When a country quadruples its tax revenue over the course of a single year, it’s time to sit up and take notice. That’s the scale of the revenue increase achieved by African mining country Ghana from its extractive industries from 2010 to 2011. How was this possible? It’s largely down to the international rules on improved financial transparency in the energy and resource sectors, which significantly reduce the opportunities for tax evasion. These rules, known as the Dodd-Frank Act, and the standards set by the Extractive Industries Transparency Initiative (EITI) feature on the agenda for the forthcoming G8 Summit hosted by the British Government at Lough Erne in Northern Ireland on 17-18 June 2013. This issue of Global Governance Spotlight outlines the new rules and the stage reached in their implementation, and considers the challenges facing resource-rich developing countries and the extractive industries, as well as the role of the U.S., Germany and the EU in this context. It concludes with policy recommendations, which focus on the international action required to curb the misuse of profits from the extractive industries and on better ways of institutionalising these measures. It also considers how the global interaction between land, energy, food, water and minerals (= the resource nexus) can be utilised to improve the knowledge base for decision-makers.

Background: markets, prices, payments

The international commodity markets are under stress. Since 2000, prices have been on an upward trajectory due to soaring demand, briefly interrupted by the financial crisis. Despite increased investments, corporate mergers, capital flows to mining companies and a boom in non-conventional fossil energy carriers, the situation is likely to remain tense. Newly discovered resource deposits are generally low in concentration and yield and are located in inaccessible regions, and new transport infrastructures often have to be put in place to enable them to be transported out of the mining area. Extractive projects are also beset with environmental problems and social tensions.

New players are appearing on the scene; they include Mongolia, Vietnam and other countries where mining legislation and policies must be newly introduced, as well as state-owned mining companies. The major emerging economies are fully aware of their own strategic interests. In parallel, resource conflicts over access to raw materials and the use of land and water resources feature in the media almost on a daily basis, along with reports about social unrest triggered by the rising costs of basic goods. A recent report by the International Monetary Fund (IMF) underlines the linkage between resource abundance and low scores in the Human Development Index.

One consequence of all these stress factors is extreme price volatility. At the same time, the incentives to make a quick profit in illegal markets are increasing. An estimated 20 per cent of the world market in coltan – a precious metal used in mobile communications – is illegally traded.

More transparency of payments is an important step towards better markets and good governance and
helps to combat corruption in mining countries. Disclosure of payments can strengthen democratic institutions and increases participation. Fair contracts, too, can guarantee a regular income for producer countries. It is therefore by no means unrealistic to assume that a sustainable extractive industry, with revenues being invested in sustainable development, can offer good economic prospects for the 100 or so resource-rich developing countries and their 3.5 billion people.

Milestones towards improved transparency

A fundamental prerequisite for this development is improved transparency in the resource sector. The first milestones have already been reached:

- The Extractive Industries Transparency Initiative (EITI) is a coalition of governments, companies, civil society groups, investors and international organisations. Its global standard requires companies to publish what they pay and governments to disclose what they receive. On this basis, a country report is produced, which then undergoes independent verification in a transparent process involving various stakeholders. Currently (May 2013), 23 countries are EITI-compliant, including Azerbaijan, Ghana, Iraq, Nigeria and Norway. The reported payments amount to around USD 1 trillion in total.

- The US Dodd-Frank Act was signed into law in 2010 and aims to regulate the financial markets. Section 1502 of the Act contains rules on the use of conflict minerals by stock exchange-listed companies, while Section 1504 contains rules on transparency in the extractive industry. Companies engaged in the commercial development of oil, natural gas or minerals must submit annual reports to the U.S. Securities and Exchange Commission (SEC) disclosing the payments made to governments at both the country and the project level.

The Organisation for Economic Co-operation and Development (OECD) has adopted similar guidelines. In April 2013, the European Union also agreed the long-awaited rules to implement the relevant provisions of the Dodd-Frank Act, and in May 2013, the EITI agreed a new and improved set of standards.

Moving forward? Implementation and challenges

Despite opposition to the adoption of the new regulations, things are moving forward. In August 2012, the U.S. Securities and Exchange Commission (SEC) adopted new rules to implement the relevant provisions of the Dodd-Frank Act, and in May 2013, the EITI agreed a new and improved set of standards.

In May 2013, the New York-based think-tank Revenue Watch produced the Resource Governance Index, whose methodology is largely based on transparency indicators. The Index measures the quality of governance in the oil, gas and mining sector of 58 countries. It identifies particular deficits in African and Asian countries.

The Africa Progress Report 2013, launched by Kofi Annan at the World Economic Forum in Cape Town, paints a cautiously optimistic picture of the future for this resource-rich continent. It confirms that progress has been made on democracy and transparency, for example in Senegal and Côte d’Ivoire, but also warns about land speculation.

Initial experience with implementing the transparency rules clearly reveals a willingness to learn. The initial scepticism about the EITI, and especially its readiness to apply stringent criteria to mediocre reports and demand improvements, has proved to be unfounded: the EITI has gone as far as to suspend some countries’ membership for non-compliance. At the other end of the spectrum, Guinea, Ghana and Liberia have actually outperformed the standards. As time has gone on, the indicators and evaluation criteria, e.g. on participation, have been improved as well. The EITI, in cooperation with its partners, is also offering training programmes and is engaged in capacity building. All its reports have been published and were evaluated in early 2012.

Some sections of the industry are still concerned about competitive disadvantages. It remains to be seen whether the costs of implementation for industry will indeed prove to be as high as some people fear. The European Commission estimates the initial total costs for European industry to be in the order of € 1.15 billion if an ambitious approach is adopted. Typically, however, the outlay then decreases significantly over time. Experience gained with implementing environmental directives also shows that the predicted costs of implementation are generally higher than the subsequent actual costs. With its participation in the EITI, the extractive industry is also pursuing its own very specific interests: its golden years are over and its state-subsidised rivals have competitive advantages, so it is now seeking to secure its position by developing new business models and establishing reputational advantages.
Taking action in challenging regions

In crisis regions, the outcomes are mixed. One question is whether transparency genuinely creates incentives for the establishment of democratic and inclusive institutions and supports the move towards sustainable development, or whether fragile states are more likely to be in thrall to criminal organisations and authoritarian structures. The eastern regions of the Democratic Republic of the Congo (DRC), for example, saw renewed clashes in late 2012/early 2013 which have made implementation of the new rules much more difficult. At the same time, the International Conference on the Great Lakes Region has gained more support in the region and, faced with the threat of market losses in key industrial countries, is seeking to improve its cooperation in relation to the external resource trade. In the final analysis, however, far more mobilisation of political forces is needed in response to these challenges.

Ultimately, it is about rights of use and benefit-sharing. In 2011, the revenue from Nigeria’s oil industry was 60 per cent higher than total official development assistance (ODA) for the sub-Saharan African countries. The profits of the largest mining companies in 2010 amounted to around USD 3 trillion. ExxonMobil reported total profits of USD 45 billion for 2012.

The energy and mining companies have traditionally been in a strong negotiating position in resource-rich developing countries, and these companies’ powerful position was reflected in many of the contracts concluded. However, this situation has changed. The nationalisation of a subsidiary of Spain’s Repsol in Argentina in 2012 has once again underlined the shift in power towards the major extractive countries. The International Bar Association has drafted a model contract, known as the model mining development agreement (MMDA), which aims to achieve a balance of interests between the parties. In relation to the EITI, however, it should be noted that none of the major emerging countries has signed up to the initiative and that the attitude towards transparency in these countries makes international analysis far more difficult.

Beyond transparency rules: other challenges

Transparency in the resource sector should go further than merely the disclosure of payments, as at present:

1. It should include all relevant payments made throughout the resource life cycle, including exploration, granting of concessions, contracts and owners.

2. It should present core data on scarcity and environmental pollution.

3. It should support economic and social development in the countries concerned by watching how the revenues gained are being spent.

The challenges for the future not only include dealing with non-compliance. The major emerging economies in particular are likely to continue to evade transparency standards; their market power and influence in growth markets make international coordination much more difficult. In those countries which are participating despite these deficits, it is about achieving broader governance – by establishing a properly functioning tax system, introducing legislation that supports a sustainable mining industry, and setting up “inclusive” institutions that promote sustainable development.

In relation to resource use, the challenges lie primarily in dealing with the resource nexus, i.e. the global interaction between the various resources that are needed to produce fuel and energy feedstocks, industrial inputs and food (see Figure 1). Each resource requires others in order for it to become usable. Energy–water–food is a much-discussed nexus, but this interaction applies to mineral resources and land use as well. For that reason, the extractive industries have no option but address the resource nexus as an issue.

Notwithstanding all the positive prospects for the resource-rich developing countries, one aspect cannot be ignored: the sustainable management of natural resources must be coordinated on a global basis. Resource efficiency is therefore the right way forward and must be developed further in the context of reduction scenarios.
Transparency in the Resource Sector. The basis for sustainable development

Recommendations

The initiatives mentioned are making progress, but stronger linkage between them is required. It is essential, in this context, to clearly identify interdependencies and shared interests. An improved knowledge base is a key prerequisite for sustainable development that reduces poverty and lessens negative impacts on the environment.

The following recommendations are made on this basis:

- All financial transactions relating to upstream activities in the value chain, from the assessment of reserves to exploration and the granting of concessions, must be disclosed. In the current core area, state-owned companies and resource funds in particular should be subjected to more stringent transparency requirements. Downstream, the international markets for recycling and disposal should be included in measures to increase the transparency of payments in resource-intensive industries. This would also help to increase resource efficiency.

- An international, open-accessible data portal on resource use should be established, to include core data on geological and other services, as well as data on environmental pressures from resource use (including the nexus and “ecological rucksacks”) and coefficients for resource-intensive areas of production.

- Germany and the EU should implement their decisions on transparency in the resource and forestry sectors, show a high level of commitment to verifying project and country reports, take up membership of the EITI, and subject their external trade and industry to its transparency requirements. The U.S. and the OECD can be regarded as pioneers in this context and should therefore assume a coordinating role.

- Germany and the EU should review their material partnerships to ensure compliance with the relevant criteria and increase support for sustainable management of resources, taking full account of the resource nexus in the countries concerned.

- Resource-rich developing countries could introduce more extraction taxes and support new fiscal systems which promote labour standards, poverty reduction, research and innovation.

- Key flanking initiatives at the international level could include a multi-stakeholder forum for sustainable resource use, an international metal covenant to promote recycling and material flow management with industry involvement, and, over the longer term, an international agreement on sustainable resource management which would also help to enhance the binding nature of the transparency rules at the international level.

Overall, then, the outcome would be a governance agenda that focuses more on regional and internationally coordinated activities involving a wide range of stakeholders than on multilateral global solutions.

Further information


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