

# **Design Summary and Implementation Document – IMF Topical Trust Fund on Managing Natural Resource Wealth**

## **Proposed program and rationale for AusAID participation**

### **i) country and sector issues, links with current programs, lessons learned**

### **ii) AusAID objectives in supporting the activity**

The International Monetary Fund (IMF) Topical Trust Fund on Managing Natural Resource Wealth (the trust fund) is of strategic relevance to AusAID and our partner countries. Many resource-rich developing countries have suffered the so-called ‘resource curse’ and failed to translate resource wealth into broad-based growth and sustainable development. Large extractive industries have the potential to finance considerable public investment in infrastructure, health and education, however, historically the performance of resource-rich developing countries in terms of growth and human development tends to be worse than that of their non-resource-rich peers.

Resource-rich developing countries face a number of unique challenges. First, economic management in these countries is generally more complex. Governments face challenges in setting appropriate policies and regulations for exploration and exploitation of natural resources. Effective management of large resource revenues can also present significant challenges to governments. Second, the quality of governance is also critical to managing the increased risk of corruption. Large resource revenue flows create strong incentives for rent-seeking and corruption, which are corrosive to economic growth and development. Governments that are not reliant on taxation revenue (such as through personal income and consumption taxes) due to large natural resource revenue flows are often less accountable and responsive to citizen taxpayers. Natural resources need to be managed with this in mind.

The trust fund can make a contribution to the ability of partner countries to achieve sustained and broad-based growth and development. Some of the key outcomes which the trust fund is expected to contribute towards include:

- increased investment into resource sectors
- increased employment creation
- greater public revenues for investment in human development
- enhanced transparency
- improved macroeconomic stability.

The trust fund will provide assistance to requesting eligible governments in a number of broad areas of economic management which are critical to making the most of natural resource wealth. The trust fund aims to make a contribution under the following modules of economic management:

1. Fiscal regimes, licensing and contracting – setting the right administrative framework to promote efficient exploitation of natural resources. An effective administrative framework will encourage private investment which helps generate economic growth, employment, and tax revenues. This is particularly important for countries such as Afghanistan which are at the earliest stages of accessing their natural resource wealth.

2. Revenue administration – ensuring the resource revenues due are collected in full and in a transparent and efficient manner. This is critical in low capacity environments which are seeing substantial private investment such as Papua New Guinea. Revenue administration is particularly difficult for the resource sector due to its complexity, the low capacity of government and the strong incentives for rent-seeking and corruption.
3. Macro-fiscal, public financial management and expenditure policy – managing the macroeconomic impact of the natural resource sector. Macroeconomic management is more difficult in resource-rich economies. There is the potential for Dutch disease which can prevent broad-based growth and development. Macroeconomic volatility can also be high which makes budget management difficult and can deter private investment and even derail the development process. Assistance in this area can be particularly useful for countries where the resources sector already has important macroeconomic implications, for example due to the size of resource tax revenues, such as in East Timor and Indonesia, or due to a significant increase in private investment such as in Papua New Guinea.
4. Natural resource asset and liability management – balancing the benefits and costs of resource wealth over time. Asset management aims to maximise the economic returns to accumulated revenues and share the benefits of resource wealth with future generations. Provisions often also have to be made for future costs caused by the resources sector. Asset and liability management are particularly important in countries such as Papua New Guinea which need to put in place arrangements such as a sovereign wealth fund to manage sizeable revenue flows that should largely be saved for the long term. Assistance in this area may also be useful for countries like Indonesia which have relatively mature resource sectors and may need to focus on liability management and building a holistic approach to asset management.
5. Statistics for managing natural resources – good economic management needs to be underpinned by robust statistics. Good statistics on natural resources can be difficult to compile. There is likely to be scope for a large number of countries to benefit from assistance in this area.

AusAID's objectives in supporting the trust fund are multifaceted. The trust fund can assist developing countries by providing independent expertise in its specific areas of economic management. This can catalyse reform. There are considerable potential synergies between the trust fund and AusAID's existing economic governance programs in eligible countries.

AusAID partner countries are demanding assistance on how to manage their natural resources. This is being reflected in broader discussion across AusAID on how to incorporate mining into the Australian development program. AusAID is also keenly engaged in various multilateral forums dealing with natural resources, such as the Extractive Industries Transparency Initiative. The trust fund will complement our participation in such forums as it deals with the issue of natural resources from an economic management rather than governance angle.

Managing natural resources is a critical long-term development issue for a number of AusAID's key partner countries including Afghanistan, East Timor, Indonesia, Papua New Guinea, Solomon Islands and many African countries. Some specific links are detailed in section 3. A contribution to the trust fund provides a useful mechanism for delivering highly relevant support both to partners in our immediate region and also to numerous countries in Africa where AusAID is expanding its presence.

## **Proposed AusAID funding amounts (including how it will be allocated and over what timeframe)**

The Acting Foreign Minister, Dr Craig Emerson, approved a contribution of \$5,000,000 to the trust fund on 10 December 2010. This contribution will be paid in 2010-11.

A contribution of \$5,000,000 makes Australia a lead donor to the Trust Fund, along with Norway and Switzerland. This contribution also gives us a seat on the Steering Committee.

## **Implementation arrangements, including a clear identification of AusAID's role in the partnership**

AusAID intends to be an active partner in the trust fund with an ongoing oversight and reporting role provided by the Economics and Public Finance Section. Overall management of Australian participation in the trust fund will be managed by the Economics and Public Finance Section. The Economics and Public Finance Section will be responsible for consulting with relevant Australian Government and AusAID stakeholders including posts, country and regional programs, and relevant thematic programs. Individual country programs may be closely involved in both trust fund assistance in respective countries and integrating trust fund outputs into country programs, depending on their priorities and availability.

Priority tasks for AusAID will include:

1. **Active participation on the trust fund Steering Committee:** Australia's contribution will provide us with a seat on the Steering Committee. This will provide us with the opportunity to engage on how the trust fund is managed. We will be engaged in approving the trust fund's indicative work plan, and provide input on the country focus and broad areas of work of the trust fund operations. In particular, AusAID will use its seat to advocate for technical assistance in relevant AusAID priority countries, such as Afghanistan, East Timor and Papua New Guinea.
2. **Building demand for trust fund assistance:** The trust fund is designed to be driven by demand from developing country governments. To maximise the impact of the trust fund, Australia could help partner governments identify reform needs and understand how the trust fund might assist them. Existing economic governance programs are an avenue to play such a role, where this aligns with country program priorities. Where this is the case, this work will be led by respective country programs with assistance from the Economics and Public Finance Section.
3. **Internal capacity development:** Where relevant and possible, AusAID will participate in trust fund missions. This will help build AusAID's knowledge of the trust fund activities and build our capacity in the sub-sector. Such capacity development will allow AusAID to support implementation of the reforms being pursued by the trust fund.

Examples of specific work where the trust fund may intersect with existing AusAID programs include:

- Australian support to the Ministry of Finance in East Timor through the PFM Capacity Building Program (PFMCBP) can be used to complement the trust fund. PFMCBP is being used to help the ministry identify its reform and capacity building needs. The trust fund could be leveraged to guide some of the reforms identified by PFMCBP (for instance to improve the macroeconomic framework). PFMCBP can also provide follow up capacity building support to help the ministry sustain these gains.
- The IMF is looking to provide advice to the Government of PNG on the design of a sovereign wealth fund to manage future LNG revenue flows. While the IMF takes the lead in its design, Australia's

existing economic governance program (the Strongim Gavman Program) could provide follow up capacity building to improve the skills of staff managing the sovereign wealth fund.

- Australia could use the existing Australia Indonesia Partnership for Economic Governance to provide follow-up or complementary capacity building support to any assistance from the trust fund to Indonesia, for example to improve macroeconomic and public financial management.

### **Monitoring arrangements, including of AusAID's contribution**

The broad approach to monitoring is set out in paragraph 68 of the Program Document. Monitoring will be in line with the IMF's Results Focused Management System approach. Each technical assistance project will have defined inputs needed to deliver specific outputs that will contribute towards the desired country level outcomes and objectives. Attainment of these outcomes will be measured using a set of verifiable indicators. Areas within IMF control and those that require action by country authorities will be distinguished. To ensure country ownership, staff will consult the country authorities in the design of the main project deliverables. See Annex 5 of the Program Document for the complete logical framework for results management under the trust fund.

The approach to evaluation is set out in paragraph 69 of the Program Document. After at least three years of operation, an independent evaluation of the work carried out under the trust fund will be conducted by a team of outside experts. The evaluation will assess the effectiveness and sustainability of the work and will formulate recommendations for improvement. The findings of the evaluation will inform discussions on operations for the remainder of the initial five-year phase and beyond.

AusAID will use the information provided by the logical framework and evaluation to influence our interventions at the Steering Committee. In addition, country program and Economics and Public Finance Section engagement in relevant technical assistance, where possible, will also help to inform AusAID's participation in regular discussions with the IMF about the trust fund and the Steering Committee.

### **Risks and risk management strategies in relation to AusAID's contribution**

Assistance from the trust fund will be on the basis of requests from partner governments. This demand-led approach will help ensure only countries with the political will to undertake reforms are likely to request assistance. Eligible countries can request assistance under the five modules outlined in section 1, above. Specific programs of assistance will be developed for each participating country.

Trust fund assistance will be short term missions by IMF staff mostly based in Washington. All IMF technical assistance delivery is designed, guided and largely delivered by Washington-based staff. Technical assistance missions typically consist of Washington-based staff complemented with external experts to cover specialised topics and bring practical experience. External experts can also be engaged as short or long-term resident advisors, but are always supervised by, and interact closely with, IMF staff. This 'backstopping' ensures the technical assistance is consistent with IMF best-practice advice. The systematic manner in which this is done stands the IMF apart from other technical assistance providers and helps it realise its comparative advantage.

All technical assistance outputs are always formally reviewed internally by the IMF by both functional and area department staff. This ensures synergies between the technical assistance and the IMF's surveillance and lending operations. IMF technical assistance reports are available to donors and other technical assistance providers to provide an additional layer of quality control.