao Tome and Principe's index of 144).

Despite abundant petroleum revenues, the standard of living of the majority of the population has not been significantly affected and poverty is widespread. Indications are that about three out of four people live with less than two dollars per day; about half the population does not have access to drinking water or sewage facilities. Between 1995 and 2000, approximately 16 percent of children under age five were malnourished. In education, the relatively low gross enrollment rate in primary education throws doubts on the capacity of Equatorial Guinea to reach the MDG of universal primary education by 2015.

Selected Human Development Indicators	Equatorial Guinea	Sao Tome and Principe
Under 5 mortality rate total per 1000 (2011)	157.9	89.7
Gross enrolment ratio Primary (%) (2010)	86	133.8
Life expectancy at birth (years) (2011)	51.5	66.3

Source:AfDB Statistics Department Database October 2011

5.4 (Klueh, et al., 2007), argue that a growing number of more recent country analyses show that it is possible to avoid the pitfalls of resource abundance by pro-actively establishing a sound institutional framework and macroeconomic management. Coordination of resource revenue windfall receipts with macroeconomic policies and institutional framework poses serious challenges in managing the economy. The challenge is to further strengthen governance in STP so as to counter political pressures for oil rent redistribution through patronage that are likely to arise as the domestic oil sector takes off.

6 LEGAL AND REGULATORY FRAMEWORK FOR MANAGING OIL SECTOR

6.1 Increase in inflows of foreign reserves that come with booming natural resource exports can provide fiscal space for Government to increase its expenditure in infrastructure and on social programs such as education and healthcare which can significantly reduce poverty and raise human capital development in the economy. However, if poorly managed, these flows have been known to cause serious and long-term macroeconomic instabilities, the most common being overvaluation of the currency, generating inflationary pressures, which often translates to the widening of the fiscal and balance of payments deficits to unsustainable levels. Therefore, striking a balance between these two opposing end results continues to confound governments and policy analysts (Elbadawi and Nandwa, 2011).

6.2 It is on this basis that the Permanent Income Hypothesis (PIH) and the Hartwick Rule (HR) have been proposed as guidelines for managing natural resource revenues in a sustainable manner. In SSA only Botswana has been successful in following and implementing the PIH in managing its resource revenues (Elbadawi and Nandwa, 2011). The most recent empirical study (Ombga and Djiofack ; 2010) that used Computable General Equilibrium (CGE) Model for Cameroon, found that while PIH reduces budget vulnerability during post oil transition, it was not directly associated with the improvement in the country's macroeconomic and sectoral indicators. Thus, PIH should not be regarded as a sole base of better management of oil revenue in the country. The relevant rule of oil revenues management in African countries should not reduce only the vulnerability of public finances, but it should also address the development needs of African oil-producing countries.

Box 3. Managing Natural Resource Abundance: What's the Policy Challenge?

Empirical evidence suggests that economies abundant in natural resources may tend to shift away from competitive manufacturing sectors where positive externalities for growth are generated. Or they may promote rent-seeking or low productive activities, especially in countries with large State participation. More recently, it has been argued that such economies tend to have a high level of income per capita, but low growth rates, given that resources will be exhausted in the future; therefore, they catch up to their steady state growth from above (Rodríguez and Sachs 1999).

The challenge for resource-abundant economies is this: How to implement a fiscal policy that is inter-temporally consistent—one that preserves resource wealth for future generations, reduces volatility in both output and government expenditures, minimizes low productive public and private investments financed by large windfalls in fiscal revenues, and consolidates a sustainable fiscal policy. (Source: Flagship report:–natural resources in Latin America and the Caribbean - beyond boom and burst. WB 2010)

6.3 It is against this background that STP has over the past few years created a number of institutions like the National Petroleum Council and the National Petroleum Agency to ensure sound regulation of the oil sector with the objective of addressing the "natural resource curse" that have plagued many African natural resource endowed countries.

6.4 STP has drafted a number of laws to make management of oil revenues balanced, transparent and accountable. The crafting of the laws and enabling regulation has been an open democratic process in which representatives from all political factions and social segments participated, in consultation with international experts[9]. According to (Segura, 2006) there are six milestones on the path to setting high transparency, accountability and governance standards in oil revenue management in STP:

- The General Law on Petroleum Exploration and Exploitation of August 2000 provides the legal framework for development of the oil sector. It states that all reserves and reservoirs of liquid and gaseous hydrocarbons belong to the state. It stipulates that petroleum operations are to be conducted either by the state, directly or through state-owned petroleum company, or by commercial companies licensed by the state. The law specifies that the state can only enter into the type of Production Sharing Agreement (PSA) that is considered best international practice.

- The treaty on the establishment of the Joint Development of Petroleum and other Resources with Nigeria in February 2001 regulates hydrocarbon operations in the Joint Development Zone (JDZ) and

[9] The Earth Institute

establishes the Joint Development Agency (JDA) and the Joint Ministerial Committee (JMC) to manage oil activities there.

- Decree No 3/2004 creates the National Petroleum Council to set national energy policies. The council has 15 members, including the President, the Prime Minister, several other Ministers, representatives of civil society and other individuals designated by the President and the Prime Minister.

- Law No 5/2004 of June 2004 creates the National Petroleum Agency (ANP). The ANP is in charge of managing oil and gas exploration and development in line with the policies devised by the National Petroleum Council.

- The Abuja Joint Declaration, signed by the Presidents of Nigeria and Sao Tome and Principe in June 2004, sets transparency guidelines to which all JDZ operations must adhere. The declaration also pledges adherence to the principles of the Extractive Industry Transparency Initiative (EITI).

- The Oil Revenue Management Law (ORML) of December 2004, which is the most critical legislation, regulates the payments, management, use and oversight of revenues resulting from oil operations in the entire national territory, including both EEZ and JDZ. The ORML sets fiscal rules about how oil proceeds are to be used in annual budgets.

6.5 Fiscal policy rule provides mechanism of resource revenue stream build-up, stable and predictable government financing of its budget and catering for intergenerational equity. Botswana is the only African country that has successfully pursued fiscal policy rule by following the Sustainable Budget Index (SBI). Botswana developed its own system for reinvestment of mineral revenues to offset depletion and the (SBI requires that all mineral revenues be reinvested. In the process, Botswana has achieved remarkable improvements in infrastructure, human capital, and the basic services supplied to its population.

6.6 STP is the second African country after Botswana to adopt and approve a fiscal rule for managing its oil resources based on Permanent Income Hypothesis (PIH) that is expected to provide sustainable government consumption and intergenerational equity while providing a predictable stream of oil revenues, so that the country can meet its pressing development needs[10]. Segura, (2006) showed that the expected oil wealth of STP is not only significant but will also be a stable source of financing the budget and for the gradual build up of the Permanent Fund for Future Generation (PFFG).

7 ESTABLISHING A SOVEREIGN WEALTH FUND

7.1 In STP, PFFG is like a Sovereign Wealth Fund (SWF). A SWF is a state owned investment fund composed of financial assets such as stocks, bonds, real estate or other instruments funded by foreign exchange assets. SWF provides resources to help diversify from non-renewable commodities; increase savings for the future; a source of sustainable long term capital growth; protect and stabilize the budget and economy from excessive volatility in revenue/exports. Setting

[10] For a discussion of the theoretical framework see Elbadawi and Nandwa (2011), Segura (2006), Franken (2006)

up of the PFFG will act as a source of stabilization fund to smooth government expenditure during boom-burst cycles and can provide an avenue for equitable intergenerational transfers. Successful and popular SWF are linked to the experiences of the Norwegian Government Pension Fund-Global (formerly known as the Norwegian Government Petroleum Fund), Alaska's Permanent Fund, Kuwait Investment Authority, Timor-Leste Petroleum Fund and Botswana's Pula Fund.

7.2 Collier, (2011) identified a four stage sequence for harnessing natural resources for sustainable development: managing the process of discovery; capturing the rents on natural resources through taxation; balancing the use of revenue between consumption and investment; and managing the investment process to achieve good returns. Collier questions whether the notion of SWF which is earmarked for future generations and is invested in international capital markets is right for a low income country like STP where the urgent needs of an impoverished present are being put on ice while low yielding financial assets are being accumulated abroad. Rather than SWF, what low-income countries need is a Sovereign Liquidity Fund of short-term assets to buffer the shocks to revenue.

7.3 Countries such as Norway, Kuwait, Botswana and Timor Leste that have successfully managed their oil wealth have subscribed to the "Santiago Principles". STP can benefit from subscribing to the "Santiago Principles" that have been adopted by the International Working Group (IWG) of SWF in 2008, which identifies the framework of generally accepted principles and practices (GAPP) in guiding the establishment of new SWF. The GAPP is a voluntary framework aimed at providing guidelines on the appropriate governance and accountability arrangements as well as the adoption of prudent investment practices by the SWFs. The GAPP framework is centered on three core areas (Elbadawi and Nandwa, 2011);

- Legal framework, objectives and coordination with macroeconomic policies.
- Institutional framework and governance structures.
- Investment and risk management.

7.4 Unlike other poor African countries that enjoy substantial oil wealth, the Government of Sao Tome and Principe has taken the proactive step to build a sound institutional and transparent framework to ensure that the benefits of the oil wealth are shared equitably and to avoid financial losses in dealing with mega oil companies. According to projections, in a few years time, Sao Tome and Principe will be able to generate its own internal resources, enough to allow for stable financing of development needs in perpetuity, from the returns of the Permanent Fund for Future Generations

7.5 The Government of Sao Tome and Principle has put in place legal and institutional framework that conforms to the GAPP and they can further deepen their engagement by subscribing to the GAPP by aligning coordination with macroeconomic policies plus investment and risk management in a holistic manner. The weak institutions, dearth of technical capacity and political will are the challenges that STP will have to overcome to adhere to the GAPP principles.

7.6 In this regard, the Natural Resource Charter, which has been adopted by NEPAD as a flagship programme and is endorsed by the African Development Bank, provides governments some guidance on the design of the institutions needed for the decision chain, and help citizens better understand key issues (Collier, 2011).

Box 4: Successful Case of Managing Oil Wealth in a Fragile State – Timor-Leste

As one of the newest independent countries in the world, Timor-Leste has valuable natural resources, including one of the most vital commodities in the global market, oil and gas. The macroeconomic framework is predicated on a rapid expansion of the oil and gas sector and an investment of oil and gas earnings in human capital, infrastructure and strategic sectors of the economy.

As a result of exploitation of the natural resources, Timor-Leste's economic situation is already extraordinary. Oil and gas earnings jumped from $141 million in 2004 to around $2.3 billion in 2008. Gross National Product rose from $460 million in 2004 to $2.9 billion in 2008 and declined modestly to $2.5 billion in 2010, reflecting the decline in oil prices since the peak of 2008.

According to projections, the current petroleum upstream revenue of $1.6 billion per year could rise to $2.0 billion per year in 2030. Administering the Petroleum fund is arguably one of the most important functions for the Government of Timor-Leste. The fund which was established with the advice of Norway in 2005 is regarded as a model of its kind. Regulations regarding investments, withdrawals and other aspects are detailed and Timor-Leste can only draw from the income generated by investment of petroleum capital with additional withdrawal requiring justification to the National Parliament.

The Government Petroleum fund has banked $6.3 billion in royalties and that could reach $20 billion by 2020. In 2009, the Peterson Institute in Washington DC, ranked it as the world's third best managed sovereign wealth fund after New Zealand and Norway. The government of Timor-Leste appointed the Bank for International Settlement to invest in non-USD Government bonds and so far 4% of the petroleum fund equivalent to approximately $215 million is invested in Australia Government bonds, Japanese Government bonds, Euro bonds and UK Government bonds and bonds issued by supranational institutions. In 2009 the Ministry of Finance assigned Tower Watson, a worldwide and highly reputable investment consultancy company to design the future investment strategy and asset allocation.

The Government of Timor-Leste benchmark the "3 percent rule" to current outlays and transfers not consuming or transferring more than the sustainable consumption level to 3 percent of the sum of the Estimated Sustainable Income (ESI) calculated as the sum of the Fund balance plus estimated NPV of future Fund revenue from petroleum.

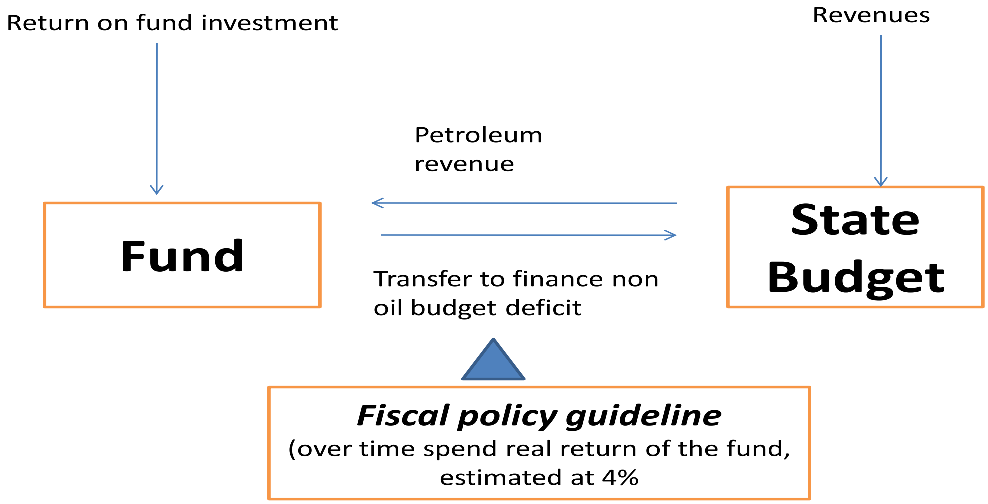
Lessons for Sao Tome and Principe

Although there are several critical challenges in Timor-Leste most important of which are political stability and poverty, Timor-Leste a lusophone country can provide valuable lessons for STP:-

1. There is strong and determined political leadership and broad ownership.
2. For a resource rich fragile state, Timor-Leste recognizes that its people, much more than land, minerals and petroleum are the ultimate sources of wealth of the country.
3. The Government has adopted a legal framework for petroleum production, taxation, and revenue management that is considered international best-practice.
3. Timor-Leste was accepted as an EITI Compliant country on 1 July 2010 becoming one of 10 EITI compliant countries worldwide.
4. The government is implementing a strategic plan with a clear framework which prioritizes investment in Human Capital, Infrastructure and Sector Investment.

Source: From Conflict to Prosperity – Timor-Leste's Strategic Development Plan 2011-2030, April 2010; www.mof.gov.tl – 2009 Annual Report

Figure 3: Norwegian GPFG Integrated with Fiscal Policy

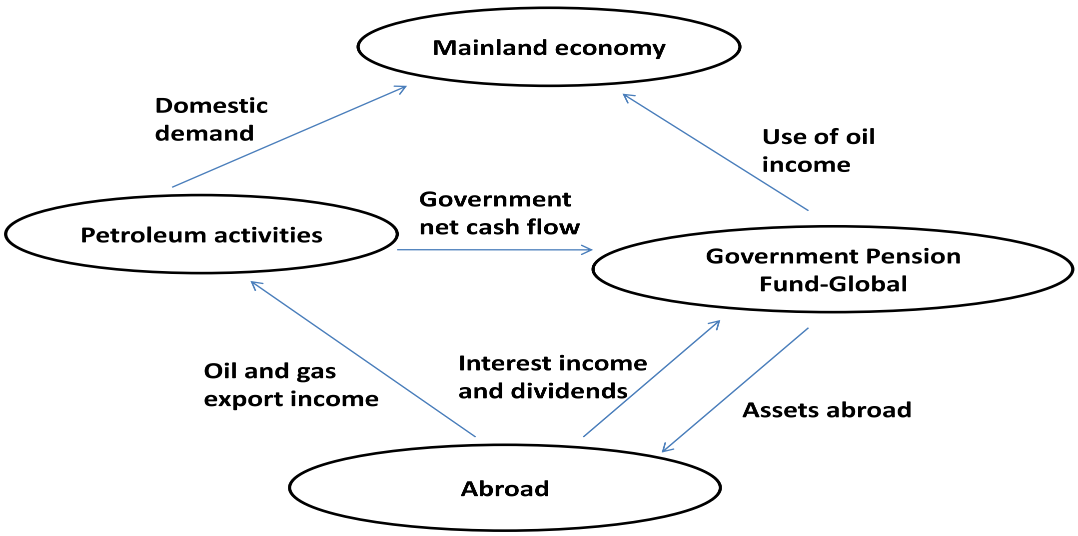


Source: http://alaskarenewableenergy.org/wp-content/uploads/2009/06/hege_eliassen.pdf

7.7 The experience of Norway in managing its oil wealth and its linkages with the overall economy might be useful for STP. Norway's Government Pension Fund-Global (GPFG) accumulates funds from all petroleum revenues while the outflows from the fund are in the form of transfer to the budget to finance non-oil budget deficit as shown in Figure 3.

- The Fund is fully integrated into the state budget. It functions as a tool to strengthen the budget process and builds on existing institutions.
- The Fund is only invested abroad in financial assets. This ensures risk diversification and good financial returns, and helps to protect the non-oil economy.
- There is a high degree of transparency and disclosure of information. This helps build public support for a wise management of petroleum revenues, and reduces the risk of bad governance.
- The Fund's inflow consists of all state petroleum revenues, net financial transactions related to petroleum activities, as well as the return on the Fund's investments.
- The outflow from the Fund is the sum needed to cover the non-oil budget deficit. This means that the Fund is fully integrated into the state budget and that net allocations to the Fund reflect the total budget surplus (including petroleum revenues). Fiscal policy, which regulates the outflow from the Fund, is anchored in the guideline that over time the structural, non-oil budget deficit shall correspond to the real return on the Fund, estimated at 4%. Parliament decides on a transfer rule.

Figure 4: Norwegian GPFG Integrated with Whole Economy



Source: Elbadawi and Nandwa (2011): Managing saving and investment of natural resource revenue in SSA

- The fund is also seamlessly integrated with the fiscal policy and the whole of the economy as shown in Figure 3. The Ministry of Finance acts as "owner" of the fund and decides the investment strategy, the benchmark portfolio and the relative risk limit. Norges Bank (the Central Bank), is the operational manager responsible for "value added" against a benchmark and reports risk and cost quarterly.

- The fund is an instrument of national financial savings. There are few profitable investment opportunities in Norway in view of the large size of the funds, hence the funds are invested abroad. This is done to avoid artificial bid up of financial asset prices so as not to lower the required return on investment in Norway and instigate capital outflow from the private sector.

- A study in 2010 by Edwin Truman found Norway Government Pension Fund tops 53 SWF in 37 countries – "Sovereign Wealth Funds; Treats or Salvation".

8. ECONOMIC DIVERSIFICATION

8.1 Productive Sectors

8.1.1 It is expected that by 2020, growth in STP will be largely driven by the oil sector. STP will need to avoid the negative experiences in the cases of other oil producing natural resources African countries, where the non-oil sector displays low growth and high unemployment. Thus, the quest for long-term, sustainable growth must consider diversification beyond the oil sector since it is a non-renewable resource. A key challenge for STP to emerge from fragility and commence a more normal development trajectory toward achieving middle income-country status is how to start building an economy today that can sustain economic growth after finite oil resources are exhausted.

8.1.2 Two sectors hold the key to economic diversification in STP (i) investment in raising agricultural productivity and (ii) promoting niche-high value tourism market[11]. These are in line with the two pillars of the *Programa do XIII Governo* to achieve sustained growth and poverty reduction, which is anchored on two pillars (i) increasing food security and (ii) promoting tourism as an engine of growth. With proper exploitation of its geostrategic location as a service hub and diversification into tourism and agriculture sectors, STP has the potential of avoiding the natural resource curse as a result of the discovery of oil. To maximize tourism potential, heavy investment in the infrastructure will be needed[12].

8.2 Tourism

8.2.1 Many developing countries are looking to tourism as a potentially promising avenue for economic and human development. Traditionally tourism was placed below manufacturing and agriculture, since it was not seen as an appropriate source of growth. In contrast, today, a "quiet but significant reappraisal" is taking place, which values tourism as a potential means of foreign exchange earnings, generating jobs – including for young people and women – promoting economic diversification and a more services oriented economy thereby reducing poverty.

8.2.2 In STP, investment in tourism is one of the sectors for "inclusive growth", given its ability to immediately employ unskilled labour and establish linkages with many other sectors of the economy. Tourism has a high potential due to STP's natural endowments and the archipelago's biodiversity with richness of its wildlife and plant life. This can be facilitated through the development impact of tourism related FDI as tourism contributes to:

(i) Export earnings.

(ii) Employment and incomes – job creation is one of the most direct channels through which investors (foreign and local) can be expected to contribute towards raising incomes and thereby contribute to poverty. Generally, investment in the tourism sector is particularly acclaimed for its potential to create jobs due to its labor intensive nature, for example activities in the hospitality industry and promoting eco-tourism that benefits the local communities.

(iii) Technology and skills – knowledge, skills and innovation in tourism business are key to success, and these could create opportunities for training institutes in the country's hospitality, transport, telecommunications and tourism industries.

(iv) Linkages to the local economy both formal and informal sectors – tourism can make an indirect contribution through linkages forged with other sectors of the local economy especially in the informal sector where the artisans operate. One of the greatest expectations of many host countries in terms of the development impacts of tourism is that the benefits may spread to other areas of the economy such as agriculture, construction, manufacturing and infrastructure, through supply chain and multiplier effects (UNCTAD 2007). Because of the extensive value chain in tourism, the more this industry is linked

[11] The small size of the country makes "mass" tourism unsustainable.
[12] The third pillar of progama do XIII governo is improving basic infrastructure.

with other sectors of the economy, the greater would be the effect on, for example, direct and indirect employment and revenue generation.

8.3 Agricultural Productivity and Food Self Sufficiency

8.3.1 Beyond oil, improving the agriculture sector offers the best opportunity for creating jobs, improving incomes and reversing food insecurity. The beginning of oil production should not lead to a loss of competitiveness of the agricultural sector despite the fact that agriculture remains the primary source of livelihood for the majority of the population especially the poorest. Agriculture represents a significant share of employment and output and any strategy for diversification cannot ignore improving agricultural productivity on both equity and efficiency grounds. STP enjoys climate diversity and soil fertility as a result of the Island volcanic constitution and high rainfall that can support a wide range of tropical crops and ensure food security. The main export crop on São Tomé is cocoa, representing about 95% of exports. Other export crops include copra, palm kernels, and coffee. Domestic food-crop production is inadequate to meet local consumption, so the country imports some of its food. Efforts have been made by the government in recent years to expand food production and achieve food self sufficiency.

8.3.2 Agriculture supports the livelihoods of the population and provides employment for about 55.0% of the economically active population in 2008. The majority of the population relies on agriculture for food and income and is a proven driver of economic growth and poverty reduction. Shared and inclusive agricultural growth is essential for improving incomes and ensuring poverty reduction in a country where the national poverty rate stands at 46%. Neglect of agriculture would create uneven growth, increase inequity and increase the risk of social unrest.

9. BANK GROUP PORTFOLIO IN STP AND LESSONS LEARNED

9.1 As a low income country STP is entitled to ADF allocations. In both ADF-11 and ADF-12 cycles, the Performance Based Allocation (PBA) for Sao Tome and Principe was UA 5.0 million. The PBA resources were supplemented with Fragile States Facility Pillar III resources of UA 2.5 million in ADF-11. One of the challenges for the Bank is how to optimize its intervention in small States and Island economies with small country PBA allocation to have a maximum impact.

9.2 Since 1976, the Bank overall portfolio in STP comprises 29 operations. This includes 24 projects, including institutional support, and 4 studies, for total net commitments of UA 107.5 million under the ADF (98.9%), as well as one special support operation of UA 1 million under the Nigeria Trust Fund (NTF). In 2010, the total disbursement rate stood at 84.6%. Agriculture has been the most important sector, receiving 24% of the total assistance. Currently, there are three active projects, totaling UA 13 million: a Human Resource Development Project (HRDP), rated as a problematic project; a Livestock Development Project (LDP II), rated as a non-problematic project; and the Infrastructure Rehabilitation for Food Security Support Project (PRIASA) project, recently approved in the context of the I-CSP 2010-11.

9.3 The lessons learnt are based on the 2005-2009 CSP completion report. The CSP focused on two pillars: (i) poverty reduction in rural areas; and (ii) promotion of good governance in public finance management. Overall, implementation of the projects selected under pillar I and pillar II produced mixed results with some progress in good governance noted, however there were shortcomings regarding the private sector's legal and regulatory framework, as well as PRSP monitoring/evaluation.

9.4 The 2005-2009 CSP completion report recommended that all stages of the project cycle should be adapted to the specific needs and peculiarities of STP. With regard to the design of operations, quality at entry criteria becomes even more relevant to: (i) simplify the technical design of projects and create conditions to facilitate their start-up (limiting the number of conditions for effectiveness, speeding up of first disbursement, etc.), (ii) adapt procurement procedures as much as possible to suit the local context (national procurement method preferred to international method), and (iii) use, as much as possible, structures that have already demonstrated their effectiveness elsewhere.

10. BUILDING STRONG ACCOUNTABLE INSTITUTIONS

10.1 STP is a country where the Bank's investment, can contribute to national development and structural transformation. This calls for the need to focus the country's PBA allocation of UA 5.0 million in ADF-12, preferably on one pillar where the Bank can add value[13]. Capacity development is now identified as one of the key drivers of country PRSPs. The Bank is but one of the several members supporting capacity development aid consortia in STP. It has been acknowledged that problems of poverty and weak institutional capacity are inextricably linked. The lack of state capacity to carry out basic public management functions means that large segments of the population do not have access to basic social services. Weak state institutions impose costs on entrepreneurs, exacerbate their risks and help perpetuate the barriers to competition by failing to enforce a robust legal and regulatory framework, thereby stunting economic growth[14]. Shifting the Bank's strategy of engagement in STP by supporting development programs to ensure that the country avoids the resource curse, and laying the foundations for job creation and service delivery should be priority area of support.

10.2 In the near future, the Bank's ADF allocation of UA 5.0 million over three years for Sao Tome and Principe will be insignificant compared to the country's projected annual revenue of US$91.9 million from oil. The Bank should consider shifting its strategy of engagement in STP by supporting development programs to ensure that the country avoids the resource curse. STP provides a unique opportunity for the Bank to focus preferably on one pillar of engagement in the country's new Country Strategy Paper and the proposal is to focus on capacity development, i.e., ***Capacity development for managing resource rent flows and utilization of resource rents for economic diversification and sustainable development.***

10.3 The Bank's entry point should assist STP in ensuring sustainable improvement of its institutional endowments in particular to manage its natural resources by improvements in the predictability, transparency and adequacy of resource management through medium term expenditure planning and better budget execution and deliver services to its citizens.

10.4 Capacity development for "managing resource rent flows" to support the country's drivers of growth are possible entry points that will respond to stimuli for change and catalyze broader

[13] There is no contention to having more than one Pillar perhaps if need be it should be a maximum of two pillars.
[14] World Bank. World Development Report 1997

capacity building constituencies over time with a focus on skills development with the capacity to manage the oil sector.

10.5 STP has been undertaking Public Financial Management reforms that can be deepened by strengthening the indigenous capacity to deliver within the context of Medium Term Expenditure Framework. Managing the oil revenue resources will require strengthening PFM capacity related to budgeting and accounting reforms, procurement, internal and external audit, and legislative oversight including the parliament and civil society to deepen financial accountability.

10.6 The Bank's clear focus on capacity development in the case of a small island economy with the minimum ADF allocation should achieve measurable results and demonstrate tangible development outcomes.

11. RECOMMENDATIONS

11.1 For São Tomé and Príncipe

11.1.1 STP should come up with strategic decisions regarding saving and investment of its oil wealth. The medium term macroeconomic framework for oil management should be linked to the underlying savings-investment strategy for natural resources. Countries with rule based fiscal institutions (such as Chile's structural fiscal surplus rule) and the natural resource funds (Norwegian and Gulf Cooperation Council (GCC) sovereign wealth funds and Timor-Leste petroleum fund) are based on variants of the PIH.

11.1.2 STP can learn from the successful experiences of Botswana and Timor-Leste where strong institutions have been critical in monitoring and enforcing government adherence to the GAPP set rules and practices. These rules ensure that the revenues from natural resources are managed in a transparent, balanced and accountable manner.

11.1.3 The Government of STP has been undertaking key institutional and policy reforms to consolidate good governance. Additional technical and capacity building support is needed to devolve more power to local units and strengthening the judiciary and legislative branches so as to develop institutional arrangements that place checks on the executive branch.

11.1.4 For a country that will soon benefit from its oil resources, the leaders in STP and civil society need to play a greater role to safeguard democracy. Leaders must adhere to the principles of transparency and accountability as spelled out in their constitutions and a stronger private sector and civil society that can demand greater accountability from the government and influence the future of democracy and the fight against corruption in engendering democracy.

11.1.5 In STP, the natural resources are sufficiently abundant relative to the size of the economy and its population (eg some of the oil producers in the Middle East). However as recent political events in North Africa and the Middle East confirm, dependence on resource rents and financial returns may fail to generate sufficient good jobs and employ growing population leading to social unrest despite high income.

11.1.6 STP should endeavor as soon as it is feasible to reapply to become and EITI candidate country. In addition to being EITI compliant, STP should subscribe to the Natural Resource Charter that will assist the government manage non-renewable natural resources in a way that generates economic growth that is inclusive, promotes the welfare of the population and is environmentally sustainable.

11.2 For African Development Bank

11.2.1 As part of the Bank's policy dialogue with the Government, the country should be encouraged to become EITI compliant so that citizens can have access to information related to oil revenue. STP can also be encouraged to pass the freedom of information law which could take transparency and accountability to an unprecedented level.

11.2.2 Engaging with resource-rich countries not only requires technically sound practical advice, but an appreciation of the political economy. Examining the micro politics of the natural resource management (NRM) sector in a systematic way is critical to identifying reforms and interventions that can help to increase accountability.

11.2.3 The Bank should promote consultations between government, the private sector, and civil society. The Bank can have a significant impact in the process if they help build the capacity of domestic civil society organizations and their understanding of the extractive industries.

11.2.4 The Bank's support should foster multi-stakeholder capacity building of both state and non-state actors (including civil society, private sector, parliamentarians and the media), to build credibility, trust, and transparency throughout the value chain. The goal is to build capacity to transform the resources into a source of income and livelihood for society as a whole.

11.2.5 The Bank through its capacity development support program to STP can facilitate sharing South-South Experience. Brazil has a lot in common with Africa and their experience on management of the wealth from their natural resources; designing safety net systems for the poor consumers is very well known. Brazil has a unique program for providing technical assistance to Africa, especially Lusophone Africa. In addition, Brazilian expertise can be used to help STP implement poverty programs, scaling up food production with scientific and technical advice from Brazilian counterparts. STP can also benefit from the Africa-Brazil Agricultural Innovation Marketplace – an initiative to enhance agricultural productivity in Africa by supporting the creation of partnerships between African and Brazilian organizations. Peer to Peer learning with Timor-Leste that will not need interpretation or translation should be encouraged.

11.2.6 The Bank should offer the services the African Legal Facility to help STP negotiate complex extractive resource contracts and create an appropriate, enabling environment with modern legal and regulatory frameworks for the extractive resource sector.

12 CONCLUSION

12.1 As outlined in the objectives, this paper attempts to demonstrate that STP, a fragile low income country can maximize its natural resource wealth and generate growth to structurally transform its economy by institutionalizing responsible management of its oil resources. Key factors for success includes cautious macroeconomic policy, fiscal based rule, good governance, domestic ownership of the reform process, control of rent seeking, a broad based consultative process, separation of state powers, social and political stability and multiparty parliamentary democracy.

12.2 STP can learn from the good experiences of Botswana and avoid the negative experiences of countries like Liberia, Sierra Leone, and Democratic Republic of Congo where natural resource wealth has resulted in conflict and fragility. In addition the experience of Timor-Leste and other countries outside the region where the hydro-carbon sector has been well managed and avoided undesirable outcomes of the natural resource curse and achieved higher growth.

12.3 With good governance and prudent management of the oil resources, accompanied by a strong, dedicated and accountable political leadership and citizen participation, Sao Tome and Principle can emulate Cape Verde, another Lusophone -speaking Island nation, in transitioning from a low income to upper middle income country.

ANNEX 1

NATURAL RESOURCE CHARTER
http://www.naturalresourcecharter.org/precepts

Preamble

Countries with non-renewable natural resource wealth face special opportunities and special challenges. Used well, these resources can create greater prosperity for current and future generations; used poorly, they can cause economic instability, social conflict and lasting environmental damage.

The purpose of the Natural Resource Charter is to assist the governments and societies of countries rich in non-renewable resources to manage those resources in a way that generates economic growth, promotes the welfare of the population and is environmentally sustainable.

The Resource Charter is an 12-point plan prepared by a group of high-profile economists, lawyers and political scientists, including Michael Spence, 2001 laureate of the Nobel prize in economics; Robert Conrad, an expert on natural resources economics at Duke University, and Tony Venables and Paul Collier, professors of economics at Oxford University.

THE TWELVE PRECEPTS

The Natural Resource Charter is a set of economic principles for governments and societies on how to best manage the opportunities created by natural resources for development. The Charter comprises twelve precepts, or principles, that encapsulate the choices and suggested strategies that governments might pursue to increase the prospects of sustained economic development from natural resource exploitation.

Precept 1: The development of a country's natural resources should be designed to secure the *greatest social and economic benefit* for its people. This requires *a comprehensive approach* in which every stage of the decision chain is understood and addressed.

Precept 2 : Successful natural resource management requires *government accountability* to an *informed public.*

Precept 3: Fiscal policies and contractual terms should ensure that the country gets *full benefit* from the resource, subject to attracting the investment necessary to realize that benefit. The long-term nature of resource extraction requires policies and contracts that are *robust to changing and uncertain circumstances.*

Precept 4: Competition in the award of contracts and development rights can be an effective mechanism to secure value and integrity.

Precept 5: Resource projects can have significant positive or negative local *economic, environmental and social effects* which should be identified, explored, accounted for, mitigated or compensated for at all stages of the project cycle. The decision to extract should be considered carefully.

Precept 6: Nationally owned resource companies should operate transparently with the objective of being commercially viable in a competitive environment.

Precept 7: Resource revenues should be used primarily to promote *sustained, inclusive economic development* through enabling and maintaining *high levels of investment* in the country.

Precept 8: Effective utilization of resource revenues requires that *domestic expenditure and investment be built up gradually* and be *smoothed* to take account of revenue volatility.

Precept 9: Government should use resource wealth as an opportunity to increase *the efficiency and equity of public spending* and enable the private sector to respond to structural changes in the economy.

Precept 10: Government should *facilitate private sector investments* at the national and local level for the purposes of diversification, as well as for exploiting the opportunities for domestic value added.

Precept 11: The *home governments* of extractive companies and *international capital centers* should require and enforce best practice.

Precept 12: *All extraction companies* should follow *best practice* in contracting, operations and payments.

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