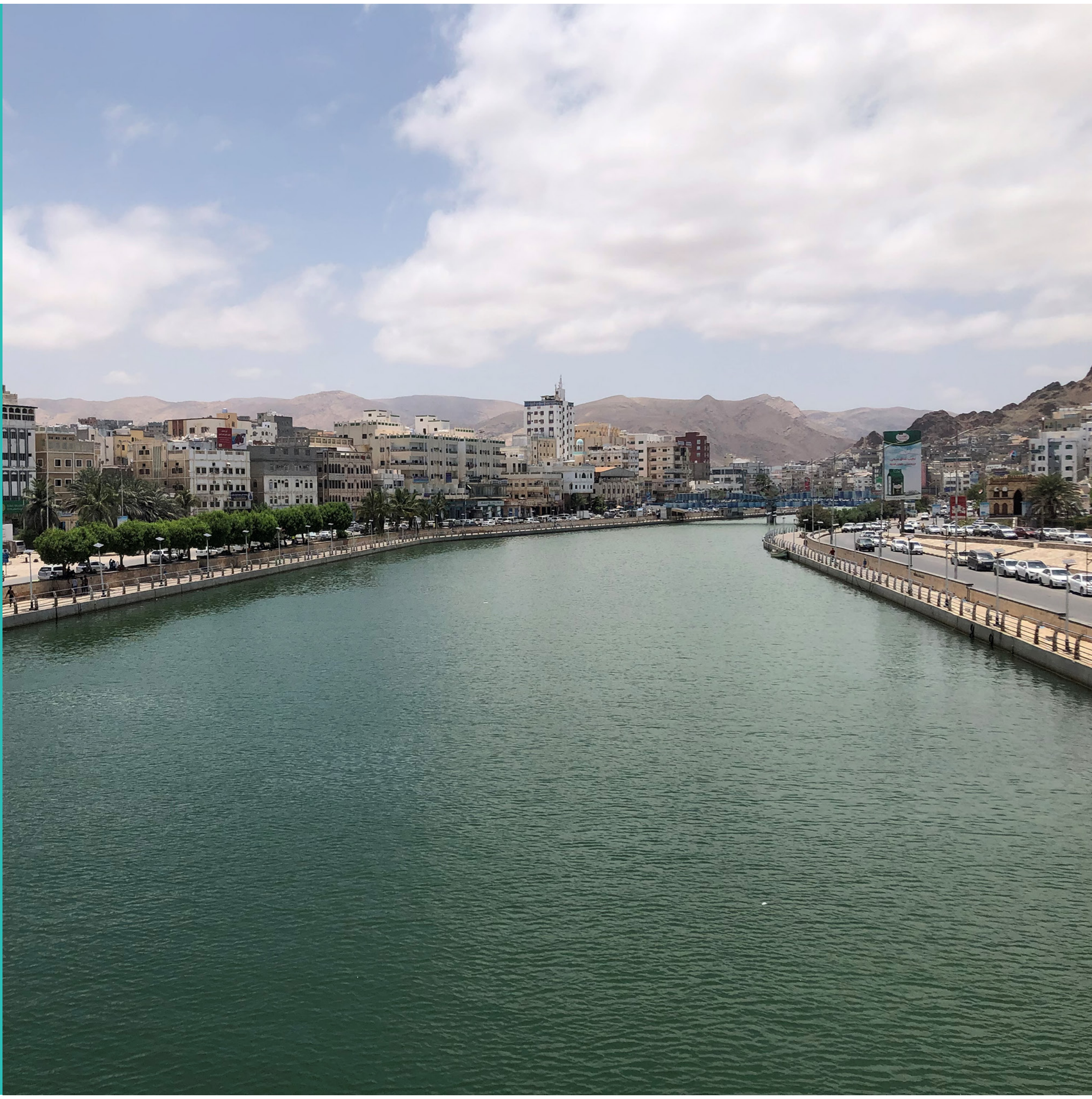
REVENUE ALLOCATION MECHANISMS IN POST-CONFLICT COUNTRIES
CHALLENGES FOR YEMEN

Policy Paper No. 29, August 2023



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Contents

Abbreviations

CDA	Constitutional Drafting Assembly, Libya
COFA	Chinese Offshore Fishing Association
DACDF	Diamond Area Community Development Fund
DDR	Disarmament, demobilization and reintegration
DRC	Democratic Republic of Congo
ECOMOG	Economic Community of West African States Monitoring Group
FGC	Financial Governance Committee, Somalia
GNC	General National Congress, Libya
KRG	Kurdistan Regional Government
LNA	Libyan National Army
MoU	Memorandum of understanding
NID	National identification
NPFL	National Patriotic Front of Liberia
NRA	National Revenue Authority, Sierra Leone
NRGI	Natural Resource Governance Institute
NTC	National Transitional Council, Libya
RUF	Revolutionary United Front, Sierra Leone
UNDP	United Nations Development Programme

EXECUTIVE SUMMARY

Since the end of 2022, the Kingdom of Saudi Arabia and Ansar Allah have been in negotiations over a range of issues. One of the main questions that the two sides are seeking to resolve is how salaries of public sector employees in areas that are controlled by Ansar Allah can be paid. In order to achieve this, the two sides will have to address a number of related issues, including but not limited to:

- what the source of the revenue should be (i.e. Yemeni public funds, Saudi public funds, a combination thereof, or other funds);
- which public sector employees should be included in any agreement (i.e. if the pre-war payroll should be used, and if not, what other list should be used); and
- what currency should be used to make the payments (particularly given the fact that different parts of the country are using different currencies).

RESOURCE ALLOCATION MECHANISMS

In comparative practice, what the parties are negotiating is known as a revenue allocation mechanism (or 'revenue sharing mechanism'; both terms are used in this paper). Such mechanisms are very common and are used in both federal and non-federal settings to allocate revenue between different levels of government. The purpose is to ensure that the revenue that is generated from a particular source is distributed based on predetermined criteria, such as population, need, or contribution. In traditional non-conflict settings, examples of revenue allocation mechanisms include tax revenue allocation systems; distribution of revenues from the sale of natural resources to different constituent parts of a state; and funds distribution models in government programmes. They can also be a means to help end or prevent violent and protracted conflict.

Allocation mechanisms can be negotiated and provided in a variety of forms and documents, including in constitutions, in ordinary legislation, in peace agreements and through ad hoc political agreements. Allocation mechanisms exist in countries including Brazil, Canada, Iraq, Libya, Nigeria, Somalia, South Sudan, Sudan, the United Arab Emirates (UAE) and Venezuela. They can also be provided for in peace agreements between different countries, for example in the Comprehensive Peace Agreement (2005) that governs the relationship between Sudan and South Sudan.

CHALLENGES FOR YEMEN

One of the particularities of what is currently being negotiated between Saudi Arabia and Ansar Allah is that the parties are contemplating establishing a revenue allocation mechanism in the absence of an overarching constitutional or political framework. For now, Yemen remains divided into different constituent parts which are self-governing and there is no reasonable prospect of that changing in the immediate future. This may create a challenge for any potential resource allocation mechanism that is adopted, as there will be a constant need to adjust and troubleshoot the mechanism, which is usually best dealt with through the type of interactions that happen within a constitutional framework and in political institutions. In the absence of a functioning framework, it is unclear how that type of challenge can be managed in the long term. One possibility is that whatever arrangement is adopted could be limited in time and could serve as a confidence-building measure that could then contribute towards an agreement on larger political issues.

THIS PAPER'S OBJECTIVE

This paper seeks to highlight some of the opportunities and challenges that are likely to present themselves if the negotiating parties manage to reach agreement on the payment of public sector employees. To be clear, this paper does not attempt to summarize Yemen's conflict dynamics or the ongoing negotiations. In addition, this paper does not offer any observations on what revenues should be used to finance the allocation mechanism; which employees' salaries should be paid through the mechanism; or what currency should be used to implement the mechanism. However, the paper does assume that if an agreement is reached, it will not be accompanied by a corresponding political agreement or mechanism (at least in the short term). As a result, the paper seeks to highlight the problems that are likely to occur in that context and possible solutions that might help mitigate the associated risks.

OUTLINE

This paper starts by explaining how revenue allocation mechanisms usually operate in practice. The paper offers a definition of revenue allocation mechanisms, including how they usually operate in centralized and federal settings. The paper explains how allocation mechanisms can function in post-conflict settings, the challenges that they often face in practice and the types of revenue allocation mechanisms that exist. In addition, the paper explores three case studies from which it seeks to draw lessons learned for Yemen's situation. The case studies in question (Sierra Leone, Somalia and Libya) are very different in nature. Sierra Leone's conflict ended some time ago, which makes it possible to gauge the effectiveness of some of the measures that were adopted. Somalia and Libya are somewhat closer to Yemen's situation in that they remain works-in-progress, but the negotiations that have taken place and their impact in practice offer some guidance for a Yemeni context. This paper ends with a conclusion that brings together all the lessons learned that can be gleaned from comparative practice for the Yemeni context.

MAIN OBSERVATIONS

On that basis, this paper offers the following observations about the likely opportunities and challenges facing the ongoing negotiations:

1. **Overall impact**. Revenue allocation mechanisms can help stabilize a country even in the most challenging of circumstances. But the existence of such a mechanism is not a panacea, even if it is functioning relatively well in practice, and even if the general principle and details of revenue allocation have been accepted by all relevant parties. Circumstances have to be propitious. Revenue allocation mechanisms that are established in conflict or post-conflict environments will inevitably be marred by political disputes, including on issues that are not directly related to the mechanisms themselves (including, for example, competition over government portfolios).

2. **Basic requirements**. In order for an allocation mechanism to have a positive impact, detailed arrangements have to be made. At the very least, institutions must be established that have as their purpose to manage the allocation mechanism, with proper mandates and staffing. In addition, sufficient provision must be made for oversight to prevent or reduce opportunities for misappropriation, waste and corruption.

3. **Through what instrument?** Revenue allocation mechanisms can be provided for through different types of instruments. Each specific format will present its own set of advantages and disadvantages.

   a. If a mechanism is reached through an interim political agreement, it is likely to be flexible and capable of regular adjustment. This can be helpful if, for example, monitoring of its implementation indicates that improvements should be made. In such case, it will be relatively straightforward to make the necessary changes. The disadvantage, however, is that there will be less incentive to respect the mechanism's terms, given that it will always be possible to renegotiate it. In practice, this means it will often be difficult to predict how much money each party will receive, which will make planning difficult and could increase political tensions in the country. The fact that a mechanism is established through an interim political agreement also makes it more likely that the mechanism will break down, either temporarily or permanently.

b. If a revenue allocation mechanism is adopted through a constitution, a peace agreement or other equivalent type of legal document, the opposite will be true—the mechanism will by definition be more long term and stable, but also more difficult to adjust if the need arises.

4. **Political mechanisms**. Normally, revenue allocation mechanisms are accompanied by overarching political mechanisms, including (for example) governments of national unity. The rationale is that allocation mechanisms are inevitably clouded by disputes over how the mechanism should function in practice, among other issues. As a result, mechanisms that are not accompanied by an overarching political mechanism will be fragile and will most likely fail over time. In order for them to survive such challenging circumstances, there has to be an overarching political framework that can be used to resolve disputes as they emerge. This is certainly the case for long-term allocation mechanisms, but short-term agreements may also require some form of political mechanism to resolve disputes.

5. **Savings**. Allocation mechanisms often assume that all revenue is allocated. This is often an imperative for post-conflict situations, given the need to invest in reconstruction and address the immediate consequences of conflict, including hunger and disease. However, over time, Yemen will likely face pressures on its economy that can only be controlled through cash injections (for example to shore up its currency), which itself can only happen if sufficient savings are made. In the absence of a provision for savings, post-conflict macroeconomic challenges could lead to significant volatility. A provision for savings may not be necessary for a short-term agreement, but should be seriously considered for any long-term agreement.

CONCLUSION

What all of the above suggests is that, even if a revenue allocation mechanism is successfully negotiated, much more will need to be done to stabilize Yemen. In particular:

1. Some form of political framework will need to be established as a platform for the country's main groups to communicate directly on contentious issues, including how the allocation mechanism should be managed over time.

2. If an allocation mechanism is negotiated, the parties should try to formalize a clear formula to determine how revenue should be allocated, to improve transparency and predictability.

3. It would also be far preferable for any agreement to be provided for in a binding legal document, to improve the mechanism's stability.

Chapter 1

REVENUE ALLOCATION MECHANISMS IN PRACTICE

IN FEDERAL AND NON-FEDERAL SETTINGS

A revenue allocation mechanism is a system or process used to distribute or allocate funds, income, or revenue among different entities, individuals, or groups. The purpose is to ensure that the revenue that is generated from a particular source is distributed based on predetermined criteria, such as population, need, or contribution.[1] In traditional non-conflict settings, examples of revenue allocation mechanisms include tax revenue allocation systems and funds distribution models in government programmes.[2] The design and implementation of a revenue allocation mechanism depend on various factors, such as the nature of the revenue source, the goals and objectives of the allocation, and the values and priorities of the entities involved.[3]

A revenue allocation mechanism is a system or process used to distribute or allocate funds, income, or revenue among different entities, individuals, or groups.

In federations, revenue allocation mechanisms are used to distribute funds from the federal government to individual states or provinces.[4] The details vary between countries, but common methods include population-based formulas, equal sharing and need-based formulas. In many federations the source of the revenues is important, so oil producing states, for example, will often receive a share of the locally produced revenues. Some federal governments also use a combination of these methods, with weightings applied to each, to determine the allocation of funds.[5] The goal of a federal revenue allocation mechanism is

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1 For an outline of some of the different allocation mechanisms that exist in countries with large extractive industries, see Arellano-Yanguas and Acosta 2014.

2 For examples from the modern US context, see, e.g., Stolz 1973.

3 Extractive Industries, Revenue Allocation and Local Politics, Working Papers on The Politics of Domestic Resource Mobilization for Social Development. Javier Arellano, Andrés Mejía Acosta. March 2014.

4 Otto G. Stolz, Revenue Sharing—New American Revolution or Trojan Horse, 58 *Minnesota Law Review*. p. 1 (1973).

5 See, e.g., Ojo, E. O. (2010). The politics of revenue allocation and resource control in Nigeria: Implications for federal stability. Federal Governance, 7(1), pp. 15–38, <https://nbn-resolving.org/urn:nbn:de:0168-ssoar-342778> (detailing the use of such formulae in Nigeria).

to ensure that each state or province receives a fair share of funding to support its public services and infrastructure. These mechanisms play a crucial role in ensuring the financial stability and equity of federal systems, and the allocation formulas are often subject to ongoing review and revision to adapt to changing circumstances and needs.[6]

A common feature in federal countries is the existence of a 'revenue sharing commission'. Where these bodies exist, they are composed of representatives from the federal government and the states or provinces. These commissions are tasked with advising on the allocation of revenue collected by the federal government among the states or provinces, independent of political interference.[7] The commission works by considering various factors such as population, need, and fiscal capacity, and then using a formula or combination of formulas to allocate the funds. The allocation formula is reviewed periodically to ensure that it continues to meet the changing needs of the states or provinces. The commission may also have the authority to make recommendations for changes to the allocation formula. The commission's decisions are usually binding and the federal government is responsible for implementing the agreed-upon allocation. The revenue sharing commission is an important institutional mechanism for ensuring that the distribution of funds is equitable, independent and transparent, and supports the financial stability of the federal system as a whole.[8]

To be clear, not all federations have revenue allocation commissions. The United States does not have a commission and instead relies on a series of ad hoc arrangements for different programmes and projects. In Canada, the federal government and the provinces enter into arduous discussions every few years, which are sometimes supported by ad hoc commissions, but in the end the federal government decides on its own how revenue should be allocated.

Revenue allocation mechanisms can also be used in non-federal countries. In a non-federal system, they are used to distribute funds from the central government to local governments, regions, or other subnational entities.[9] The exact mechanism varies between countries but here again, common methods include population-based formulas, need-based formulas and equal sharing. As in federal countries, the formulas may be subject to ongoing review and revision. The goal is to ensure that subnational entities receive adequate funding to support their public services and infrastructure, and to promote fiscal equity across different regions.

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6 Ibid.

7 Adam B. Felsenthal, Is Iraq the Next Nigeria: Revenue Sharing and the Natural Resources Curse, 27 *Arizona Journal of International and Comparative Law*, 787 (2010).

8 Ibid.

9 The United Kingdom provides an example of such a system in a non-federal state. See: D. Heald, 'Decentralization in some non-federal countries: the case of the United Kingdom' in *Texts Submitted for the International Symposium on Fiscal Imbalance* (Québec Comission sur le déséquilibre fiscal, 2002).

IN POST-CONFLICT SETTINGS

Revenue allocation mechanisms are most common in traditional federal and non-federal settings, but they are also a key tool when resolving conflicts.

Revenue allocation mechanisms are most common in traditional federal and non-federal settings, but they are also a key tool when resolving conflicts. Conflicts often stem from—or are exacerbated by—competition over resources, including financial resources. Some literature on the course of civil wars, supporting what is termed the 'greed thesis' (c.f. 'grievance'-based arguments), suggests that competition over resources and a rebellion's financial viability play important triggering roles.[10]

One example of a conflict exacerbated by competition over resources was the Darfur conflict in Sudan, which ranged from 2003 to 2020 and is still ongoing.[11] The conflict arose partly from competition between Arab nomadic groups and non-Arab sedentary farmers over access to water, arable land and grazing areas, and was exacerbated by climate change and desertification, which made these resources even more scarce. In addition, a long-standing history of marginalization and discrimination against non-Arab ethnic groups in Darfur by the central government contributed to growing alienation.[12] As a result, armed groups emerged and the conflict soon escalated into a brutal civil war, with large-scale violence and human rights abuses committed by all sides.[13] Darfur is a powerful example of how competition over resources can lead to violence and conflict, and how the absence of effective mechanisms for managing and allocating resources can contribute.[14]

Another example is the ongoing conflicts in central Mali that have threatened the livelihoods of virtually every community in the region. These conflicts exhibit a cyclical nature, with agriculturalists accusing pastoralists of disregarding designated paths for animal movement, resulting in crop destruction. Conversely, herders have accused farmers of encroaching on their passage rights. Additionally, fishers contend for access to waterways. Amid these internal tensions, external factors, including land investors, contribute additional pressure on already fragile local equilibriums.[15]

Revenue sharing mechanisms can help to address these structural causes of conflict by providing a clear and fair distribution of financial resources among different groups. This can help to reduce tensions and promote a more stable and peaceful environment. Moreover, limiting disproportional access to natural resources and associated revenues can reduce the funding driving the conflicts.[16] Additionally, revenue sharing mechanisms can provide a source of funding for peacebuilding initiatives, such as economic development

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[10] The seminal Collier-Hoeffler Model, first put forward in a May 2000 World Bank study, supports these claims. See P. Collier and A. Hoeffler, 'Greed and grievance in civil war', World Bank Policy Research Working Paper 2355, 2004.

[11] Darin E. W. Johnson, Revolution, Peace, and Justice in Sudan, 43 *University of Pennsylvania Journal of International Law*. 187 (2021).

[12] Riya Mishra and Anjan Bhandari, The Darfur Crisis (a Case Study of Sudan Genocide), 4 *International Journal of Law Management and Humanities*. 709 (2021).

[13] Ibid.

[14] Andrew S. Natsios, Sudan, South Sudan, and Darfur: What Everyone Needs to Know 8 (2012).

[15] Clingendael Netherlands Institute of International Relations, Anca-Elena Ursu, Under the gun: Resource conflicts and embattled traditional authorities in Central Mali (2018).

[16] Tom Brower, Constitutions as Counter-Curses: Revenue Allocation and the Resource Curse, 24 *Journal of Law and Policy*, 291 (2016).

Revenue sharing mechanisms can help to address structural causes of conflict by providing a clear and fair distribution of financial resources among different groups.

projects, as well as reintegration and disarmament programmes, which can help to further strengthen the peace process. Finally, including revenue sharing mechanisms in peace agreements can help to build trust between different groups and promote long-term stability through the transparency and accountability they bring to financial resource management.[17]

As a result, revenue allocation mechanisms are often used in post-conflict countries to support peacebuilding and reconciliation efforts. For example, they can be used to distribute funds from the central government to different regions or ethnic groups—either to help address imbalances in economic development or to support reconstruction efforts.[18] However, the implementation of revenue allocation mechanisms in post-conflict countries can be complex, and it is important to ensure that they are designed and implemented in a way that is transparent, fair and responsive to the needs of different communities.

There are many examples of post-conflict countries where revenue allocation mechanisms have been used. In addition to the three case studies of Sierra Leone, Somalia and Libya explored in detail below, the following three countries provide examples of different sorts of mechanisms implemented.

Sudan

In 2005, a Comprehensive Peace Agreement was reached between north and south Sudan after a long civil war. One of the key provisions of the agreement was a revenue sharing mechanism, where the South would receive 50 per cent of the revenue generated by oil exports from its territories. In addition, small percentages were allocated to certain producing areas.[19] This mechanism aimed to address the economic disparities between the two regions and reduce the potential for future conflict. In particular, it sought to provide a much-needed infusion of wealth into nascent South Sudan, which historically had not seen the benefits of the country's oil reserves. Most of Sudan's oil reserves were in the south, but before the civil war the revenues generated from oil exports were primarily directed to the central government in Khartoum and disproportionately benefited the northern regions.

The revenue sharing mechanism was partially successful in providing a stable source of income for the south until independence, but the independent monitor and an international non-governmental organization, Global Witness, found evidence that the Government of Sudan did not fully respect the agreement. Since South Sudan's independence, the issue of revenue sharing has taken on a new dimension, with Sudan using South Sudan's need to use its pipelines to get to market as a point of leverage. However, resource sharing within South Sudan itself has been less successful. Challenges such as corruption and mismanagement have affected the effective utilization of these

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17 Ibid.

18 To see an illustrative programme proffering revenues back to diamondiferous regions in Sierra Leone, see Maconachie 2012.

19 'Oil or Nothing: Dealing with South Sudan's Bleeding Finances', Crisis Group Africa Report N°305, 6 October 2021.

oil revenues for development purposes and contributed to South Sudan's slide into its own civil war.[20]

Iraq

In 2005, Iraq ratified a new Constitution which included the outlines of a revenue sharing arrangement between the federal government in Baghdad and the Kurdistan Regional Government (KRG)—requiring transfers to be proportional to the population size in different parts of the country.[21] However, the Constitution did not include essential details on how the mechanism should function. As a result, since 2005 the amount of revenue transferred from Baghdad to Erbil and the mechanism through which it should be transferred has been the subject of much tension and attempted renegotiation.[22] Traditionally, the understanding has been that the KRG would be entitled to 17 per cent of the budget share (minus a deduction for some federal expenses).[23] On some occasions, such as in 2014 and in 2017, major disagreements have broken out between the two sides regarding this allocation, resulting in no transfers being made for extended periods of time.[24] Among other things, the KRG has exported oil internationally through Turkey without then sharing any of the revenue with the federal authorities in Baghdad, which worsened the relationship between the two sides. There has also been serious disagreement between Baghdad and the KRG on whether monies that are transferred to the KRG should be subject to oversight and auditing. After a number of developments that limited the KRG's ability to act independently, the 2023 annual state budget law imposed a number of new measures that subjected transfers to the KRG to further oversight by Baghdad.

Bosnia and Herzegovina

After the Bosnian War ended in 1995, the Dayton Accords established a revenue sharing mechanism to distribute funds from the central government to its two constituent entities, the Federation of Bosnia and Herzegovina and the Republika Srpska. At the time, the former was primarily established for the Bosniak and Croat populations, while the latter largely encompassed the Bosnian Serb population.[25] The mechanism helps to ensure that each entity, comprised of different ethnic groups and containing many cantons and municipalities within them, receives adequate funding for its public services and infrastructure. However, it has since been plagued by the relative

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20 Martell, Peter. *First Raise a Flag: How South Sudan Won the Longest War but Lost the Peace* (Oxford: Oxford University Press, 2019).

21 'Constitution Building and Federal Options in Iraq: The Kurdish Challenge', Brendan O'Leary and John McGarry (Rights & Democracy, 2005) <https://reliefweb.int/report/iraq/constitution-building-and-federal-options-iraq-kurdish-challenge>.

22 Lasa Aresti, M. Oil and Gas Revenue Sharing in Iraq (Natural Resource Governance Institute, 2016) <http://www.resourcegovernance.org/analysis-tools/publications/revenue-sharing-case-study-oil-and-gas-revenue-sharing-iraq>.

23 'Kurdistan and Baghdad: A Tangled Web Over Oil and Budgets', United States Institute of Peace, 30 January 2018, <https://www.usip.org/publications/2018/01/kurdistan-and-baghdad-tangled-web-over-oil-and-budgets>.

24 'Kurdistan and Baghdad: A Tangled Web Over Oil and Budgets', United States Institute of Peace, 30 January 2018, <https://www.usip.org/publications/2018/01/kurdistan-and-baghdad-tangled-web-over-oil-and-budgets>; Lasa Aresti, M. Oil and Gas Revenue Sharing in Iraq (Natural Resource Governance Institute, 2016), <http://www.resourcegovernance.org/analysis-tools/publications/revenue-sharing-case-study-oil-and-gas-revenue-sharing-iraq>.

25 Fox, William F. and Christine Wallich. *Fiscal Federalism in Bosnia-Herzegovina: The Dayton Challenge*. Vol. 1714. World Bank Publications, 1997.

weakness of the central government vis-à-vis the two constituent entities and its lack of taxing power.[26]

Implementing a revenue allocation mechanism can be a complex and difficult process.

CHALLENGES

Implementing a revenue allocation mechanism can be a complex and difficult process for several reasons, including:

1. Political considerations. Revenue allocation mechanisms often involve complex political negotiations, as different groups and political entities may have competing interests and different ideas about how resources should be allocated. Balancing these interests and reaching a consensus can be challenging when the mechanisms are being negotiated and when implemented in practice.

2. Technical difficulties. Designing and implementing a revenue allocation mechanism requires technical expertise in areas such as financial management, economic analysis and statistical data analysis, among others. This can pose a challenge, especially in post-conflict or developing countries where such expertise may be limited.

3. Resistance to change. The establishment of a new revenue allocation mechanism can be met with resistance from established interests who benefit from the current system and therefore want to preserve it.

4. Lack of transparency and accountability. Implementing a revenue allocation mechanism that is transparent, accountable and fair is crucial to its success, but can be difficult to achieve in practice. Corruption, mismanagement and lack of political will can undermine the implementation process.

5. Monitoring and enforcement. Ensuring that the revenue allocation mechanism is being implemented as intended and that all parties are adhering to the agreement (compliance) requires effective monitoring and enforcement mechanisms to be put in place. In some cases, independent international oversight has been used temporarily and as a transitional measure to ensure some form of oversight.

6. Sustainability and flexibility. To be effective, a revenue allocation mechanism must be sustainable in the long term. This requires continuous monitoring and adjustments to ensure that the mechanism remains relevant and responsive to changing circumstances, and flexibility from the parties to accept adjustments.

[26] Werner, Jan, Laurent Guihéry and Ognjen Djukic. 'Fiscal Federalism in Bosnia and Herzegovina'. *The Journal of Economic Asymmetries* 3.2 (2006): 125–148.

In many cases, countries that enter into peace agreements that include revenue sharing mechanisms do not relapse into conflict, but such mechanisms are not a panacea. Many post-conflict countries do relapse into conflict for a combination of reasons, including but not limited to the following:

1. If the revenue allocation mechanism does not ensure a fair distribution of resources, it can create resentment and frustration among certain groups, which can lead to renewed conflict.

2. If the parties involved in the conflict do not trust each other or the revenue allocation mechanism, they may not adhere to the agreement and may continue to pursue their interests through other means, including violence. The parties may decide not to trust the mechanism for a number of reasons, including if early implementation is flawed, or if is not sufficiently detailed.

3. Implementing a revenue allocation mechanism can be a complex and difficult process and, if not done properly, it can create new tensions and trigger conflict.

4. If the parties involved in the conflict have unequal power dynamics, this can lead to unequal distribution of resources, perpetuation of the same power structures and dissatisfaction with the peace agreement, all of which can increase the risk of relapse into conflict.

5. The peace agreement and revenue allocation mechanism may address the immediate causes of the conflict, but if the underlying issues such as inequality, discrimination and lack of political representation are not addressed, the risk of relapse into conflict remains.

Therefore, implementing a revenue allocation mechanism requires careful planning, effective communication and strong political will to overcome these challenges and ensure its success.

TYPES OF REVENUE ALLOCATION ARRANGEMENTS

Revenue sharing agreements can be implemented and adopted in a variety of ways. The majority of resource-specific revenue sharing agreements are adopted by legislation, regulation, or executive decree.[27] In some cases, however, the agreements or corresponding mechanisms are included in the country's constitution. This is the case in Brazil, Canada, Iraq, Nigeria, South Sudan, the UAE and Venezuela.[28] Revenue sharing arrangements can also be provided for in peace agreements.

[27] Bauer, A., Gankhuyag, U., Halling, S., Manley, D. and Venugopal, V. (2016). Natural resource revenue sharing. UNDP, p. 34, <https://resourcegovernance.org/sites/default/files/documents/nrgi_undp_resource-sharing_web_0.pdf>.

[28] Ibid.

Revenue sharing arrangements can be made on an ad hoc basis without a legally recognized formula.

Revenue sharing arrangements can also be made on an ad hoc basis without a legally recognized formula. A Natural Resource Governance Institute (NRGI) and United Nations Development Programme (UNDP) report criticizes these types of arrangements as inferior to formula-based ones because they are inconsistent from year-to-year and are often the result of unpredictable political impulses.[29] The unpredictability of ad hoc arrangements can make it difficult for subnational governments to plan their budgets.

The literature on resource revenue sharing agreements classifies them as falling under three different categories: (a) derivation-based; (b) indicator-based; and (c) mixed systems. The frest of this section will describe each system, provide country-specific examples and outline the advantages and disadvantages associated with each. By highlighting these characteristics, this section aims to provide additional guidance for the best type of revenue sharing arrangement for other post-conflict scenarios.

Derivation-based

Derivation-based agreements allocate revenues according to where the resources were derived from. In these countries, revenues from natural resources are collected by the national government and then allocated to regional/provincial/state governments and/or municipal/district governments.[30] The percentage of revenue awarded will vary based on the type of recipient (i.e. state government vs. district government) and whether the receiving government is a producer or non-producer of the resource.[31]

For instance, in the Democratic Republic of Congo (DRC), the central government receives 60 per cent of royalties from minerals, while producing regional/provincial/state governments receive 25 per cent and producing municipal/district governments receive 15 per cent. Under this formula, non-producing subnational governments in DRC do not receive any share of the revenue.[32] Conversely, in Brazil, the central government receives only 15 per cent of royalties from onshore oil, while producing regional/provincial/state governments receive 20 per cent, non-producing regional/provincial/state governments receive 25 per cent, producing municipal/district governments receive 10 per cent, and non-producing municipal/district governments receive 30 per cent.[33]

Derivation-based revenue sharing arrangements have the advantage of requiring less data; they are often easier to calculate and explain to citizens than are indicator-based arrangements.[34] Given this relative simplicity,

29 See, e.g., <http://qed.econ.queensu.ca/pub/faculty/flatters/writings/ff&ms_sacursf_2006.pdf>.
30 See, e.g., <https://resourcegovernance.org/sites/default/files/documents/oil-gas-revenue-sharing-iraq.pdf>.
31 Bauer, A., Gankhuyag, U., Halling, S., Manley, D. & Venugopal, V. (2016). Natural resource revenue sharing. UNDP, p. 37, <https://resourcegovernance.org/sites/default/files/documents/nrgi_undp_resource-sharing_web_0.pdf>.
32 Ibid.
33 <https://repositorio.pucp.edu.pe/index/bitstream/handle/123456789/52358/Viale_renta_industrias_extractivas.pdf>; Bauer, A., Gankhuyag, U., Halling, S., Manley, D. and Venugopal, V. (2016). Natural resource revenue sharing. UNDP, <https://resourcegovernance.org/sites/default/files/documents/nrgi_undp_resource-sharing_web_0.pdf>.
34 Bauer, A., Gankhuyag, U., Halling, S., Manley, D. and Venugopal, V. (2016). Natural resource revenue sharing. UNDP, p. 47, <https://resourcegovernance.org/sites/default/files/documents/nrgi_undp_resource-sharing_web_0.pdf>.

derivation-based arrangements are particularly well-suited for countries with lower governmental capacity. These systems are also usually successful in providing substantial wealth to producing regions.[35] That being said, derivation-based systems also have several drawbacks. Subnational governments can come to depend on resource revenue transfers for their budgets, as is the case in parts of Nigeria and Peru where more than 80 per cent of certain governments' budgets are derived from resource revenue transfers.[36] Governments relying on derivation-based revenues are subject to increased volatility because the government's budget is directly linked to the price of the resource. Additionally, by allocating resources based on origin rather than need, this system often ignores the actual financial conditions and responsibilities of subnational governments. As a result, derivation-based sharing arrangements can further exacerbate regional inequalities.[37]

Indicator-based

Indicator-based arrangements allocate revenue according to certain indicators, such as population and poverty level. By basing allocation on various independent criteria, indicator-based systems do not consider the origin of the natural resource. For instance, Mexico divides its oil revenue using an indicator-based system that takes into account population and revenue generation.[38] Similarly, Ecuador divides 40 per cent of the oil revenue dedicated to municipalities equally to all Amazonian municipalities without regard to size, while allocating the remaining 60 per cent based on population.[39]

Indicator-based systems aim to better address poverty by allocating revenues based on actual need. By assessing need, indicator-based arrangements can promote equality and budget stabilization across subnational governments.[40] This system may also compensate areas surrounding producing regions, whose environment or public health may have been negatively impacted by resource extraction. As with the derivation-based system, indicator-based systems also raise several challenges. First, deciding on the relevant indicators can be quite complex and often requires large amounts of data that are unlikely to exist in developing or conflict-affected countries. Second, disregarding the origin of the resource decreases local ownership over the resource and may fail to compensate the producing region for possible harms associated with extraction.[41]

Indicator-based systems aim to better address poverty by allocating revenues based on actual need.

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35 See, e.g., <https://www.diamonds.net/Docs/About/FT-SierraLeone-Rapaport-ReportPDACL735-2008.pdf>; infra note 54.

36 Bauer, A., Gankhuyag, U., Halling, S., Manley, D. and Venugopal, V. (2016). Natural resource revenue sharing. UNDP, p. 33, <https://resourcegovernance.org/sites/default/files/documents/nrgi_undp_resource-sharing_web_0.pdf>.

37 Ibid., p. 48.

38 For an in-depth study of Mexico's allocation criteria, see S. Alatorre, 'Fiscal federalism and intergovernmental fiscal revenue sharing in Mexico: The municipal perspective', University of Pennsylvania ProQuest Dissertations Publishing, 2002.

39 Ecuador's formula is described in more detail in the following sources: Bauer et al. (2016: 34); Viale Leyva (2015); J. J. Herrera and S. Jarrín, *Generación y distribución de ingresos petroleros durante 2012* [Generation and distribution of oil revenues during 2012] (Quito, Ecuador: Grupo Faro, 2013: 44).

40 See Canada's equalization programme as an example. E. Roy-César, *Canada's Equalization Formula* (Library of Parliament Research Publications, Government of Canada, 2013), <https://lop.parl.ca/sites/PublicWebsite/default/en_CA/ResearchPublications/200820E>.

41 Bauer et al. 2016: 51.

Mixed systems

Countries following mixed systems use indicators, but also consider the origin of the resource when making allocation decisions.[42] For example, the Nigerian Government allocates at least 13 per cent of oil revenues based on state production, while the remaining 87 per cent is pooled with the state's other fiscal revenues. Of that 87 per cent, 53 per cent goes to the central government, while 47 per cent is allocated using a formula based on population, social development and revenue generation indicators.[43]

42 Bauer et al. 2016: 34.

43 Bauer et al. 2016; for a more detailed elucidation of the Nigerian revenue sharing system, see E. Ahmad and R. Singh, *Political economy of oil-revenue sharing in a developing country: Illustrations from Nigeria*, IMF Working Paper 03/16 (Washington, D.C.: International Monetary Fund, 2003), <https://www.imf.org/en/Publications/WP/Issues/2016/12/30/Political-Economy-of-Oil-Revenue-Sharing-in-a-Developing-Country-Illustrations-from-Nigeria-15955>.

Chapter 2

CASE STUDIES

The following section examines three cases of revenue allocation mechanisms that were adopted in an attempt to resolve the countries' respective conflicts. The three case studies show marked differences. Sierra Leone's conflict ended in 2002 following negotiated peace agreements and protocols involving the Government of Sierra Leone. The subsequent revenue allocation mechanisms have now been in force for two decades, with evidence of modest impact over time. The Sierra Leone case study shows that while the country's revenue allocation mechanism has been limited in scope, the ruling authorities have been committed to maintaining and improving its implementation where possible, which has led to some positive effect. In another contrast to the other two case studies and to the Yemeni case—besides the mechanism's longevity during a relatively stable post-conflict era—Sierra Leone's conflict did not involve rival governments with distinct political parties.

Somalia and Libya share some characteristics with Yemen. They are both divided territorially and rival political groups compete over resources. Neither country has seen meaningful elections for some time. However, in both cases, agreements have been entered into on how resources should be allocated despite ongoing divisions. This makes both case studies particularly relevant for Yemen, but they both remain works in progress and the long-term impact of the arrangements that were negotiated are still unclear. The section concludes with some reflections on what lessons learned can be derived for Yemen and the negotiations that are currently ongoing.

SIERRA LEONE

The conflict in Sierra Leone can be distinguished from Yemen in a number of respects. As stated above, the conflict concluded more than two decades ago with successful military interventions led by forces from India, Nigeria, Pakistan and the United Kingdom.. Since then, the state has remained generally centralized, which is not currently being contemplated in Yemen.[44] However, the peace agreement and subsequent legislation have established some revenue allocation mechanisms that are designed to promote stability, mainly by supporting vulnerable communities. Those arrangements have had some positive impact on the communities, although the rest of the population has not directly benefited, which has led to some criticism. Some subsequent adjustments have been made in response.

Background

The Sierra Leone Civil War started in 1991 and lasted until 2002.[45] It was primarily a conflict between the Sierra Leonean Government, supported by its international allies, and rebel groups, mainly the Revolutionary United Front (RUF).[46]

The root causes of the conflict are complex and multifaceted, but some of the key factors include: spillover from the nascent civil war in neighbouring Liberia; widespread poverty and inequality; political corruption; the breakdown of the government's ability to provide core services such as education; dissatisfaction with the ruling one-party government; and a lack of representation and political participation for many Sierra Leoneans.[47] The buildup of these factors led to over three decades of the state progressively failing to provide Sierra Leoneans with basic necessities. In addition to the aforementioned grievances, the 'blood diamond' trade played an important role in incentivizing actors to perpetuate the war once it had begun.[48]

The conflict officially began in 1991 when a group of rebels, led by former Sierra Leonean army corporal Foday Sankoh, launched an insurgency against the government with the goal of overthrowing it and establishing a new political order.[49] They received assistance and training from Muammar Gaddafi's Libya, as well as the Liberian rebel group National Patriotic Front of Liberia (NPFL), headed by Charles Taylor.[50] Taylor was, in turn, retaliating against the existing Sierra Leonean administration's decision to allow the Economic Community of West African States Monitoring Group (ECOMOG) to use Sierra Leonean airstrips against the NPFL. Over the course of the war, the

44 Note, however, that Sierra Leone took some steps away from its strong unitary state and towards a more decentralized model in the years after the war. In 2004, the Local Government Act re-established local councils across Sierra Leone. The amended Local Government Act of 2022 now provides for 22 municipal and local councils, elected for a tenure of five years and with some authority to generate local revenues and decide on local development priorities.

45 For a timeline of the conflict see: BBC 2008, <https://www.bbc.com/news/world-africa-14094419>.

46 'Sierra Leone: A Political History', by David Harris, Hurst & Co. (2013).

47 For further reading on the causes of the civil war and a refutation of neo-Malthusian understandings of conflict in Sierra Leone, see: P. Richards, *Fighting for the Rain Forest: War, Youth and Resources in Sierra Leone* (London: International African Institute 1996); see also Abdullah 1998; Britannica 2008.

48 <https://www.researchgate.net/profile/MohamedSuma/publication/268368949_Transitional_Justice_and_DDR_the_Case_of_Sierra_Leone/links/5d81f21a299bf1996f74e489/Transitional-Justice-and-DDR-the-Case-of-Sierra-Leone.pdf>; <https://www.e-ir.info/pdf/29018>.

49 <https://www.britannica.com/place/Sierra-Leone/Civil-war>; <https://www.bbc.com/news/world-africa-14094419>.

50 <http://peri.umass.edu/fileadmin/pdf/Sierraleone.pdf>; Abdullah, Ibrahim. 'Bush Path to Destruction: The Origin and Character of the Revolutionary United Front/Sierra Leone'. *The Journal of Modern African Studies*, 36/2 (1998): pp. 203–35, <http://www.jstor.org/stable/161403>; <https://www.e-ir.info/pdf/29018>.

conflict became characterized by widespread violence, rape, torture and the use of child soldiers, among other human rights abuses.[51]

The exact number of casualties from the Sierra Leone Civil War are not precisely known, but conservative estimates suggest that as many as 200,000 people were killed, in addition to an estimated more than 2 million people displaced from their homes.[52] The conflict had a significant impact on Sierra Leone's economy and infrastructure, and its long-term effects are still being felt in the country today.[53]

Abuja Accords

The war officially ended in 2002 with successful interventions by a number of parties: Nigerian soldiers under ECOMOG, Indian and Pakistani UN peacekeeping troops, and a direct British military intervention in the form of Operation Barras.[54]

Much of the post-war framework was provided by a series of treaties signed around 2000 and 2001, referred to alternatively as the Abuja Accords, Abuja Protocols, or the Abuja Ceasefire Agreement.[55] In addition, other elements of the peace process were provided for by a number of earlier internationally mediated agreements, including the 1996 Abidjan Peace Accord, 1997 Conakry Peace Plan and the 1999 Lomé Agreement.[56] These treaties collectively provided for the end of the war, made provisions for the RUF's formal participation in Sierra Leonean politics, and facilitated the disarmament of rebel groups, as well as starting other elements of the reconstruction and post-conflict processes. More than 76,000 combatants, including more than 6,000 child soldiers, were disarmed by the conclusion of 2002.[57] The main elements of the accords included:

1. Ceasefire. In response to renewed attacks on UN peacekeepers by the RUF, the major feature of the first of the Abuja Protocols was the institution of an immediate ceasefire, bringing an end to hostilities and allowing for the deployment of peacekeeping forces to all parts of the country.

2. Disarmament, demobilization and reintegration (DDR). The agreements focused on establishing a fast-tracked DDR process to help former

51 <https://www.cambridge.org/core/journals/african-studies-review/article/abs/military-patrimonialism-and-child-soldier-clientalism-in-the-liberian-and-sierra-leonean-civil-wars/3584F02E1A58C9178E808FA5A099A6C4>; <https://www.researchgate.net/profile/MohamedSuma/publication/268368949_Transitional_Justice_and_DDR_the_Case_of_Sierra_Leone/links/5d81f21a299bf1996f74e489/Transitional-Justice-and-DDR-the-Case-of-Sierra-Leone.pdf>.

52 <https://www.britannica.com/place/Sierra-Leone/Civil-war>.

53 <https://www.france24.com/en/tv-shows/revisited/20211008-two-decades-on-sierra-leone-still-scarred-by-civil-war>.

54 <https://www.tandfonline.com/doi/abs/10.1080/09700160801994852?journalCode=rsan20>; <https://www.nam.ac.uk/explore/operation-barras>.

55 <https://www.researchgate.net/profile/Abu-Bakarr Bah/publication/265900601_The_Contours_of_New_Humanitarianism_War_and_Peacebuilding_in_Sierra_Leone/links/5af30775aca2720af9bfd89c/The-Contours-of-New-Humanitarianism-War-and-Peacebuilding-in-Sierra-Leone.pdf>; <https://www.peaceagreements.org/view/320>.

56 See, e.g., <https://peaceaccords.nd.edu/accord/abidjan-peace-agreement>.

57 <https://www.researchgate.net/profile/Mohamed-Suma/publication/268368949_Transitional_Justice_and_DDR_the_Case_of_Sierra_Leone/links/5d81f21a299bf1996f74e489/Transitional-Justice-and-DDR-the-Case-of-Sierra-Leone.pdf>.

combatants return to civilian life and to bring about the end of the RUF. The DDR programme in the second of the Abuja Protocols included the collection of weapons, the provision of training and support to former fighters, and efforts to reintegrate them into society—such as by absorbing them into the official army after a screening process.

3. Institutional security sector reform. The Abuja Protocols included provisions for the reform of the security sector, including the police and military. In particular, attention was given to providing internationally run training to the Sierra Leone Police and Republic of Sierra Leone Armed Forces, and to change Sierra Leonean public perceptions of them—which were generally negative due to state forces' complicity with the pre-war, one-party government.

4. Transitional justice institutions. Beginning with earlier treaties and continuing with the Abuja Protocols, many transitional justice measures were taken including the establishment of the Truth and Reconciliation Commission, the Special Court for Sierra Leone and a Special Fund for War Victims.

These agreements were a crucial turning point in ending the conflict in Sierra Leone and helped to bring stability and security to the country. In particular, the second of the Abuja Protocols stands out as an example of a rapid and successful DDR campaign, with tens of thousands of rebel fighters disarmed within a year. Revenue sharing agreements became another important feature of reconstruction efforts in the country. These agreements aimed to address issues of economic disparity and promote equitable distribution of resources among different regions and communities in Sierra Leone.

Revenue sharing

Resource sharing in post-war Sierra Leone was presaged by discussion of diamond profit sharing between the government and the RUF in the 1999 Lomé Agreement and mentioned briefly in the Abuja Protocols. However, the government's main effort to alleviate the grievances of mining communities occurred through the 2001 Diamond Area Community Development Fund (DACDF).

Sierra Leone's National Revenue Authority (NRA) was established in 2002 to centralize governmental revenue collection. It has been largely successful in raising more revenue, increasing the amount collected annually in its first decade of operation from only SLL 231.8 billion (then approximately USD 118m) in 2002 to SLL 2.219 trillion (then approximately USD 513m) in 2013. In addition to revenues from diamond mining, these funds include proceeds from the sales of Sierra Leone's other natural resources, including gold and bauxite. The NRA also certifies and values all diamonds that are legally exported from the country, before imposing a 3 per cent tax on them.[58]

[58] <https://www.nra.gov.sl/about-nra/history-and-mandate>.

The DACDF works by setting aside one-quarter of the revenue generated by Sierra Leone's 3 per cent diamond export tax (i.e. 0.75 per cent of revenue) for investment in mining communities. This money has been used for the repair or construction of roads, bridges, hospitals, schools, prisons and community grain stores, with nearly 75 per cent of DACDF funds going towards infrastructure development.[59] Researchers have found that areas benefiting from the DACDF have performed much better in the provision of services such as education and in creating employment than non-DACDF areas.[60] Moreover, the existence of the DACDF has promoted decentralization and responsible local governance, with communities incentivized to stop illicit trading and to participate in official governmental programmes.

The DACDF has also faced some criticism. The decentralized nature of the programme has meant that revenues distributed to some areas suffer from misappropriation and a lack of oversight. In 2006, the central government took action to address these concerns by disbursing funds to districts rather than the smaller area subdivisions, and instituting district-level supervision of community projects. These measures greatly improved the efficiency and accountability of the DACDF.[61]

Another concern with the DACDF has been that local development committees are often made up of members of the rural elite, to the exclusion of women and youth.[62] The Sierra Leonean Government has attempted to address this by instituting new procedures and guidelines (since 2006) that require extensive monitoring of local committees and establishing a paper trail before funds can be disbursed. However, the local power structures mentioned above and longstanding patrimonial institutions continue to prevent some segments of society from participating in these committees.[63] Finally, local communities appear to be frustrated by the fact that a relatively low proportion of the revenues generated have been dedicated to local investments.

In sum, government-supervised revenue sharing in Sierra Leone, in the form of a fund benefiting local mining communities, has been largely successful in improving the infrastructure and services available in diamond-rich areas. However, the DACDF's impact on alleviating the grievances of the general

Government-supervised revenue sharing in Sierra Leone, in the form of a fund benefitting local mining communities, has been largely successful in improving the infrastructure and services available in diamond-rich areas.

59 Roy Maconachie, 'The Diamond Area Community Development Fund: Micropolitics and community-led development in post- war Sierra Leone', in P. Lujala and S.A. Rustad, *High-Value Natural Resources and Peacebuilding* (Routledge 2012), <https://www.researchgate.net/profile/Roy-Maconachie/publication/264890380_The_Diamond_Area_Community_Development_Fund_Micropolitics_and_community-led_development_in_post-_war_Sierra_Leone/links/541832540cf2218008bf2c6e/The-Diamond-Area-Community-Development-Fund-Micropolitics-and-community-led-development-in-post-war-Sierra-Leone.pdf>.

60 <https://www.diamonds.net/Docs/About/FT-SierraLeone-Rapaport-ReportPDACL735-2008.pdf>.

61 <https://www.researchgate.net/profile/Roy-Maconachie/publication/264890380_The_Diamond_Area_Community_Development_Fund_Micropolitics_and_community-led_development_in_post-_war_Sierra_Leone/links/541832540cf2218008bf2c6e/The-Diamond-Area-Community-Development-Fund-Micropolitics-and-community-led-development-in-post-war-Sierra-Leone.pdf>.

62 Roy Maconachie, 'The Diamond Area Community Development Fund: Micropolitics and community-led development in post- war Sierra Leone', in P. Lujala and S.A. Rustad, *High-Value Natural Resources and Peacebuilding* (Routledge 2012), <https://www.researchgate.net/profile/Roy-Maconachie/publication/264890380_The_Diamond_Area_Community_Development_Fund_Micropolitics_and_community-led_development_in_post-_war_Sierra_Leone/links/541832540cf2218008bf2c6e/The-Diamond-Area-Community-Development-Fund-Micropolitics-and-community-led-development-in-post-war-Sierra-Leone.pdf>.

63 Ibid.

population is less clear, since more marginalized local actors are still excluded from the revenue sharing process and the funds reserved for local investments remain low.

SOMALIA

The conflict in Somalia has been ongoing for decades. Currently, the country is governed through the 2012 a Provisional Constitution, which provides for a federal system. However, federal authorities in the country have very little control and the central state remains highly fragile. It has a fraught relationship with the various constituent states, with some considering themselves to be completely independent. Some effort has been made to adopt a constitution that includes revenue allocation mechanisms, including on issues relating to fisheries, natural resources and port revenues. Very little revenue has actually been allocated under these mechanisms. A basis is being laid for increased allocations in the near future. However, there is a concern that the mechanisms that have been established will eventually increase inequalities in the country and make the country less rather than more stable.

Background

Somalia is balkanized into five semi-autonomous federal member states (Puntland, Jubbaland, Southwest, Galmudug and Hirshabelle) loosely overseen by the federal government in Mogadishu.[64] Somaliland is a self-declared sovereign state, which the Somali Government still considers to be a federal member state.[65]

Article 125 and article 50 collectively require the establishment of revenue collection mechanisms and the transparent and equal distribution of the collected resources.

Somalia has attempted—but not yet succeeded—to negotiate a permanent constitution that could help stabilize the country. Until such a constitution is ratified, a Provisional Constitution adopted in 2012 sets out the interim governance arrangements, including the basis of a revenue sharing mechanism. More specifically, article 125, which establishes the National Reserve, and article 50, which sets out the principles of federalism, collectively require the establishment of revenue collection mechanisms and the transparent and equal distribution of the collected resources.[66]

The Provisional Constitution does not resolve all critical issues that would normally be addressed, however. For example, the Provisional Constitution provides for the establishment of a federal structure of government but leaves most details to subsequent negotiations. In particular, the Provisional Constitution provides that there are two levels of government: (a) the federal government level; and (b) the federal member states level, comprised of

64 Bahadur, Jay. 'Fishy Business: Illegal Fishing in Somalia and the Capture of State Institutions' (2021); 'Where We Work: Somalia'. The World Bank, 2023, <https://www.worldbank.org/en/country/somalia/overview>.

65 'Federal Member States'. Ministry of Planning, Investment and Economic Development – Federal Republic of Somalia, 2023, <https://mop.gov.so/federal-member-states>.

66 Provisional Constitution of the Federal Republic of Somalia, 2012, <https://web.archive.org/web/20130124010543/http://www.somaliweyn.com/pages/news/Aug_12/Somalia_Constitution_English_FOR_WEB.pdf>.

the federal member state government and the local governments—but the allocation of responsibilities between these levels is not determined. This is very unusual in comparative practice.

Article 54 of the Provisional Constitution provides that '[t]he allocation of powers and resources shall be negotiated and agreed upon by the Federal Government and the Federal Member States (pending the formation of Federal Member States), except in matters concerning: (A) Foreign Affairs (B) National Defence (C) Citizenship and Immigration (D) Monetary Policy, which shall be within the powers and responsibilities of the federal government.' The allocation of natural resources is addressed specifically by article 44, which states only that '[the] allocation of the natural resources of the Federal Republic of Somalia shall be negotiated by, and agreed upon, by the Federal Government and the Federal Member States in accordance with this Constitution' (Somalia 2012).

In that spirit, since the Provisional Constitution entered into force, there have been attempts to negotiate revenue sharing mechanisms in relation to discrete areas, including port revenues, licence fees from the fisheries industry, and oil and gas (which is still uncertain for now, as no reserves have yet been discovered). These efforts have been complicated by a range of factors including: (a) a lack of coordination between the central government and federal member states; (b) a lack of capacity at virtually every level; and (c) widespread corruption and weak state institutions. Partially as a result, the federal government and federal member states have had significant difficulty negotiating revenue sharing agreements. Additional detail on fisheries, natural resources and port revenues is set out below.

Fisheries

Somalia's territorial waters are considered to be rich fishing grounds, specifically because Somalia itself does not have significant capacity to carry out the type of industrial fishing that takes place in other countries. The Provisional Constitution does not provide significant guidance on how fisheries should be dealt with. Instead, and as mentioned, article 44 merely states that the federal and state levels of government will reach agreement on the allocation of natural resources, without providing any detail on how that agreement should be constructed.

In February 2018, pursuant to discussions within government circles and between the government and international organizations, the central government and federal member states reached an agreement on fisheries.[67] That agreement was entered into by the Federal Government of Somalia (represented by the Ministry of Fisheries), the presidents of federal member states, and the Banadir Regional Administration. The agreement provides that federal member states may grant licences within 24 nautical miles and the

[67] See 'Somali federal government and regional states reach interim agreement on resource sharing', Goobjoog News (11 February 2018), <https://goobjoog.com/english/federal-government-and-regional-states-reach-interim-agreement-on-resource-sharing>.

federal government will be responsible for granting fishing licences beyond 24 nautical miles.[68] The agreement also provided that:

- The Ministry of Fisheries should have a representative in every regional capital to facilitate licensing.

- A Somali Fisheries Authority should be established to regulate the fishing industry. The Minister of Fisheries and Marine Resources presides over the Authority, the Ministers of Fisheries of federal member states are members and the responsibilities of the Authority are to be decided by a group made up of the President and Prime Minister of the Federal Government, Presidents of federal member states and the Governor of Banadir Region.

- Revenues are to be deposited in an account at the Central Bank of Somalia and managed by the Federal Ministry of Finance. Withdrawals must be authorized by the Fisheries Revenue Management Committee, which is made up of the head of the executive of the Federal Government, Presidents of the federal member states and the Governor of Banadir Region.

- Spending must prioritize security and reconstruction of the country. Revenues should be spent according to a committee chaired by the President and Prime Minister of the Federal Government of Somalia, Presidents of federal member states and the Governor of Banadir Region.

Pursuant to the agreement, the Somali Ministry of Fisheries and Marine Resources of the Federal Government of Somalia signed a memorandum of understanding (MoU) with the Chinese Offshore Fishing Association (COFA) in July 2018 outlining terms and conditions of COFA fishing in Somalia's exclusive economic zone. These licences were controversial within Somalia, as local fishers feared foreign vessels would outcompete them and harm local livelihoods. Pursuant to the MoU, a total of 31 licences were issued to Chinese vessels in November 2018.

The revenue was deposited with the Central Bank of Somalia but the different levels of government had yet to reach agreement as to how these revenues would be allocated. In March 2019, an interim 18-month agreement was reached enabling distribution of revenues from the 2018 licences. The revenue shares from licensing were agreed to as follows:

- Federal Government: 29 per cent share;

- Puntland: 18 per cent share;

- Jubbaland: 13 per cent share;

[68] Even though the February 2018 agreement stipulates that federal member states cannot issue licences beyond 24 nautical miles, Puntland (which is a semi-autonomous federal member state in Somalia) continues to do so. Puntland has reportedly given licences to Chinese, Iranian, Thai and Yemeni vessels. For more, see Bahadur 2021.

- Southwest: 13 per cent share;
- Galmudug: 13 per cent share; and
- Hirshabelle: 14 per cent share.

In May and June 2019, revenues were distributed to federal member states in accordance with this formula. According to the agreement, 40 per cent of the revenues to the Federal Government and federal member states would be reinvested in the fisheries sector. In addition, the federal government planned to create a more comprehensive agreement in the future.

However, the March 2019 resource sharing agreement expired in September 2020. This lack of coordination paved the way for illegal, unreported and unregulated fishing, whereby foreign vessels fished Somali waters without proper licences—including with environmentally harmful fishing techniques. This also involved federal member states granting fishing licences to foreign vessels despite not having the authority to do so.[69] Currently, the Federal Government is negotiating a new MoU with a different Chinese company and the revenue sharing agreement has been extended to October 2023.[70]

Lack of coordination paved the way for illegal, unreported and unregulated fishing, whereby foreign vessels fished Somali waters without proper licences.

Regarding the revenue that was distributed, there is no scrutiny of how federal member states spend the revenue. International organizations including the World Bank are trying to develop a proper financial management system whereby the Federal Government and federal member states all use the same procedures, but at the time of writing this is still a work in progress.[71]

Oil and gas

Somalia does not currently generate revenue from oil and gas resources, as no significant reserves have been identified yet.[72] However, offshore and onshore exploration efforts are ongoing, with an expectation that some resources will eventually be identified.[73] In that event, Somali authorities have negotiated an agreement for how revenues should be distributed.

Under the agreement, which has been adopted into law, onshore producing federal member states (i.e. those from which resources are located, extracted and eventually sold) are allocated the vast majority of the revenue; non-producing member states and the central government are granted very little.

The agreement also provides that revenues generated from offshore oil resources will be allocated through the same mechanism, with revenues going to the nearest federal member state. That arrangement is very unusual in comparative practice. Typically, revenue from offshore resources would be

69 See Frontiers, 'Foreign Illegal, Unreported, and Unregulated Fishing in Somali Waters Perpetuates Conflict', <https://doi.org/10.3389/fmars.2019.00704>.
70 See FGC summary of meeting 20 February 2023 | Ministry of Finance – Somalia (mof.gov.so).
71 See Consolidated Fiscal Reports (FGS & FMS) | Ministry of Finance – Somalia (mof.gov.so).
72 See Financial Governance Report July 2020 | Ministry of Finance – Somalia (mof.gov.so).
73 See Somalia Federal Government Signs Off on Seven PSAs – Petroleum Africa.

allocated to the central government. Somalia's arrangements could lead to a host of problems related to defining boundaries between its member states.

Should reserves be located in the country, this system will create vast inequalities between different member states. With no rebalancing mechanisms, non-producing states will be progressively poorer than producing ones. In its July 2019 Report, the Financial Governance Committee (FGC),[74] stated that:

> revenue shares currently set out in the Baidoa Agreement have significant implications from a financial governance perspective, as they raise the prospect of potentially unequal development across [federal member states]. They also raise the prospect of fiscal volatility, with revenues fluctuating year on year in line with fluctuations in the oil price and production volumes. Moreover, oil-producing districts may receive more revenue than they can absorb, raising the prospect of inefficient and wasteful spending.[75]

The central government will not be able to rebalance because it will have to use its own share (which in any event will be very small) to cover its own expenditure. This could cause serious discontent in the country and could contribute to instability. This arrangement was improved somewhat through the Public Financial Management Act which provides that in the event revenues exceed a certain amount, a share of that revenue would have to be saved and the rest would be distributed between different member states.

Port revenue

Since 2012, the central government has tried to start capturing revenues that were already being collected at the regional level. One major source of revenue that is collected at the regional level is customs that are collected at ports. Under the current arrangement the central government controls revenues from Mogadishu port. Previously, these revenues were collected and controlled by the Mogadishu Regional Administration. The central government has now taken these over, while allocating a certain portion to the Mogadishu Regional Administration. The remainder of the revenue is used to cover federal government expenditures. Puntland and Jubbaland federal member states control revenues from their own respective ports. The remaining three federal member states do not have major ports, so are highly disadvantaged.

Port arrangements are under constant scrutiny and some efforts have been made to introduce improvements in the way in which the customs revenue collection is managed. One major challenge for the federal government has been consolidating revenues/collecting revenues nation-wide from federal member states. The country is moving towards a common customs system

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[74] The FGC was established in early 2014 by mutual agreement between the Federal Government of Somalia, donors and international financial institutions to provide a forum for dialogue and advice on strategic financial governance issues. The FGC's mandate is renewed annually, subject to agreement between the federal government and the international community.

[75] See Ministry of Finance/Financial Governance Committee, Financial Governance Report, July 2019, pp. 50–51.

(based on value, not volume), but has not yet established a clear revenue sharing system.

LIBYA

Out of the three case studies, Libya's conflict dynamics are perhaps most similar to Yemen's current situation. Until recently, both countries had centralized governments which have since given way to territorial divisions and the emergence of rival administrations, which led to divisions in the state's payroll. There are also a number of important differences, however: Libya's population is far lower than Yemen's; also, Libya has access to far greater natural resources, which means that its capacity to allocate resources in an attempt to resolve its conflicts is far greater.

In that context, significant efforts (supported by international assistance) have been made in Libya to reconcile rival interests through a revenue allocation mechanism. Partially as a result, there has not been any new fighting in Libya since 2020. However, the arrangement that was adopted was ad hoc and remains unstable, requiring frequent interventions—including by the international community—to ensure smooth implementation. In addition, the mechanism has proved insufficient to fully unify the country, as various political groups continue to compete over a variety of issues, including control over specific government portfolios.

The mechanism has proved insufficient to fully unify the country, as various political groups continue to compete over a variety of issues, including control over specific government portfolios.

Background

The civil war in Libya can be traced to 2011 with civil unrest and popular protests against the rule of long-time dictator Muammar Gaddafi. The protests escalated into an armed conflict, with various factions vying for control of the country. Since the fall of the regime and the capture and killing of Muammar Gaddafi on 20 October 2011, the country has faced ongoing challenges in its efforts to establish stability and rebuild its political and economic systems.

In early 2011, a National Transitional Council (NTC) was formed. The NTC was formed by anti-Gaddafi opposition and was recognized as the legitimate governing authority in Libya by the international community. In August 2011, the NTC announced that it had adopted a 'Constitutional Declaration', which was designed to serve as an interim constitution. The Declaration provides for a parliamentary system of government in which the executive is elected by a General National Congress (GNC), which serves as the legislative body. The GNC was to remain in power until a new constitution could be drafted and adopted through a popular referendum. According to the roadmap specified in article 30 of the Constitutional Declaration, the constitution of the country was supposed to be drafted by a body appointed by the GNC within 60 days from its first meeting.

In July 2012, the GNC was elected. In the meantime, the Constitutional Declaration was amended a few days before the elections to specify that the body to draft the constitution should be elected through direct popular vote and not appointed by the GNC. The elections for the Constitutional Drafting Assembly (CDA) finally took place on 20 February 2014. As a result of concerns about the GNC's performance, another round of elections was held in 2014 to elect a new parliament (the House of Representatives) and to form a new government.

Following the 2014 elections, the GNC refused to recognize the House of Representatives and Libya became divided into two main factions, east and west. The division was primarily a result of competing political and military groups vying for control over the country. A government based in the capital, Tripoli, had control over the western region of the country. Meanwhile, a rival government that controlled the eastern region, including the city of Benghazi, was supported by military leader Khalifa Haftar and his Libyan National Army (LNA). In parallel, the CDA finalized its draft constitution in July 2017, but the document sparked additional controversies and has never been put to a referendum. It is also worth noting that the draft constitution failed to address the issue of the revenue distribution and decentralization, but deferred the issue for the laws that should have been issued subsequently.[76]

Divisions in the state's payroll

Starting in late 2014, the country and the state was split into two separate entities. Rival coalitions of security forces controlled different parts of territory, and two rival governments and military coalitions tried to administer all public institutions in the territories under their control, including medical and educational facilities. One of the main ways this materialized was through the national budget, which was funded in large part through the sale of natural resources on international markets. Revenues were being paid to the Central Bank, which was in the west but not controlled by the western government.

Tripoli decided that it should continue to pay anyone who was on the payroll before the country was separated into different territories in 2014, including state employees who were based in parts of the country that it no longer controlled, including the east.

Traditionally, funds that are deposited at the Central Bank are distributed to relevant ministries in accordance with the annual state budget law and other laws that have a budgetary impact. The national budget and decisions as to where available funds would be invested, and who should be paid, were still being made by the western government in Tripoli. Tripoli decided that it should continue to pay anyone who was on the payroll before the country was separated into different territories in 2014, including state employees who were based in parts of the country that it no longer controlled, including the east.

However, the eastern government proceeded to make a number of changes to the government departments and basic services in the territory under its control. Some state employees were removed from their functions and some new staff was recruited. Further, the LNA became a new entity engaged in warfare that required funding for personnel and material, with personnel getting higher pay than military personnel in the west. In practical terms, this included state employees, teachers, security officials and municipal officials. Because the western government did not recognize the eastern government's

[76] See Zaid Al-Ali, 'Libya's draft constitution: A contextual analysis', ConstitutionNet, December 2020.

existence, it also refused to recognize its decisions and to make funds available to pay for these additional employees.

This prompted the eastern-based authorities to fund these positions through parallel mechanisms, including through raising revenues and expending funds independently of the western-based authorities. The eastern-based government financed itself mainly through treasury bills that it stipulated with the eastern branch of the Central Bank of Libya, which Tripoli did not recognize as legitimate but which were recognized by the Tobruk-based parliament.

Consolidating the state payroll

After the country was divided in late 2014, the Ministry of Finance in Tripoli, with a minister from the east, led an effort to consolidate the state payroll and bridge public sector payments between the east and west. This process was carried out to reunify the country, but it ignored the huge expansion in public sector employment (the country's total payroll increased from LYD 24 billion to 33 billion, which is the equivalent of USD 5 billion to USD 6.9 billion). Still, some consider it to have been an important confidence-building measure that contributed to the later decision to form a national unity government in 2021.[77] Others noted that the east may not have had any choice but to negotiate a solution with the west, given that the east's central bank was nearly exhausted and had little scope for continuing to fund a separate budget.

The process to consolidate the state payroll was assisted by the World Bank and the International Monetary Fund and depended in part on the UN's good offices. That process took approximately three years to complete. The result was that a unified database of all state employees was created, with some important exceptions.

As part of this process, the Central Bank requested that the national identification (NID) numbers of all state employees be disclosed. Officials from the two sides would meet in World Bank hosted meetings and go through lists of employees for every ministry. This was a means through which absolute numbers could be calculated and double counting prevented. However, the LNA in the east did not share any of the NID numbers in its disposal, based on the rationale that disclosing the presence of specific individuals as employees in the eastern-based security services constituted a security risk. This led to the establishment of two parallel systems:

(a) All state employees for whom NID numbers have been disclosed to the Central Bank, and all military officers who were in the defence ministry payrolls before 2015, including those aligned with the LNA and for whom NID numbers were disclosed, are paid directly by the Central Bank in Tripoli;

(b) For LNA employees whose NID numbers were not made available to the Central Bank (meaning those who were recruited

[77] Interview with senior international official, February 2023.

after 2014), salaries are paid through a lump sum payment from the Central Bank to the LNA. Salaries are paid through quarterly lump sums, the amount of which varies, allegedly between LYD 100 to 250 million a month (USD 20–50 million). The LNA has stated that it employs approximately 80,000 personnel but that number has not been verified by any independent sources.

Impact

Despite this process of unifying the accounts, the parallel financing of the eastern-based government continued for the military effort and the two governments and military coalitions went again to armed conflict in 2019–2020. Only after the end of the conflict and Haftar's defeat in the frontlines did the eastern-based authorities stop parallel financing and agree to form a new unity government based in Tripoli in 2020. However, the Government of National Unity's ability to influence decision making in the east remained limited, where significant political control was still exercised by the LNA.

The payment of the lump sum for military salaries continues until today but remains controversial. In late 2021 and the first half of 2022, payment was delayed on a number of occasions, presumptively because of concerns that eastern-based authorities were pursuing their own independent policies and did not fully recognize the authority of the internationally recognized government. Eastern-based authorities responded by threatening to close off ports, which risked significantly impacting the state's ability to sell natural resources on international markets. This in turn threatened to destabilize the entire political process, including negotiations to complete the constitutional process and organize new elections.

As a result, the UN intervened on more than one occasion to request that the western-based authorities operate the lump sum payment. Some observers have expressed concern that this arrangement will be a constant source of instability and must be resolved.[78] Others have said that one of the conditions for this is for the payroll to be fully consolidated, which is far from being achieved given existing levels of trust.

Libya still appears to be relatively far from the level of division that existed in 2015, but there are important concerns that the eastern authorities could start raising their own revenues and expending those funds independently of the Government of National Unity.

As of mid-2023, even though its revenue sharing mechanism appears to be functioning relatively normally, Libya's politics remain unstable. There are strong indications that the country may be fracturing again. The Government of National Unity currently has very little influence in the east and the south of the country. A separate government has officially formed with the support of the eastern parliament but has been unable to assume its functions in Tripoli. The country still appears to be relatively far from the level of division that existed in 2015, but there are important concerns that the eastern authorities could start raising their own revenues and expending those funds independently of the Government of National Unity.

[78] Interview with senior international official, March 2023.

CONCLUSIONS

The general discussion and the case studies above provide important lessons learned that should be taken into account in Yemen, including but not limited to the following:

1. Sierra Leone provides an example of how resource allocation mechanisms can help build peace and stability in a post-conflict country. At the same time, it also shows that challenges will inevitably arise during implementation and that a mechanism will require regular adjustments, which are best handled through political negotiations and institutions.

2. Somalia shows that revenue sharing requires a solid basis to function. This includes ensuring that there is sufficient revenue to finance an allocation mechanism, that the mechanism actually provides for an equitable distribution of the revenue in question, and that there are sufficient oversight mechanisms to work against waste and corruption. There is significant concern in Somalia that existing arrangements are not sufficiently transparent and that they could lead to an increase in inequality.

3. Finally, Libya also shows that resource allocation mechanisms help build stability in a conflict or post-conflict environment. However, Libya also clearly shows that a functioning revenue allocation mechanism is not enough to fully stabilize a country, as other imperatives (in Libya’s case, government formation, elections and other issues) are critical to stability as well. Libya shows that successfully negotiating a revenue allocation mechanism does not automatically translate into greater political unity and that without a joint political mechanism of some type, the revenue allocation mechanism will itself remain fragile and subject to failure.

As far as Yemen is concerned, this suggests that even if a revenue allocation mechanism is successfully negotiated, much more will need to be done to stabilize the country.

As far as Yemen is concerned, this suggests that even if a revenue allocation mechanism is successfully negotiated, much more will need to be done to stabilize the country. In particular:

1. Some form of political framework will need to be established as a platform for the country's main groups to communicate directly on contentious issues, including how the allocation mechanism should be managed over time. This is applicable for both short-term and long-term arrangements, although long-term arrangements will obviously require a more robust political arrangement.

2. If an allocation mechanism is negotiated, the parties should try to formalize a clear formula to determine how revenue should be allocated, to improve transparency and predictability. This is crucial to try to reduce waste and corruption and to increase the likelihood that whatever revenue is allocated is used for its stated purpose.

3. It would also be far preferable for any agreement to be provided for in a clear and binding legal document, so as to improve the mechanism's stability. An allocation mechanism can be provided for in peace agreements, bilateral or multilateral agreements as well as other types of instruments.

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One of the particularities of what is currently being negotiated between Saudi Arabia and Ansar Allah is that the parties are contemplating establishing a revenue allocation mechanism in the absence of an overarching constitutional or political framework.

This paper seeks to highlight some of the opportunities and challenges that are likely to present themselves if the negotiating parties manage to reach agreement on the payment of public sector employees. In addition, the paper explores three case studies from which it seeks to draw lessons learned for Yemen's situation.

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