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1 CCDP Issue Brief

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Guidelines for Mediators

Income Sharing from Natural Resources

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The presence of natural resources in conflict zones has been an influential aspect of many armed conflicts. Natural resources have shaped belligerents' objectives for using armed force, provided the means to fight, and integrated conflict areas into global markets. This CCDP Issue Brief explores the opportunities for peace mediation provided by the presence of natural resources and income sharing arrangements and suggests several reasons why these dimensions are important:

- Natural resources are central to understanding many armed conflicts because they influence the motives and mobilization of state and non-state armed groups. While mostly associated with the outbreak and duration of armed conflict, natural resources are also important for conflict de-escalation and termination.
- Capital and technology intensive natural resources can provide incentives for conflict termination because they cannot be fully commercialized during an ongoing armed conflict. Natural resources such as oil and gas therefore provide an opportunity for conflict resolution. They can be used to construct cooperative relationships and transitional pacts between parties through income sharing arrangements.
- Income sharing from natural resources addresses the ends and means of a past dispute, and creates new visions of future livelihood opportunities and post-conflict economic orders.
- To be an effective mediation instrument, income sharing arrangements should clearly define what is to be shared and how this will be done. Such arrangements should also include diagnostic and monitoring procedures on the prospects, value and distribution of natural resource wealth, while remaining flexible in allowing income sharing to occur without an agreement on resource ownership.

This CCDP Issue Brief is one of a three-part series on guidelines for mediators of peace processes. Part of a multi-year research project, it aims to introduce income sharing arrangements as an economic instrument in peace processes, identify opportunities and risks for mediation practice, and propose questions for the planning and management of peace processes.

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BACKGROUND

Natural resources and armed conflict

Natural resources are actual or potential sources of wealth that occur in nature. Some examples include timber, water, land, wildlife, minerals, metals, stones, and hydrocarbons. They are also distinguishable as renewable or non-renewable resources. After the Cold War, a number of African conflicts placed the spotlight on the relationship between natural resources and armed conflict. The issue gained prominence through proceedings of the United Nations Security Council Sanctions Monitoring Mechanism, and multi-stakeholder processes against conflict diamonds and the illegal behaviour of companies in conflict zones. Crucial driving forces for natural resource exploitation have been the global demand for primary commodities; the interaction between 'rough' companies, private military security providers, and logistics networks; as well as the persistence of impunity.

Over a decade of research has shown that the relationship between natural resources and armed conflict deserves a more nuanced understanding. The impact of natural resources on conflict dynamics depends largely on their patterns of dispersion (concentrated or diffuse); geographical location (proximate or distant from the capital); specific characteristics (lootable or non-lootable); and possible ways of exploration (labour or capital intensive). Natural resources have provided insurgents with the means to self-finance military operations. Oil, diamonds and drugs have shown to be particularly effective funding sources because revenue streams are relatively high and immediate, and can be easily centralized. Natural resources have also provided a motive for secession or demands for higher levels of autonomy and are usually intricately connected to socio-economic and political grievances, as well as interethnic disputes.

Natural resources and peace processes

Natural resources are part of the economic issues negotiated in peace processes. They relate to the backward looking functions of peace processes that address the ends and means of a past dispute, as well as forward looking functions that shape transitional pacts and visions of a new society and economic order.

Natural resources have been addressed in peace processes through wealth sharing arrangements. These arrangements have the specific functions to:

- Address a purported cause of conflict if disputes over natural resources were a cause for the outbreak of hostilities;
- Target the means of financing if natural resources were used to pay for a conflict; and
- Shape alternative futures if the parties agree to sharing provisions that define and regulate the use of domestic income sources for post-conflict economic recovery and development.

Income sharing is also often integrated into broader power sharing or constitutional negotiations that enable processes of 'normal' politics through institutionalized and non-violent problem solving. Constitutions can play an important role in formalising agreed revenue assignments, sharing principles, and transfer modalities. In this context, income sharing from natural resources is an economic incentive for the parties.

Negotiating income sharing from natural resources also implies laying the foundations for the prevention of future armed conflict. Wealth sharing addresses security dilemmas by balancing the relative gains from natural resources between the parties. Income sharing therefore regulates access to finances that could potentially be used for another round of conflict.

REVENUE CENTRALIZATION AND DECENTRALIZATION

Income sharing from natural resources involves addressing questions over who controls what percentage of the income and can decide over its disbursement. Discussions between central and regional state authorities on these matters can be politically sensitive and include the following arguments for revenue centralization or decentralization.

Arguments for revenue centralization

- Natural resources are 'owned' by the state or people, but for practical reasons the respective government may assert custodial rights over these resources. Revenue first needs to be centralized, before deciding on a political process that defines how revenues ought to be shared.
- Extractive industries seek out the government as contractual partners to ensure sovereign guarantees and increase security of contract.
- Most countries resort to centralized revenue management schemes to ensure macro-economic stability. Windfall revenues have to be administered centrally to manage price and market volatilities, strengthen macro-economic policy, and support national development plans.
- Centralized income sharing arrangements prevent debt financing of sub-national entities and therefore strengthen macro-economic stability.
- Income has to be centralized first before being shared with producing regions (vertical sharing) and non-producing regions (horizontal sharing) in order to strengthen national unity.

- In fragile natural resource rich countries, institutional capacity and expertise to manage large windfall revenues is often concentrated at the national level. Although this capacity may be weak in absolute terms, it is usually even weaker – if not non-existing – at the sub-national level.

Arguments for revenue decentralization

- Income sharing is politically important in order to balance centre-periphery relations and appease secessionist tensions.
- Oil producing regions are claiming the 'ownership' of resources and request a 'fair share' for selling off the heritage of local communities.
- Income sharing compensates producing regions for negative externalities such as pollution, social pressures, or disease.
- Decentralization of revenue is a strategy to strengthen state-society relations by devolving responsibility, building the capacity of sub-national institutions, and bringing the delivery of state services closer to the population.
- A central government can also agree to revenue decentralization because the taxes or informal measures levied against the private sector by local authorities against the will of the central government may result in market distortions and deteriorating investment conditions.

Box 1:

MANAGING THE OWNERSHIP OF NATURAL RESOURCES IN SUDAN

In the peace process between Northern and Southern Sudan, the ownership of land and natural resources was at the heart of the dispute over state sovereignty and national self-determination. For the government, state ownership of surface and sub-surface land was the prerequisite for an equitable distribution of resources and long-term development planning. It considered itself as the only legitimate and capable institution to redistribute national resources. Southern Sudan rejected such national ownership and made reference to principles of customary land use rights. During the negotiations of the Agreement on Wealth Sharing, a compromise evolved that rested on leaving the ownership issue 'unresolved'. This compromise allowed both parties to keep face with their constituencies because they had not given in on a critical issue. In this way, disagreement on a fundamental issue did not prevent progress on wealth sharing that was central to both parties' economic interests.

Sudanese Vice-President Ali Osman Taha (L) and Sudan People Liberation Army rebel leader John Garang, shake hands as they show documents they signed in Naivasha after agreeing on a wealth sharing deal on 7 January 2004. Source: AFP.

Box 2:

NATURAL RESOURCES AND PEACE NEGOTIATIONS IN ACEH

Even though natural resources have been acknowledged since the 1970s as important conflict drivers, they did not feature prominently in Aceh's 2005 peace negotiations because of their declining relative significance for the future economy in this particular case. Acehnese oil and gas production peaked in the 1990s and production facilities are likely to close by the next decade. In addition, a principle agreement on income sharing existed as part of an autonomy law.

Natural resources became an issue during peace negotiations in Finland when the Acehnese delegation insisted on compensation for past exploitation. The Indonesian government, however, argued that all records necessary to document the volume and value of oil production in Aceh had been destroyed by the Tsunami. While the parties agreed on a sharing formula for current and future hydrocarbon deposits and other natural resources in the 2005 Memorandum of Understanding, the issue of compensation for past production was to be addressed in the future as part of a truth commission.

INCOME SHARING FROM NATURAL RESOURCES

Income sharing usually occurs at two levels: It occurs between the company and the government, as well as between the government and sub-national entities.

Company-to-government transfers

- Company-to-government transfers are usually part of larger negotiations on natural resource ventures that structure the relationship and obligations between a company and a state. These can involve license agreements, production-sharing contracts, joint ventures, and service agreements.
- Production sharing contracts are the most common arrangement to structure company transfers. These are agreements between a company and a host government; the company usually bears all exploration costs and risks – as well as development and production costs – in return for a stipulated share of the production.
- Wealth sharing in company terms captures the transfers to the government in accordance with contractual obligations. Everything that happens after this transfer is perceived as a matter of national policy and development priorities of the host government.
- In many contexts, companies resort to sharing revenue directly with local communities through investments in social, health, education, or transport infrastructure. Central governments can, however, view these investments with reservations because they want to monopolise relations with oil companies.

National wealth sharing schemes

- The sharing of natural resource rents with sub-national entities and the population involves various income sharing schemes including horizontal and vertical sharing, as well as direct distribution and tax base adjustments (see Table 1).
- The income from natural resources is often shared according to the derivation principle by which the share of each sub-national entity is related to the revenue from natural resources originating in its territory. Other sharing principles relate to the size of the population, development needs, or existing tax capacity.
- Direct distribution of income from natural resources to citizens is an exceptional practice and difficult to apply in fragile or conflict contexts due to weak institutions and incomplete citizen registries.
- The assignment by the government of tax bases to sub-state entities can be part – as in Indonesia – of a broader reform of centre-periphery relations. From an economic standpoint, they are the least distorting option of income sharing, and generally more effective if natural resource deposits are located in areas that are not strongly natural resource dependent. In the case that the economic base is weaker or revenues are high, income sharing can occur through a mix of tax base assignments and vertical sharing, which can help diversify the economy.
- In order to preserve the future development value of natural resources, income is often collected in national revenue funds. These represent a permanent endowment that is invested to nurture national economic and human development and manage market and price volatility without depreciating the endowment. National revenue funds can therefore become a strategic instrument for forward-looking peace negotiations and the construction of a new economic future.

Table 1:
INCOME SHARING SCHEMES

Horizontal sharing	Income sharing between natural resource rich and poor sub-state entities that often involves revenue equalization schemes. In such cases, the federal government collects and redistributes income from natural resources to sub-state entities according to an agreed upon formula.
Vertical sharing	The sharing of income from natural resources between the central government and producing sub-state entities that specifies how much belongs to the national level, and how much to the sub-state entity.
Direct distribution	Direct payments to citizens living in producing areas. In the United States (Alaska) and Canada (Alberta), natural resource revenue accrues directly at the state or provincial level and revenue is shared through direct payments to citizens.
Tax base assignments	Income sharing from natural resources is converted to authority for sub-national entities over tax bases. Such assignments can entail an increase of the share of taxes extracted in the sub-national entity, additional transfers from the central government, or special purpose grants or transfers.

LESSONS FROM INCOME SHARING NEGOTIATIONS

- *Clearly define what is shared, and how*. A clear understanding on the object and modalities of income sharing is important to prevent complications during the peace process. In Sudan, the government became more open to income sharing once it became clear that the proposed sharing formula would only apply to specific wells on the north-south border line, and not to all oil wells in Sudan.
- *Keep negotiations flexible enough to allow resource ownership to remain unresolved if necessary, thus enabling future progress on revenue sharing.* Governments often emphasize the sovereign ownership of natural resources, while local communities insist that natural resources are part of their heritage. As Box 1 illustrates, agreeing on income sharing – but not insisting on ownership – allows a peace process to move forward and the parties to keep face.
- *Create information on natural resource wealth to level the playing field and manage expectations.* Information about the occurrence and value of natural resources is often unreliable after years of conflict. The parties can have hugely differing perceptions on the prospects and value of natural resources. Box 2 emphasizes that the importance of natural resources within a conflict can change over time. Progressive resource depletion, for example, reduces their significance for future economic development. The challenge for the mediator is to broker a joint vision of a new economic reality that becomes an acceptable bottom line for a transitional pact.

An Indonesian soldier stands guard around an ExxonMobil gas field in Lhokseumawe, Aceh, in 2001. Source: AFP.

- *Negotiations on income sharing can alter relations between the parties.* Interests in revenue sharing can represent an incentive that overrides intergroup or personal animosities. In Sudan, oil represented an incentive for peace because major extraction and investments could not occur in a war context. Oil revenue incentives contributed to tactically informed choices aimed at relocating the fighting from the battle field to the negotiation table.
- *Income sharing from natural resources occurs in the context of formal as well as informal economies.* The issue of natural resources can be effectively off-limits in peace talks because they can be central to conflict financing and local political economies. As Box 3 shows, insisting on their inclusion may even lead to the outright rejection of the entire peace process. In contrast, tacitly allowing the parties to control informal economies may be the best choice for a mediator given the possibility of other more negative outcomes. Such a solution is also important for forging transitional pacts, and preparing the transformation of non-state armed groups into political parties.

Workers stand on a muddy cliff as they work at a gold mine in Chudja, near Bunia in 2009. The conflict in the DRC has often been linked to a struggle for control over its minerals resources. Source: AFP.

- *Having a good income sharing agreement does not guarantee post-conflict economic recovery.* The positive long-term effects of income sharing are often undermined by other problems of war-to-peace transitions. These include, for example, implementation problems, a lack of security guarantees, or persistent distrust between former belligerents. Immediate conditions after peace agreements also differ and define how people and governments experience post-conflict transitions.

QUESTIONS FOR THE MEDIATOR

Identifying the resource base for income sharing

- What are potential revenue sources? How do natural resource revenues compare to other sources of revenue? What are the main natural resource-related income sources? Who captures these resources?
- What are the characteristics of the natural resources? Are they lootable or non-lootable, labour or capital intensive, concentrated or diffuse, proximate or distant from the capital city?
- What are the main information sources on the resource base? How do different estimations of present and future income possibilities compare?

Scoping the attitude of stakeholders towards income sharing

- Who controls which revenue source at the time of engagement of the parties into the peace process? Who are the local and international actors associated with the commercialization of natural resources in a given country or region? What are their expected benefits or losses from income sharing arrangements?
- Has previous resource exploitation or resource management fostered grievances in producing regions? Have these grievances led to secessionist violence, demands for more autonomy, or other forms of community mobilization? What are their claims for compensation of past exploration?
- How have companies structured their natural resource extraction projects? Have they exclusively dealt with the central government? Have they fostered relations with local communities, or non-state armed groups?

Preparing income sharing negotiations

- What are different estimates on future value and prospects? How do these estimates compare to local perceptions? Where are the knowledge gaps that need to be filled?
- What is the level of expertise on natural resource

management of the parties? Is there a need for training initiatives? In what subjects or areas?

- What is defined as 'income'? What are the modalities for income sharing? How will the parties structure payments? What is the income supposed to be used for? What is the process that determines disbursement decisions?
- What new institutions are necessary to manage income sharing? Will these be located within or outside the country? What degree of centralization or decentralization is acceptable to the parties and beneficial for post-conflict economic recovery?
- What are necessary monitoring and reporting procedures? How will economic data be presented to account for inflows and outflows? What is the role of civil society in performing checks and balances on revenue transparency and disbursement of income from natural resources?

Box 3:

DEALING WITH THE 'VISIBLE' AND 'INVISIBLE' ECONOMIES IN THE DEMOCRATIC REPUBLIC OF THE CONGO (DRC)

During the 2002 peace negotiations in the DRC, none of the belligerents or complicit third parties wanted to openly acknowledge the conflict's economic dimensions. Ignoring this dimension allowed them to avoid exposing their involvement in natural resource exploitation during the conflict. The few references that were included in the agreement resulted from foreign pressure but were never given much credit by the parties. Had natural resources been addressed more explicitly, it is likely that the parties would have withdrawn from the process. Instead, they focused on a power-sharing arrangement that would regulate the control of resources once the armed conflict was over. The parties had an interest in the overall success of the process, which they hoped would given them additional economic opportunities while maintaining control over natural resources through the shadow economy. This example highlights that negotiations over natural resources often relate to the 'visible' and 'invisible' economy, and therefore to what the parties want to discuss, and what is effectively off-limits for them.

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Diamond prospectors in Koidu, eastern Sierra Leone, 250 km east of Freetown in 2001.
Source: AFP.

The Centre on Conflict, Development and Peacebuilding (CCDP) is a research centre of the Graduate Institute of International and Development Studies in Geneva, Switzerland. It aims to offer policy relevant research built upon strong academic foundations on a variety of themes and issues, including: peacebuilding and reconciliation; post-conflict transitions and state-building; armed violence and development; and multi-stakeholder initiatives and the politics of monitoring and evaluation. CCDP Issue Briefs comprise one stream of the centre's publications. Their primary objective is to distil research findings amongst the relevant community of policy-makers as well as amongst practitioners and scholars.

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For more information, see
http://graduateinstitute.ch/ccdp/tools-peace-processes.html.

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