

REPORT

***SUSTAINABILITY AND
ENVIRONMENTAL
JUSTICE IN RESOURCE-
RICH COUNTRIES***

FIDANKA MCGRATH

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The paper discussed the need of improved transparency as a prerequisite for sustainability and environmental justice in resource-rich countries. It argues that transparency is instrumental in overcoming the '*resource curse*' through two important functions: first, empowering citizens and communities to participate in decision-making, and secondly, fostering more accountable governments and corporations.

THE EU ACCOUNTING AND TRANSPARENCY DIRECTIVE AND THE DODD-FRANK ACT

The idea for the research topic was inspired by the present discussions in Brussels about the new European Union (EU) Accounting and Transparency Directive to address the need for greater disclosure of financial information by the extractive and logging industries. The proposal for amending the existing Transparency Directive (2004/109/EC) and Accounting Directives (78/660/EEC and 83/349/EEC) comes as a response to developments in the United States (US), where in 2010 Congress passed the landmark Dodd-Frank Act.

The Dodd-Frank Wall Street Reform and Consumer Protection Act came as a response to the recession and widespread calls for changes in the system for financial regulation.

Essentially the Act aims to change fundamentally the US financial regulatory environment, as the provision SEC 1504 (3), which concerns disclosure by extractive companies, is part of Title XV on Miscellaneous Provisions. SEC 1504 (3) requires reporting on payments relating to the acquisition of licenses for exploration and production - including fees, production entitlements, bonuses, and other material benefits.

Following the signing of Dodd-Frank Act the European Parliament requested from the Commission to follow suit and advance the new transparency standard, in order to avoid regulatory arbitrage and create a level playing field for extractive companies listed in the two jurisdictions.¹ Additional to that '*technical*' justification, the Commissioner for Employment, Social Affairs and Inclusion, László Andor, expressed his support by saying: '*Socially responsible business stems from a realisation that the crisis is not just economic and financial but also about ethics. Values like solidarity, sustainability, inclusiveness and integrity are not always upheld by business and I believe our economies have suffered as a*

1 European Commission, 2011, '*Executive Summary of Impact Assessment for financial disclosures on a country-by-country basis*', Commission Staff Working Paper, EU web site, last viewed on 13.03.2013, URL: http://ec.europa.eu/internal_market/accounting/docs/other/20111025-ia-summary-part-2_en.pdf

result.'²

This '*ethical*' justification is echoed in the impact assessment accompanying the Commission proposal, which anticipates that increased transparency aims '*to provide civil society in resource-rich countries with the information needed to hold governments to account for any income made through the exploitation of natural resources.*' Ultimately the new reporting systems seeks to clarify the extractive companies' financial impact in host countries and to '*encourage more sustainable businesses.*'³

EXTRACTIVE COMPANIES AGAINST INCREASED TRANSPARENCY

A number of multinational corporations from the extractive sector - among which Shell, BP, Total, Rio Tinto- have objected the proposal made by the European Commission (EC), in particular rejecting two of its elements: the country-by-country reporting and the

project-by-project reporting.⁴ Some of these companies, members of the American Petroleum Institute, have also gone to court in the US in an attempt to overturn the new legislation, resulting in delays in the rule-making process by the US Securities and Exchange Commission (SEC) by more than a year.

The extractive lobby is unlikely to gain much public sympathy, especially in the aftermath of the major BP spill, which has raised new demands for reshaping the role these companies play both at home and in the developing world, where similar devastating spills in the past have remained largely unnoticed. The Presidential Commission investigating the Deepwater Horizon spill in the Gulf of Mexico has discovered that stronger regulations might have prevented the spill, whereas the Minerals Management Service, the regulator at the time of the accident, has been disbanded following accusations for '*regulatory capture*' by the oil industry.⁵

2 European Commission, 2011, '*More responsible business can foster more growth in Europe*', Press Release, 25.10.2011, EU web site, last viewed on 13.03.2013, URL:

http://europa.eu/rapid/press-release_IP-11-1238_en.htm?locale=en

3 *Ibid.*

4 Detheridge, A., 7 February 2013, '*The oil industry wants to water down transparency rules – Europe must resist*', The Guardian, on-line Comment is free, last viewed 13.03.2013, URL: <http://www.guardian.co.uk/commentisfree/2013/feb/07/oil-industry-transparency-europe>

5 Carrington, D. and Hawkes, A., 14 September 2011, '*BP bears brunt of blame for Deepwater Horizon catastrophe*', The Guardian, last viewed 13.03.2013, URL: <http://www.guardian.co.uk/environment/2011/sep/14/bp-blamed-deepwater-horizon-report>

The opposition of extractive companies is not a surprise, yet their arguments sound hollow – for example they claim that the new rules will prevent them from helping the US and EU countries out of economic stagnation. Perhaps they are unaware of the growing public and political consensus, which ascribes the current crisis to deregulation and opaque financial practices, and amplifies calls for reversing the deregulatory course and claiming more power for the state and for a wide array of public stakeholders.

Other arguments of the extractive lobby centre around fears of losing competitive advantage to Russian and Chinese companies.⁶ However, Global Witness points out that Rosneft is listed on the London Stock Exchange and China's three biggest oil companies are all listed in the US, so they will be subjected to the same reporting requirements.⁷ This in fact demonstrates how the US and EU initiative will effectively have global impact.

Last but not least, a number of companies, among which the Norwegian oil company Statoil, have been disclosing voluntarily

country-by-country and project-by-project data, and claim that this has been a competitive advantage for them.⁸ The EC Impact Assessment for financial disclosure on country-by-country (CBC) basis also points that '*a majority of extractive industry respondents to the public consultation were in favour of disclosing CBCR of payments to governments as a means to improve government accountability [so] it has been judged that the loss of competitive position from this policy would be limited.*'⁹

EFFECTIVE REGULATION BEYOND VOLUNTARY MECHANISMS LIKE THE EITI

The above-discussed new proposals for more detailed financial reporting are marking a decisive step back in the direction of command-and-control regulation. Three

6 Gerard, J., 16 August 2012, '*The Dodd-Frank Threat to US Energy*', Wall Street Journal, last viewed 13.03.2013, URL:

<http://online.wsj.com/article/SB10000872396390444184704577589384247249096.html>

7 Hayman, G., 25 May 2012, '*What Big Oil is hiding about EU transparency*', EU Observer, last viewed 13.03.2013, URL:

<http://euobserver.com/opinion/116377>

8 Rubesa, B., 5 February 2013, '*Regarding Dodd-Frank Act Section 1504 and the law suit initiated by the American Petroleum Institute*', Letter from Statoil to Global Witness, Global Witness website, last viewed on 13.03.2013, URL:

<http://www.globalwitness.org/sites/default/files/library/Statoil%20Letter%20to%20Global%20Witness.pdf>

9 Washington Post, URL:

<http://www.washingtonpost.com/wp-dyn/content/article/2010/07/15/AR2010071500464.html>

decades since the Reagan administration started promoting deregulation¹⁰, and two since the EU embarked on its '*Better regulation*' agenda¹¹ – the promotion of '*new instruments*' favouring self-regulation, co-regulation, voluntarily and market-based mechanisms - social cohesion and environmental policy objectives have been overshadowed by economic competitiveness and growth priorities.¹² The reversal is not surprising, given that these '*new instruments*' have tended to reflect disproportionately the interests of the polluting industries and have not been effective in addressing the power asymmetries in decision-making processes relating to the environment.

The Extractive Industries Transparency Initiative (EITI) is one example of a '*new instrument*' for increasing transparency in the extractive sector globally. It is a multi-stakeholder initiative comprised of governments, companies, civil society groups, investors and international organizations. Announced in 2002 on the Johannesburg Summit on Sustainable Development by Tony

Blair in 2007 it established an independent Secretariat in Oslo. Both countries and companies can become members of the EITI, as once a host country endorses the initiative, the EITI process is mandatory for all extractive industry companies operating within that country, including those that are state-owned.

Although the initiative has mobilised significant resources from its stakeholders, the results delivered by the EITI have been underwhelming. As the EC pointed out in its Impact Assessment¹³, out of the 50 countries considered to be hydrocarbon or mineral rich by the International Monetary Fund (IMF) only 9 are currently EITI compliant.

The initiative was embraced by extractive companies like Shell and BP, yet they have not demonstrated much of an interest in improving the reporting rules in line with recommendations of the EITI Strategic Review Process. Industry representatives on the EITI Board have blocked recent attempts of other stakeholders to strengthen the initiative by introducing requirements for disclosure on resource contracts and project level payments.¹⁴

10 Kramer, L. 2004, "*The roots of divergence*" in Vig, N.J. And Faure M.G. (eds), "*Green Giants? Environmental Policies of the United States and the European Union*", Massachusetts Institute of Technology Press

11 Jordan, A.J. & Lenschow, A. (eds) 2008, "*Innovation in Environmental Policy? Integrating the Environment for Sustainability*", Edward Elgar, Cheltenham.

12 *Ibid.*

13 EC, 2011, *op.cit*

14 Global Witness, 30 October 2012, '*EITI makes partial progress despite Big Oil resistance to contract and project level disclosure*', Global Witness web site, last visited on 13.03.13, URL: <http://www.globalwitness.org/library/eiti-makes-partial-progress-despite-big-oil-resistance-contract-and-project-level-disclosure>

In summary, although it is a step forward in increasing transparency in the extractive sector, the EITI presents an example of a voluntary mechanism that has made only insufficient progress – as one keen commentator remarked '*much of the petroleum world is still shrouded in secrecy*'.¹⁵ In other words, if the ultimate aim of the initiative – transparent extractive sector and accountable host governments – would be compared to Mount Everest (8,848m), the extractive industries are saying that they are not interested in going any further than the southeast ridge Base Camp at 5,380m.

So with policy objectives far from sight and with growing realisation that the mechanisms at hand are inefficient, there seems to be no better time to move forward with stricter regulation, like the Dodd-Frank Act and the proposed EU Accounting and Transparency Directive. At a time like this it is important to raise questions about the purpose of transparency and the elements of effective transparency regulation.

TRANSPARENCY: A MEANS TO AN END

In academic literature transparency is given many definitions, nuanced according to the

15 Ross, M., 2012, '*The Oil Curse. How Petroleum Wealth Shapes the Development of Nations*', Princeton University Press

policy context it is regarded in. It is most broadly defined by Florini as '*the degree to which information is available to outsiders that enables them to have informed voice in decisions and/or assess the decisions made by insiders*'.¹⁶

The importance of transparency as one of the '*environmental access rights*' was articulated in Principle 10 of the Rio Declaration, signed at the first Earth Summit in 1992. The Principle sets the three access rights as crucial for sustainable development and as '*constitutive principles*'¹⁷ of environmental governance. In the Principle 10 formulation transparency is seen as a precondition to informed participation in decision-making, rather a means to an end than a stand-alone right.

A lot of critics claim that transparency, as '*a potent weapon in the anti corruption arsenal*',¹⁸ is essential in promoting accountability. It is arguable instrumental in promoting also equity and justice in environmental decision-making by creating a '*level playing field in which citizens can protect their interests against those of more*

16 Florini, A. (ed) 2007, '*The right to know. Transparency for an Open World*', Columbia University Press, New York

17 Gupta, A. 2008, '*Transparency Under Scrutiny: Information Disclosure in Global Environmental Governance*', Global Environmental Politics 8:2, Massachusetts Institute of Technology

18 Florini, *op.cit.*

powerful actors.¹⁹ Nonetheless, critics are not blind for the limitations and perils in the rapid advance of transparency regulation in the two decades since Rio.

One concern is that transparency regulation can be too preoccupied with establishing disclosure procedures, or becomes absorbed in the setting up of public participation processes. Trying to '*get the process right*' can become a distraction, diverting valuable resources from the ultimate policy objectives.²⁰ For example, disclosure and public participation in the Environmental Impact Assessment (EIA) process are a vivid example of how things can go wrong. In many countries as long as the EIA report is disclosed in some inconvenient location and the public consultation dates are announced in some unpopular newspaper, the requirements of the procedure are satisfied. The objectivity and quality of the EIA's content, the comprehensibility of the information, the decision-making culture of the interested stakeholders - or '*decision-making routine*' as defined by Weil²¹ - are considered inconsequential.

Another danger is that the agreed disclosure

and participation processes can get '*subverted by those with the power to deny their original intent*.'²² Disclosing huge amounts of aggregated data or highly technical information, without regard of the cognitive processes and capacity of public stakeholders to utilise it, are examples of transparency that fails to empower the information users in the decision-making process. It introduces the need for intermediaries, such as NGO experts, but more importantly, it degrades the trust between stakeholders.

The above examples show that transparency does not automatically produce the anticipated policy outcome.²³ In such cases transparency fails to address the information asymmetries, as well as the power asymmetries, which it was intended to remedy.

Langley points out that there are considerable normative differences in interpreting the legitimate purpose that increased transparency should serve. For example business prefers to depoliticise transparency and environmental decision-making processes²⁴, and to employ technical tools for self-regulation, like auditing and environmental management systems. Langley

19 Ramkumar, V and Petkova, E. 2007, '*Transparency and environmental governance*', in Forini, A. (ed), '*The right to know. Transparency for an Open World*', Columbia University Press

20 Gupta, *op.cit.*

21 Weil, D. at al, 2006, '*The Effectiveness of Regulatory Disclosure Policies*', *Journal of Policy Analysis and Management*, Vol. 25, No. 1, 155–181

22 Gupta, *op.cit.*

23 Weil, *op.cit.*

24 See also Gaventa, J. and McGee, R. 2010, '*Synthesis Report. Review of Impact and Effectiveness of Transparency and Accountability Initiatives*', Transparency & Accountability Initiative, Open Society Foundation

insists that regulation should not reduce the way stakeholders interact with each other and with the environment to technical solutions. Instead, effective regulation should produce *'not only new techniques to manage the environment, but also shifts in social relations.'*²⁵

With these critical considerations in mind, we can approach the question on how transparency can bring sustainability and social justice in resource-rich countries?

IMPACTS OF RESOURCE EXTRACTION AND THE CAUSES OF THE 'RESOURCE CURSE'

*'Rich countries with poor people'*²⁶ is only one of the definitions of the *'resource curse'* that plagues countries endowed with an abundance of natural resources, such as oil, gas, gold, coal, copper and gold. The academic literature is prolific with economic analysis that regards the *'resource curse'* (or *'the paradox of*

plenty') merely as weak economic performance or the failure of resource-rich countries to deliver robust growth from the exploitation of their resource wealth.²⁷

Development researchers, however, have expanded the definition of the concept to include a wide array of inequalities, which often mark these countries. In fact even in resource-rich countries with steady economic growth, a variety of problems - such as unusually high poverty, poor health care, widespread malnutrition, high rates of child mortality, low life expectancy, poor educational performance and degraded environment²⁸ - have been the cause of concern and inspiration for researchers and campaigners alike. Ross therefore defines the *'resource curse'* as *'the failure of states to take measures to change the resource abundance from a liability to an asset.'*²⁹

The various negative development impacts of resource extraction, which are captured by the *'resource curse'* concept, are barriers to sustainable development and cause grave social and environmental injustice in resource-rich

25 Langley, P. 2001, *'Transparency in the Making of Global Environmental Governance'*, Global Society, Vol. 15, No. 1

26 Stiglitz, J. 2005, *'Making Natural Resources into a Blessing rather than a Curse'*, in Tsalik, S. and Schiffrin, A., *'Covering Oil. A reporter's Guide to Energy and Development'*, Revenue Watch and Open Society Institute

27 Ghura, D. and Pattillo, C. (eds), 2012, *'Macroeconomic Policy Frameworks for resource-rich developing countries'*, International Monetary Fund

28 Karl, T. 2005, *'Understanding the Resource Curse'* in Tsalik, S. and Schiffrin, A. (eds), *'Covering Oil. A reporter's Guide to Energy and Development'*, Revenue Watch and Open Society Institute

29 Ross, M. 1999, *'The political economy of the resource curse'*, World Politics 51, 297-322.

countries.³⁰ The revenues from exploiting their resource wealth can go a long way in remedying the deep injustices and meeting the urgent development needs of their people. For example, transparency campaigners have pointed out that in 2010 Africa's oil and mining exports were worth around 333 billion USD, or almost seven times the value of international aid to the continent. Unfortunately, these revenues are squandered in a non-transparent manner by governments who either lack the capacity to manage these resources prudently, or all too often are too corrupt to do so.

The causes of the '*resource curse*' may appear obvious – corruption, lack of accountability, weak institutions would be the first guesses and most repeated claims of campaigners. Yet attempts to provide robust empirical evidence in support of such claims have produced contradictory results, which demonstrate the complexity of the problems, rooted in the diversity of countries and development outcomes.³¹ Nonetheless, a couple of decades of research on the topic have drawn several conclusions.³²

30 See Stiglitz and Ross, 2012, *op.cit.*

31 Alexeev, M. and Conrad, R. 2009, '*The Elusive Curse of Oil*', *Review of Economics and Statistics*, Vol. 91, No. 3, pp. 586–98.

32 Ross, M. 2003, '*The Natural Resource Curse. How Wealth Can Make You Poor*', in Bannon, J. and Collier, P. (eds) '*Natural resources and violent conflicts. Options and Actions*', The World Bank

VOLATILITY³³

First of all, the '*resource curse*' is ascribed to volatility, which is mostly exhibited by the country's vulnerability to the volatile prices of commodities on global financial markets. For example short-sided or over-ambitious governments may expand institutions after windfall resource revenues and then face budget deficits when inevitable revenue drops follow. Van der Ploeg & Poelhekke show that volatility effects are magnified by factors such as the lack of a sophisticated financial system, whether a country is landlocked or not, as well as ethnic tensions and conflicts, which are often fueled by resource wealth.

COMMODITY EXPORT DEPENDENCE

Resource-dependent states are particularly vulnerable, as a bias towards the development of the extractive sectors is in the way of diversification of the economy to a wider set of sectors, which could ensure stability and could cushion exposure to commodity price volatility. This relationship between a strong extractive sector and a declining manufacturing or agricultural sector is known as the '*Dutch*

33 Van der Ploeg, F. and S. Poelhekke, 2008, '*Volatility and the Natural Resource Curse*', Oxford Centre for the Analysis of Resource Rich Economies

disease.³⁴ Diversification, for example to agriculture, is not always easy, especially if the extractive sector has caused migration and widespread environmental degradation and people have lost their connection with the land – i.e. the necessary knowledge and skills to raise animals or grow crops, or their land altogether.

CORRUPTION

Due to the nature of corruption, gathering comprehensive evidence to study the problem is not an easy task. Nonetheless, non-governmental organisations (NGOs), such as Transparency International and Global Witness, have gathered sufficient data and cases to demonstrate that corruption indeed is at the heart of the '*resource curse*.' According to Global Witness³⁵, almost 1 billion USD disappeared from government accounts in 2001 in Africa's main oil-exporting countries.

Corruption is compounded by weakened accountability of states, which are dependent on external rents for extracting resources, and therefore less dependent on taxation from their

citizens. Such states – referred to as '*rentier states*' - are less likely to be democratic and transparent than states, which are tax-reliant and thus develop stronger accountability bonds with citizens/tax-payers.³⁶ Fiscal planning and reporting systems in '*rentier states*' is described by researchers as opaque and '*rudimentary, perhaps intentionally so*'³⁷, and provides no space for public participation.

CAN STRICTER TRANSPARENCY HELP RESOURCE- RICH COUNTRIES OVERCOME THE 'RESOURCE CURSE'?

There is wide consensus among researchers that greater transparency in how governments collect, manage, and spend their oil revenues is instrumental in overcoming the '*resource curse*.' Transparency can do that through two important functions: first and foremost, by fostering more accountable governments, it is a precondition for curbing corruption,

34 Ross, 1999, *op. cit.*

35 Global Witness, 2002, quoted in Ross, M. 2003, '*The Natural Resource Curse. How Wealth Can Make You Poor*', in Bannon, J. and Collier, P. (eds) '*Natural resources and violent conflicts. Options and Actions*', The World Bank, Washington D.C.

36 Ross, M. 2001, '*Does Oil Hinder Democracy*', *World Politics* 53, 325-61

37 Swanson, P., Pldgard, M., Lunde, L. 2003, '*Who Gets the Money? Reporting Resource Revenue*' in Bannon, J. and Collier, P. (ed.), '*Natural resources and violent conflicts. Options and Actions*', The World Bank

mismanagement and diversion of funds.³⁸

Secondly, transparency is fundamental in empowering citizens and communities to participate in decision-making. However, as pointed above, increasing state accountability is about shifting the power balance between the state and citizen. Thus the effectiveness of regulation depends on its ability to foster a shift in social relations and to address the information and power asymmetries of the information users and providers.

This point is echoed by Kolstad and Wiig, who argue that despite the popularity of the transparency concept, transparency is insufficient in itself to curb corruption, and needs to be complemented by other types of policies.³⁹ Their in-depth study on the impacts of transparency on natural resource growth concludes that transparency is instrumental in alleviating the '*resource curse*', yet in an indirect way, by attacking the underlying mechanisms that reproduce the '*resource curse*', namely patronage and rent seeking.

As regards to decreasing the vulnerability of resource-rich countries to volatility,

transparency is important in several ways: most importantly, improved financial disclosure can foster confidence and credibility in the eyes of investors and financial markets⁴⁰; but additional effects can be prevention of ethnic conflicts by countering misinformation spread by opposition parties or separatist regional movements.⁴¹

Last but not least, with respect to resource-dependence and promoting diversification, improved transparency can play important role in galvanising support for government proposals for changes in policy direction. This requires an open approach for communicating clearly the trade-offs and resource limits that the country faces, and for empowering the public to assess and plan for risks to which they are exposed through the government's fiscal policy.⁴²

There are benefits from increased transparency to be gained by extractive industries as well. As Stiglitz argues, effective disclosure and participation policies can strengthen the '*social license*' of the extractive business to exploit a countries resource wealth by clearly showing their positive contribution to the state or local authorities budgets. Furthermore, transparency would protect

38 Swanson, P., Pldgard, M., Lunde, L. 2003, '*Who Gets the Money? Reporting Resource Revenue*' in Bannon, J. and Collier, P. (ed.), '*Natural resources and violent conflicts. Options and Actions*', The World Bank

39 Kolstad, I. And Wiig, A. 2009, '*Is Transparency the Key to Reducing Corruption in Resource-Rich Countries?*', World Development, Volume 37, Issue 3, Pages 521–532

40 Dickson, T. and Lim, A. 2007, '*Transparency and sustainability of the public balance sheet, perspectives from APEC*', Australian Treasury

41 See Ross, 2003, *op.cit.*

42 Dickson & Lim, *op.cit.*

companies from allegations of complicity with corrupt governmental practices. And finally, transparent and diligent revenue management contributes to sustainable development, which in turn creates a stable business environment. The need to invest in the environmental and social resilience of resource-rich countries cannot be overstated, as it will be critical not only to the extractive industries, but to the long-term global resource security.⁴³

43 Lee, B. et al., 2012, '*Resources Futures*', Chatham House Report, London



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