

WILL THE NEW TRANSPARENCY REPORTING INITIATIVES IMPACT CORRUPTION IN THE EXTRACTIVE INDUSTRY?

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By Jeremy Sandbrook¹

*"...to protect the Treasury from being defrauded, let all money be issued openly in front of the whole city,
and let copies of the accounts be deposited in various wards..."* -

- Aristotle, The Politics

"Sunlight is said to be the best of disinfectants; electric light the most efficient policeman".

- U.S. Supreme Court Justice Louis Brandeis

Overview:

The exploitation of oil, gas and mining resources now play a critical role in a growing number of developing countries. The proceeds they generate contribute substantially to their GDP, and in many cases form the bulk of the host government's revenue. It directly affects the country's economic growth, its environment, domestic security, social development and overall well-being. Unfortunately the domestic wealth generated by these extractive industries, has not translated into improved living conditions for the majority of citizens, with revenues earned by host governments wasted or lost through corruption and financial mismanagement. The lack of overall transparency has been seen as a key contributor to this. In an attempt to address the issue, legislators in the United States, the European Union/United Kingdom, and more recently Canada, have introduced transparency reporting initiatives², which require companies in the extractive industries to publically declare payments made to governments. Seen by many as a corporate social responsibility (CSR) initiative, or even as a form of social policy intervention by stealth, this paper provides a brief overview of the nexus between corruption and the extractive industries, and examines whether increased transparency will have a positive impact on overall corruption levels within resource rich countries.

¹ Jeremy Sandbrook is the founder and CEO of Integritas360, an organisation established to advance integrity and raise ethical practices in global development. He specialises in designing and implementing bespoke solutions to addressing challenges organisations have in the inter-related areas of anti-corruption, integrity, governance, and accountability. While focusing on the international development and government sectors, Jeremy also supports commercial entities wishing to expand into frontier and emerging markets. He can be contacted at Jeremy.sandbrook@integritas360.org

² See Appendix two for an overview of the transparency legislation

§1. The Role of Extractive Industries in International Development

The extractive industries (made up of oil, gas and mining) currently generate around US\$3.5 trillion in annual gross revenue, or 5 per cent of global gross domestic product (GDP)³. The companies who make up the sector are large and influential. In 2010, six out of the top 10 global corporations – in terms of revenue – came from the extractive sectors⁴. At the time they enjoyed record profits, fuelled by a significant increase in commodity prices. Paradoxically, the *resource curse*⁵ has meant that people living in most of the countries where the extraction has taken place, continue to live in poverty. First used by Richard Auty in 1993, the *resource curse* describes the paradox around why resource rich countries have not been able to use this wealth to boost economic development. Counter-intuitively, these same countries have traditionally had lower economic growth, less democracy, and worse development outcomes than countries without an abundance of natural resources.

Notwithstanding this, the size and importance of the revenue generated by the extractive industries remain crucial to the overall development of these countries, and the well-being of the citizens living in them. This is emphasised by The World Bank's claim that non-renewable mineral resources now play a dominant role in 81 countries around the world. Collectively, these countries account for a quarter of the world's GDP, half of its population, and nearly 70 per cent of those living in extreme poverty⁶. An examination of the reports submitted by 35 EITI (The Extractive Industries Transparency Initiative) member countries, show that for almost a quarter of them, proceeds from the extractive industries comprise over 50 per cent of the country's total government revenues. For four of these, it is over 80 per cent⁷.

While many would argue that there is no direct connection between the activities of the extractive sector and a country's development⁸ (as highlighted by the EITI example above) there is a growing dependence by governments on the revenue flows its generates. If properly accounted for, these resources can have a direct influence on the overall well being of its citizens. Like it or not, this makes companies operating in

³ Le Billon P. (2011). *Extractive sectors and illicit financial flows: what role for revenue governance initiatives?*. Bergen: Chr. Michelsen Institute (U4 Issue).

⁴ Sigam C., and Garcia, L. (2012). *Extractive Industries: Optimizing Value Retention in Host Countries*. New York and Geneva: UNCTAD.

⁵ For a good overview of the differing theories see Rosser, A (2006). *The political economy of the resource curse: A literature survey* (IDS Working Paper 268). Brighton: IDS (University of Sussex)

⁶ World Bank, Extractive Industry Overview at <http://www.worldbank.org/en/topic/extractiveindustries/overview>

⁷ EITI Progress Report 2015 – Making transparency matter: The importance of natural resources for government revenue at <http://progrep.eiti.org/2015/glance/importance-natural-resources-government-revenues>

⁸ In this context of this paper 'development' is defined as the need and the means used to provide better lives for those most in need. It includes not only economic growth, but also human development (i.e. the provision of basic needs such as health, nutrition and education).

the extractive space crucial actors in the process whether they acknowledge this or not. So where does corruption fit in to all of this?

§2. The Dynamics of Corruption: Supply and Demand

Described by the World Bank as “Public enemy number one”, corruption is estimated to cost the global economy around US\$2.6 trillion a year⁹. Of this between US\$1.0 to US\$1.5 trillion is made up of bribes¹⁰. The largest share of this falls on developing countries, who lose around US\$1.1 trillion in illicit financial flows a year; US\$7 for each dollar of aid received¹¹. Corruption costs the resource rich continent of Africa around US\$148 billion a year¹². It has become so pervasive, that it is now interwoven into the very fabric of a growing number of societies, and is a now systematic feature of many economies. While certain aspects of the *resource curse* continue to be contested¹³, what is not is its nexus with corruption.

While taking a multitude of different forms, corruption¹⁴ in resource rich developing countries has tended to manifest itself through the political and ruling elite. The enormous revenue flows that characterize the extractive industries – from the *demand-side*¹⁵ of the corruption equation – make it a lucrative target for politicians and senior government officials seeking some form of self-enrichment (e.g. a facilitation payment in return for issuing a government contract, concession or license, or to allocate some scarce resource). The perpetrator is rarely acting alone however, and is usually part of a deeply entrenched patrimonial network made up of family, friends and close associates, who – in return for ongoing loyalty and support – are rewarded with a share of the benefits (usually a portion of the facilitation payment or access to related financial opportunities). Acting as a quasi-social welfare system, the sheer number of people benefitting from the network creates a significant (and powerful) vested interest in maintaining and protecting the status quo. In support of this, it is not uncommon for organs of the state such as the judiciary and law enforcement bodies, to be used by government to repress or silence any potential threats.

⁹ World Economic Forum, Network of Global Agenda Councils Reports 2011-12: Anti-Corruption at <http://reports.weforum.org/global-agenda-council-2012/#view/global-agenda-council-2012/councils/anti-corruption/>

¹⁰ IMF Staff Discussion Note (May 2016). Corruption: Costs and Mitigating Strategies (SDN/16/05). p.5 A 2015 estimate, it is an extrapolation of an earlier estimate of \$1.1 trillion contained in Kaufmann, D. (2005). "Myths and Realities of Governance and Corruption." MPRA Paper 8089, Munich. (2005).

¹¹ Global Financial Integrity (2013). 'Illicit Financial Flows from Developing Countries: 2002-2011' (by Dev Kar and Brian LeBlanc).

¹² Based on a 2002 report commissioned by the African Union, at the amount quoted represented around 25% of the continent's gross domestic product (GDP), and was estimated to increase the cost of goods by as much as 20%.

¹³ *Supra* note 4.

¹⁴ While commonly defined as the abuse of entrusted power for personal gain, in the case of the extractive sector the main form of corruption that legislators and policy specialists' focus on is bribery.

¹⁵ As with any transaction, bribery involves two actors: the person who solicits or receives the bribe, the *demand-side* (or “passive” bribery); and the person who offers, promises, authorizes, or pays a bribe, the *supply-side* (or “active” bribery).

This system is more entrenched in cases where extractive industry revenue is the primary source of government income. Instead of a country's political process being built on broad-based public sentiment, (as happens when taxation forms the bulk of the income), encourages (or even reinforces) the divide between a country's citizenry and its political elite. Political competition is driven (and reinforced) by the patrimonial system described above, where public spending is used to maintain political control rather than directed towards the public good¹⁶. The end result of this is the development of policies based on short-term personal gain, rather than long-term development objectives. The conundrum here is how to break this vicious cycle.

Countries need to address these governance challenges by providing the appropriate legal, regulatory and institutional framework, which together create an environment where all actors (both local and foreign) are equally – and impartially – held to account. To do this requires sufficient political will to challenge the status quo. Without this it will be difficult to effectively tackle the *demand-side* of corruption.

Until then, increased focus needs to be placed on reducing the opportunities that give rise to corrupt transactions taking place. This can be done by tightening up the *supply-side* of the corruption equation. It is this side that provides the political elites with access to various forms of 'facilitation payments', 'signature bonuses', and 'royalties', which provide the opportunity for state-owned resources to find their way into an individual's bank account rather than the state treasury. The overall size of the contracts at risk have the potential to significantly boost a company's bottom-line, with the *opportunities* associated with offering the inducements needed to obtain lucrative contracts, significantly outweighing any potential *threat* of detection and prosecution for bribery or corruption. An example of this is the US\$1.2 billion settlement (in 2010) between US authorities and a group of oil and gas service companies accused of corruption in the construction of a liquefied natural gas plant in Nigeria. The consortium paid bribes to senior Nigerian government officials (through a series of agents and intermediaries) in return for being awarded contracts worth US\$6 Billion¹⁷. The bribery scheme operated for over a decade before being brought to light.

This case is not an anomaly. In the last few years there has been a marked increase in FCPA enforcement actions involving the extractive industries. In their annual Global Enforcement Report, TRACE International reported that between 1977 and 2010, there were 61 enforcement cases involving the extractive sector. In 2011 this increased to 68, and in 2012 to 113 cases, accounting for the highest number of enforcement actions across all given industries. This trend has continued, with TRACE's 2015 report

16 Standing, A. (2007). *Corruption and the extractive industries in Africa: Can combatting corruption cure the resource curse?* Pretoria, South Africa: ISS (Paper 153) and McMillan, J. (2005). *Promoting transparency in Angola*. *Journal of Democracy*, 16 (3).

17 See DOJ Press Release at <https://www.justice.gov/opa/pr/snampromgetti-netherlands-bv-resolves-foreign-corrupt-practices-act-investigation-and-agrees>

showing that the extractive industry has once again topped all sectors, with 157 FCPA investigations and enforcement actions concerning bribery of domestic and foreign officials¹⁸.

While the global resource boom may have ended, it does not mitigate the ongoing pressures placed on companies to continue delivering profits to its shareholders. This in turn gives rise to the potential use of dubious methods to secure lucrative future contracts. This type of activity is usually channelled through a series of intermediaries, agents and legal structures, which provide sufficient opaqueness and distance, for the organisation to successfully argue a case of plausible deniability.

Notwithstanding this, some progress is being made. As stated by the World Bank, in a December 2013 speech calling on partners to join the fight against corruption:

*“The private sector has to be part of the solution as well. Oil, gas, and mining firms are increasingly disclosing their contracts with governments. This gives everyone a chance to scrutinize the behaviour of corporate and public officials.”*¹⁹

§3. The Rationale for Transparency

But is transparency an effective method for countering corruption? The commonly held belief is that it is, which is why – from a policy perspective – it has become the *sine qua non* for tackling corruption in the extractive industries. Focusing on making information on revenue flows more accessible, it is based on the concept of *open data* as a public benefit. At the core of this is the argument that corruption is more likely to flourish in societies where access to information is limited, and revenue flows lack transparency. Its effectiveness is premised on the assumption that access to such information will increase public scrutiny. This in turn will deter corruption by empowering citizens of resource-rich countries to hold their governments accountable for the wealth generated by these resources. The logical conclusion? A break in the corruption *resource curse* nexus!

§4. Transparency in the Extractive Industry

This rationale has led to a number of international transparency initiatives aimed at promoting transparency and accountability within the sector. The two most notable are the Publish What You Pay (PWYP) campaign²⁰ and the Extractive Industries Transparency Initiative (EITI)²¹. While voluntary in nature, both

¹⁸ See reports at TRACE’s Global Enforcement Reports at <https://www.traceinternational.org/publications>.

¹⁹ World Bank Press Release (December 19, 2013) at <http://www.worldbank.org/en/news/press-release/2013/12/19/corruption-developing-countries-world-bank-group-president-kim>

²⁰ See <http://www.publishwhatyoupay.org/about/>

²¹ Haufler, V. (2010). Disclosure as governance: the extractive industries transparency initiative and resource management in the developing world. *Global Environmental Politics*. 10 (3), 53–73.

focus on promoting increased transparency in the management of natural resources, by requiring information along various points of the extractive industry value chain (from the point of extraction, to how the revenue makes its way through the government, and ultimately how it benefits the public) being made openly accessible²².

From a policy perspective, this has led to the following mandatory reporting requirements, which require companies in the extractive industries to declare payments made to governments:

- New mandatory reporting requirements for the extractive sector to be introduced by the U.S. Securities and Exchange Commission (SEC's) pursuant to the *Dodd-Frank Wall Street Reform and Consumer Protection Act*²³;
- The European Union's (EU's) reporting standards pursuant to its *Accounting and Transparency Directives*²⁴; and
- Canada's *Extractive Sector Transparency Measures Act* (ESTMA)²⁵

According to the Revenue Watch Institute, combined, these initiatives will cover around 76% of publically listed global extractive companies by value, or \$5.8 trillion in market capitalization.²⁶

§5. The Case of Nigeria

So just how effective are these initiatives? While still too early to tell, a good case study that highlights the magnitude of corruption within the extractive sector is Nigeria. In 2007, the country's national assembly passed the Nigeria Extractive Industries Transparency Initiative (NEITI) Act²⁷, making it the first country to make the reporting of payments by extractive companies, and revenues received by government, a legal obligation. Four years later (in April 2011) EITI endorsed Nigeria's management of its extractive industry

²² Currently 51 countries are implementing the EITI standard, of which 31 are now fully compliant with it. In total US\$1.9 trillion worth of government revenues from oil, gas and mining have been disclosed in various IATI reports (see Extractive Industries Transparency Initiative Factsheet (2016): https://eiti.org/files/eiti_factsheet_en_0.pdf)

²³ The rules will require certain disclosures by resource extractive companies that are subject to the reporting requirements of the SEC. See <https://www.sec.gov/news/pressrelease/2015-277.html>

²⁴ Passed by the EU Parliament in June 2013, the new reporting standards requires EU member states to enact rules that require companies operating in the extractive industry to report payments made to governments over €100,000. See http://europa.eu/rapid/press-release_MEMO-13-541_en.htm. The United Kingdom became the first member country to implement the new transparency directive when they introduced *The Reports on Payments to Government Regulation 2014*.

²⁵ ESTMA came into force in June 2015. See <http://www.nrcan.gc.ca/mining-materials/estma/18180>

²⁶ Revenue Watch Institute. (2016). *Oil & Mining Companies on Global Stock Exchanges*. Retrieved from <http://data.revenuewatch.org/listings/index.php?i%5B%5D=ES&i%5B%5D=CAN&i%5B%5D=DE&i%5B%5D=NL&i%5B%5D=BE&i%5B%5D=PT&i%5B%5D=FR&i%5B%5D=UK&i%5B%5D=CA&i%5B%5D=CAV&i%5B%5D=US&submit=Calculate>

²⁷ Available online at <http://www.neiti.org.ng/sites/default/files/documents/uploads/neitiact.pdf>

revenue, giving it EITI Compliant Country status. Despite the increased transparency these measures have brought, it appears little has changed. This is evidenced by the following irregularities:

- A July 2010 **KPMG Audit** found that between 2007 and 2009, the country's state owned oil company, the Nigerian National Petroleum Corporation (NNPC), had over-deducted funds in subsidy claims totalling N28.5 billion, none of which could be accounted for. The audit, commissioned by Nigeria's Federal Ministry of Finance, followed allegations of "wrongful deductions at source by the NNPC to fund its operations" by 36 state governors²⁸.
- In 2012, the findings of the **Petroleum Revenues Special Task Force**, established by Nigeria's President (Goodluck Jonathan) to examine the country's oil industry, painted a discouraging picture. Led by the former head of the anti-corruption agency, Nuhu Ribadu, the 146-page report implicated ministers, parastatals and a number of major international oil companies in mismanagement, missing royalties and unaccounted for signature payments. Conservatively, it was estimated to have cost the country US\$35 billion over 10 years. Companies named in the report included Total, Eni, Shell, Sinopec, and Nigeria's state-owned NNPC²⁹.
- In 2013 the **Governor of the Central Bank**, Lamido Sanusi, wrote to Nigeria's President alleging that the NNPC had retained between US\$12 billion, and US\$50 billion, in oil revenue that was owed to the government³⁰. The NNPC denied any wrongdoing, and Sanusi was subsequently stood-down on charges of "financial recklessness and misconduct"³¹.
- In 2014, a **PricewaterhouseCoopers (PwC) review** covering the period from January 2012 to July 2013, recommended that the NNPC refund a minimum of US\$1.48 billion to the government, which could increase to US\$4.29 billion depending on an investigation of the validity of US\$2.81 billion in deductions³².

To date no one has been held to account for any the irregularities highlighted in the above reports.

In April of this year, Nigerian Civil society groups called on the country's government to criminalize acts of impunity and corruption in the country's extractive industry. At the heart of the issue is successive government's failure to implement the bulk of recommendations stemming from the various probes and

²⁸ Sahara Reporters: Monumental Oil Subsidy Fraud And Corruption At The NNPC-The Damning KPMG Report: Premium Times <http://saharareporters.com/2011/12/09/monumental-oil-subsidy-fraud-and-corruption-nnpc-damning-kpmg-report-premium-times> 09/12/11

²⁹ Reuters. Exclusive: Nigeria losses billions in cut price oil deals - report. 24/10/12 <http://www.reuters.com/article/us-nigeria-oil-idUSBRE89N0VV20121024>

³⁰ Sanusi Lamido Sanusi, "Dear Mr. President, The NNPC Has Stolen \$50 billion Of Crude Oil Earnings"- Transcript of The Letter From The CBN Gov To President Jonathan', <http://saharareporters.com/2013/12/10/dear-mr-president-nnpc-has-stolen-50-billion-crude-oil-earnings-transcript-letter-cbn-gov>

³¹ See <http://www.bbc.com/news/world-africa-26270561>

³² See <http://www.aljazeera.com/programmes/countingthecost/2015/08/corruption-blights-nigeria-oil-industry-150818132048576.html> 19/08/15

audits into the sector. It is estimated that this lack of action has cost the country over N7.1 trillion³³ in the last decade alone. The irony here is how the most investigated industry in the country, has managed to remain the least responsive to various attempts to curb corruption.

So why did the NEITI and EITI transparency initiatives in place not have a greater effect on corruption?

§6. Why Transparency on its own not enough

While **transparency** is an important element in the fight against corruption, it is not the panacea that many hold it out to be. While it can be used as an effective mechanism to remove the opaqueness needed to shield various types of corrupt practices, its overall effectiveness is heavily dependent on the presence of two other interrelated (but qualitatively different) concepts: **publicity** and **accountability**.

The increased risks of having information about an individual's corrupt activities made publicly available (transparency) is unlikely to affect an elite actors' behavior unless: one, the information is broadly spread; two, it is appropriately processed and interpreted; and three, the actor/s involved are appropriately sanctioned (accountability). In the case of Nigeria, while information was made available, and some of it was publically disseminated, those responsible were not held accountable for their actions. The result: Ineffective transparency.

While civil society play a key role in ensuring government is held to account, in many parts of the world the sector remains relatively weak and disorganised. It also tends to be hampered by a lack of capacity and infrastructure, which limits its ability to find and access the information needed to hold governments and other actors to account. This, combined with low literacy levels (which results in a less informed and engaged citizenry), and a growing trend for governments in the developing world to target advocacy based civil society groups they see as a threat³⁴, all serve to reduce the effectiveness of transparency based initiatives when trying to counter *demand-side* corruption.

In addition to this, while in most cases transparency can be used to help deter corruption, in certain circumstances, it could potentially foster it. While the information around payments to governments is being publically disclosed to both the regulatory bodies and the general public, it is also being disclosed to corrupt actors. While this disclosure will deter a certain number of corrupt activities, it could facilitate others. A good example of this is political donations, where public disclosure records can be used by politicians to identify private actors who support 'compliant' candidates, or – alternatively – be used by

³³ See <http://www.premiumtimesng.com/business/business-news/202160-groups-want-nigerian-govt-punish-corruption-oil-gas-industry.html>

³⁴ For examples of this see <http://www.economist.com/news/asia/21650548-democratic-asian-governments-well-authoritarian-ones-crack-down-ngos-whos-afraid> and <https://www.theguardian.com/law/2015/aug/26/ngos-face-restrictions-laws-human-rights-generation>

private actors to identify politicians who ‘reward’ their benefactors. It can tell politicians which speakers support candidates who vote in their interest—and therefore which speakers are reliable. The same disclosure, combined with voting records, tells speakers which politicians reward their backers—and therefore which politicians can be trusted.

It would not take much to translate this model over into the extractive industry, where disclosure laws could reduce corruption on one hand, but facilitate it on the other (i.e. by providing a mechanism to enable ‘Corruptors’ to identify suitable ‘Corruptees’ and vice-versa³⁵).

§7. Conclusion

While the introduction of the extractive industry transparency reporting initiatives in the United States, the European Union / United Kingdom and Canada, are an extremely positive development for the industry as a whole, they are not a panacea. Although still too early to gauge its overall effectiveness, it is anticipated that the initiatives will have a positive impact on *supply-side* corruption. In the case of the *demand-side* however, its overall impact is expected to be relatively limited.

³⁵ The corollary to this is if total disclosure (transparency) may facilitate corruption, could total anonymity reduce it?

Appendix

Overview of New Extractive Industry Transparency Reporting Initiatives

The following legislation has been enacted as part global efforts to increase transparency and deter corruption in the global extractive sector.

(1) The United States

Coming into affect on 26 September 2016, the United State's (US) transparency reporting initiative is covered by Section 13(q) of the United States Securities and Exchange Act of 1934 (the US Exchange Act), which was added in 2010 with the inclusion of Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). It directed the SEC to:

“issue final rules that require each resource extraction issuer to include in an annual report . . . information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals, including (i) the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals, and (ii) the type and total amount of such payments made to each government.”

The rule requires resource extraction issuers to file an annual report with the SEC containing information on all payments made by the resource extraction issuer (and its affiliates) to either a foreign government or the US federal government for the purpose of the commercial development of oil, natural gas, or minerals.

For more see: <https://www.sec.gov/news/pressrelease/2015-277.html>

(2) European Union (EU):

The EU's mandatory disclosure rules are based on guidelines developed by the EITI and have similar disclosure obligations as Rule 13q-1 of the US Dodd-Frank Act (above).

They are covered by Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 as amended (Accounting Directive) and Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 as amended (Transparency Directive). The purpose of these Directives is to provide the public with the information it needs to hold governments accountable and to promote the adoption of EITI. The disclosure required is on a country-by-country and project-by-project basis.

The Directives go beyond the SEC's rules in two ways: It is not just limited to the oil, gas and mining industries, but includes the logging of primary forests; and it applies to both listed and unlisted companies.

The first country to enact the Directives has been the United Kingdom.

For more see: http://europa.eu/rapid/press-release_MEMO-13-541_en.htm

(3) Canada

Canada's *Extractive Sector Transparency Measures Act* (ESTMA) came into force on June 1, 2015 and introduced new reporting and transparency obligations on extractive businesses engaged in the commercial development of oil, natural gas, or minerals.

Its reporting requirements are broadly aligned with the EU and the US measures, and are an effort to ensure a level playing field for Canada's extractive companies operating domestically and abroad. As Canada is a major player in the extractive industry its transparency regime is expected to influence a significant volume of global extractive sector reporting.

For more see: http://europa.eu/rapid/press-release_MEMO-13-541_en.htm

