The rough guide to transparency and natural resource revenues

A CAFOD briefing

"How can one understand that during the last three decades, the frequent start-up of oil wells, always important, has not been accompanied by any kind of visible sign of economic transformation or rectification of the social situation of our population? Our oil must be an instrument for the life and not the death of our people."

Catholic Bishops of Congo (Brazzaville), 1999

Natural resource revenues in developing countries

Oil, gas and mining are critically important economic sectors in about 60 developing and transition countries, which are home to more than two-thirds of the world's poorest people: 1.5 billion people in these countries live on less than $2 a day. Twelve of the world's 25 most mineral dependent states, and six of the most oil dependent, are classified by the World Bank as Highly Indebted Poor Countries. Their human development levels – measured by health, literacy and gross domestic product (GDP) – are among the worst in the world.

Natural resource revenues flow into countries in every continent. In Asia, for example, oil and gas are significant in Kazakhstan, Azerbaijan, Indonesia, East Timor, and in the Middle East, including Iraq. In Latin America, Colombia, Brazil and Venezuela rely on natural resources. In Europe, Norway's prosperity is based on North Sea oil reserves.

Sub-Saharan Africa, which includes the poorest countries in the world, is in the middle of an oil boom. The Gulf of Guinea region, stretching down the west and the centre of the continent, is the most lucrative centre of exploration for oil companies. Some countries, such as Nigeria and Angola, have been exploiting oil for years. Others, such as Chad and Equatorial Guinea[1], are relative newcomers to the industry. Yet more, including Guinea Bissau and Mauritania, look set to join the oil rush. In all these countries, improvements in exploration and production technology, especially deep water drilling, are opening up hitherto inaccessible and vast oil fields offshore.

[1] The other Gulf of Guinea states currently producing oil are Congo-Brazzaville, Gabon, Cameroon, the Democratic Republic of Congo and Sudan.

Africa attracts multinational oil companies for several reasons. First, the oil is typically of high quality. Second, it can be transported easily to US markets – and is more accessible than the fields of the Middle East. Third, oil production in Africa is less risky for multinationals, because most of it takes place offshore without the risks of social and political disruption associated with onshore sites. An exception is Nigeria, where oil extraction in the Niger delta has led to conflict and protest as local people challenge the oil companies and the central government for a share of the proceeds.

As a result, oil revenues are an increasingly important part of Africa's economy. The extractive sector accounts for more than half of the continent's exports and made up 65 per cent of its foreign direct investment in the 1990s. The Gulf of Guinea region will receive more than $200 billion in oil revenues over the next decade and overall production is expected to jump from 3.8 million barrels per day (bpd) in 2003 to 6.8 million bpd by 2008.

The paradox of plenty

Countries endowed with an abundance of natural resources seem unlikely candidates for chronic, deep poverty. Surely oil revenues provide a route out of poverty for their populations? But the reality is the opposite. Natural resource revenues in poor countries are associated with worsening poverty, corruption and conflict, and authoritarian government lacking in transparency, accountability and fairness. Taken as a group, less developed countries that depend on oil exports have seen living standards drop dramatically. Countries without petroleum resources grew four times more quickly than those with petroleum resources between 1970 and 1993, although the resource-poor countries had half the savings of the resource-rich countries in 1970. Oil-rich countries are 'among the most economically troubled, the most authoritarian and the most conflict-ridden states in the world today.'[2]

Managing oil

The management of a massive influx of oil revenues poses serious challenges for any government, but especially for those without strong democratic and accountable institutions:

- Power and resources in oil states become concentrated in the hands of the state, encouraging citizens to make their living through ties with the government. This practice, known as 'rent seeking', reduces the incentive for other forms of productive activity.
- In authoritarian states, counter pressures do not exist to push governments to develop economic strategies which are not oil-dependent or oversight mechanisms for oil revenue management. Authoritarian states do not have

[2] Bottom of the Barrel, Global Witness, March 2004, p.18

democratically accountable executives or open and transparent policy-making processes. They rarely have efficient civil service and tax authorities, independent legal systems, or active and informed civil societies.

- Incentives from outside the country encourage oil dependence. Some oil companies are willing to make secret deals and Northern governments sometimes form strong alliances with authoritarian leaders. The World Bank and the International Monetary Fund (IMF) routinely encourage development strategies based on the comparative advantage of petroleum. And they support lending to deeply indebted oil exporters when it is clear that debt only supports unproductive activities and prolongs the ability of government to mismanage oil revenues.
- Oil development often brings an initial boom: higher per capita income, more employment, better nutrition and health, and more and better infrastructure. But boom usually soon turns to bust as rent-seeking and mismanagement of resources, and sometimes volatile oil prices too, undermine the positive outcomes.
- The negotiating position of poor host governments is weak. Only a few, very large and powerful, oil companies have the technology to extract Africa's deep oil. Exxon's profits of $15 billion in 2001 are more than 10 times greater than Chad's GDP of $1.4 billion. This means oil companies drive hard bargains over the percentage of oil profits accruing to them, often winning greater shares than they have been able to in other parts of the world.

The resource curse

The more a country depends on natural resources, the worse is its growth performance. Oil dependence hurts development for the following reasons:

- The promise of oil wealth creates a 'boom mentality': governments create grandiose plans, work ethics are undermined and productivity sinks.
- Public spending increases dramatically, because governments expect massive revenue increases (which usually turn out to be less than expected).
- The quality of public spending declines. Money is wasted on corruption as government officials accept bribes in return for awarding benefits such as import quotas, industrial licences and access to foreign exchange.
- The volatility of oil prices hinders growth, distribution of wealth and poverty alleviation.
- Booms encourage the loss of fiscal control and inflation, which further hampers growth, equity and poverty alleviation.
- Foreign debt rises as governments borrow to cover shortfalls in expected oil revenues.
- Other sectors of the economy, such as manufacturing and agriculture, decline as a result of oil dependence.
- Income from oil replaces tax revenues, thus removing the need for government to account to people for how it spends their money.

Characteristics of oil-rich states

- Poverty. Nigeria, the biggest oil producer in Africa, has received more than $300 billion in oil revenues over the past 25 years, yet more than 70 per cent of the population has a per capita income of less than $1 per day, 43 per cent lack sanitation and clean water, and infant mortality is amongst the highest in the world.
- Militarisation. As economic growth fails to live up to expectations, governments in oil-rich states resort to repression to retain power. In the decade from 1984 to 1994, OPEC[*] members' share of military expenditure as a percentage of total central government spending was three times that of developed countries, and two to ten times that of non-oil-producing developing countries.
- Authoritarian government. Oil resources have been used to fund authoritarian regimes, from President Abacha of Nigeria to Saddam Hussein in Iraq.
- Corruption. Dependence on oil encourages many forms of corruption: companies make payments or loans to government officials to secure contracts and other benefits. Elites may siphon off profits for their own private spending, to fund their business interests, or purchase arms to protect their hold on the natural resources.
- Civil war. Oil can exacerbate pre-existing tensions in society as different groups demand a share of revenues. Oil can also sustain conflict: for example, in Sudan, the DRC and Indonesia.

Examples of oil rich states

Angola

Angola is the poster child for the destruction which oil dependence can wreak: the second most oil-rich country in Africa, its citizens have seen no benefit from this wealth. The country is notorious for corrupt use of resources by an elite. From 1997 to 2001, around $1.7 billion has gone missing annually.

In a recent report, Global Witness produced evidence that millions of dollars are paid directly to President Dos Santos and claimed that the president has a Luxembourg bank account containing $37 million. Other money is misappropriated through money laundering, overpriced arms purchases and oil-backed loans.

While oil revenues have enriched the ruling Popular Movement for the Liberation of Angola (MPLA), the vast majority of Angolans are desperately poor. Angola ranks 161st out of 173 countries in the UN's Human Development Index. One in four Angolan children dies before the age of five. More than one million internally displaced people depend on international food aid, with even more relying on the UN to distribute tools, seeds and materials to build schools and hospitals. After years of civil war, conflict has ceased in most of the country, but in the oil-rich

[*] Organisation of Petroleum Exporting States

enclave of Cabinda fighting continues between government troops and separatist rebels.

There are some signs of change. Despite its vast oil reserves, Angola is running out of money. Consequently, the government has made some attempts to improve its image and access international finance. For example, it has allowed the publication of some IMF investigations into its accounts and, in May 2004, disclosed details of a deal with the US oil company Chevron Texaco. But national elections remain on hold, borrowing against future oil continues and details of oil income are kept secret. And there is no guarantee that moves towards transparency will be sustained if IMF financing is obtained.

Oil and diamonds, almost exclusively, fed the conflict we suffered for the last twenty-five years. And since the war has ended, many people have been very surprised that these same resources have not been able to feed our internally displaced people … In this public examination of conscience, we ask the competent authorities correctly to inform Angola's citizens about the profits coming from the exploration of oil and other natural resources, as well as provide information about how they are used. … It is essential that the exploration of oil and other natural resources leads to investment which can generate wealth for the country. If this does not happen, the country will become poorer still and will end up with no oil, no diamonds and no lasting benefit whatever.

Statement of the Catholic Bishops of Luanda, 24 March 2004

Congo Brazzaville

Congo is the fourth largest oil producer in sub-Saharan Africa. Once one of the richest states in Africa, it now has the highest per capita debt in the world. The national oil company makes a multimillion dollar profit without paying a penny to the government. Some $250 million a year is unaccounted for and one-third of government income is spent on servicing loans secured against future oil production. According to the World Bank, mismanagement of the country's rich natural resources is the main factor fuelling the violent conflict that has claimed the lives of thousands of people.

The Congolese people do not know much about how much our country receives from this black gold , and even less about how the revenues are managed. What it does know is the price of oils is measured not in barrels, or dollars but in suffering misery, successive wars, blood, displacement of people, exile, unemployment, late payment of salaries, non-payment of pensions.

Open letter from Congolese bishops to their president, 2002

The Chad-Cameroon pipeline

The Chad-Cameroon Oil and Pipeline Project aims to turn the "resource curse" into a "resource blessing" for the host countries. The $3.7 billion project involves oil companies ExxonMobil, Chevron and Petronas (the Malaysian National oil company), the World Bank, the governments of Chad and Cameroon, and others. The World Bank has provided financing for the project and is seeking to ensure that governments use the revenues to reduce poverty.

Chad, one of the world's poorest states, has very weak institutions, an over-powerful president, highly flawed democratic procedures and a constant threat of violence between north and south. Cameroon is one of the world's most corrupt countries.

The World Bank has recognised the need for measures to ensure that revenues reach the poor, and has helped to set up legal and administrative structures to manage oil revenues. However, without political will from the host governments to achieve good governance and respect for human rights, there is no guarantee that the poor will actually benefit.

Our oil is still, in most cases, the private reserve of the powers that be ... Central Africa wallows in misery despite the growing discoveries of oil ... Our prophetic mission impels us to launch a heartfelt appeal to all those who participate in oil exploitation in our region or who wield any political and economic power.

Statement of the Catholic Bishops of Central Africa, July 2002, issued in Malabo, Equatorial Guinea

From resource curse to resource blessing?

Oil extraction does not inevitably result in poor development. If revenues are managed transparently, accountably and fairly, they can benefit citizens of oil-exporting countries: Norway has used its North Sea oil to become the UNDP's best development performer. Progress, however, requires concerted international political will and co-operation between all the relevant parties: multinational and state owned oil companies, and their host and home governments.

Publish What You Pay

CAFOD, together along with Global Witness, Save the Children and Transparency International (UK) is a leading member of the Publish What You Pay (PWYP) coalition in the UK. The coalition has more than 200 members around the world.

PWYP is calling for oil, gas and mining companies to publish the payments they make to each national government. While host governments bear the primary responsibility for managing oil revenues well, these companies (such as Shell and BP in the UK; ExxonMobil and Chevron Texaco in the USA; and TotalFinaElf in France) play a role in the mismanagement and embezzlement of oil revenues by elites when they fail to be transparent about their own dealings with governments. These include:

- royalty payments, measured as a percentage value of production;
- bonus payments on signing a contract;
- corporate income tax and other taxes.

PWYP calls on all extractive companies to disclose annual net figures for these payments in a readily available, comprehensible and comparable form.

There is a strong moral case for companies to publish what they pay. By keeping silent on their dealings with corrupt governments, they are complicit in the squandering of resources belonging to poor people. For CAFOD, the need for transparent management of natural resource revenues emerges clearly from Catholic Social Teaching on the universal destination of earthly goods, solidarity and the common good, the preferential option for the poor, and the promotion of peace.

There is also increasing recognition of the business case for transparency. One group of investors recently stated that legitimate but undisclosed payments to governments by companies may lead to accusations that companies contribute to conditions where corruption can thrive.[3] Such accusations undermine companies' social "licence to operate" making them more vulnerable to local conflict and insecurity, and compromising long-term commercial prospects.

The international community

Since the launch of PWYP in 2002, considerable international political will to achieve transparency has been generated. In part, this is because of a threat to energy security. African countries currently supply about 15 per cent of US oil imports, a figure expected to rise to 25 per cent by 2015. Since 11 September 2001, President Bush's administration has moved to increase oil supplies from Africa at the expense of Middle Eastern producers. The US wants the countries from which it imports oil to be stable and safe: instability increases prices. There is thus a short window of opportunity to create a policy environment for using oil wealth to build viable economies and reduce poverty. In June 2003 the G8 (the eight states with the world's largest economies) declared:

we will encourage governments and companies, both private and state-owned, to disclose … in a consistent fashion and common format, revenue flows and payments from the extractive sectors. This information should be published at an aggregated level, in accessible and understandable ways, while protecting proprietary information and maintaining contract sanctity.[4]

Governments must translate such statements into action.

The Extractive Industries Transparency Initiative

The Extractive Industries Transparency Initiative (EITI) was convened by UK Prime Minister Tony Blair in September 2002 after the World Summit for Sustainable Development in Johannesburg. Led by the Department for International Development of the UK government, this initiative seeks to galvanise the international community to achieve transparency. Members include home and host governments, companies and NGOs from the UK Publish What You Pay coalition, including CAFOD.

The EITI is a positive contribution to the international effort to achieve transparency. It has identified which revenue flows should be disclosed by oil and

[3] Investors' Statement on Transparency in the Extractives Sector, Joint Statement by ISIS Asset Management et al, 17 June 2003, revised February 2004.
[4] Fighting corruption and improving transparency, A G8 Declaration, June 2003.

by mining companies and established pilot projects to increase transparency in Nigeria and Azerbaijan.

PWYP, however, believes that EITI has some serious inadequacies. It relies mainly on voluntary reporting by companies and governments and is therefore unlikely to draw in the countries where lack of transparency is most severe, such as Angola. And without mandatory requirements to disclose information, companies can argue that they are prevented from publishing payments by confidentiality clauses in their agreement with governments. A mandatory requirement would override these clauses.

The PWYP proposal

The Publish What You Pay campaign is calling for a cocktail range of measures to address this complex problem:

- **Disclosure requirements for companies trading on regulated markets.** Most of the biggest extractive industry companies are either listed or likely to seek listing on regulated markets such as the London Stock Exchange. The European Union recently took a first step towards this with a provision in the Transparency Obligations Directive (TOD). PWYP calls on the EU to follow through on the preliminary commitment in the TOD, and on the US Securities and Exchange Commission to require disclosure of payments to governments.
- **International lending.** It should henceforth be a standard condition for lending to governments that the recipient is transparent about its resource income and expenditure. This should apply to all loans including those from export credit agencies and private banks.
- **World Bank and IMF assistance.** Revenue transparency should become a condition of all future lending and technical assistance.
- **Corporate governance.** International Accounting Standards for extractive industry companies should include a requirement to disclose payments to governments. In the UK, requirements for companies to disclose material risks should expressly include a requirement to disclose such payments.

Notes

This Rough Guide draws heavily on two comprehensive reports on natural resource revenue management: Bottom of the Barrel: Africa's Oil Boom and the Poor, Ian Gary and Terry Lynn Karl, Catholic Relief Services, June 2003; and Time for Transparency: Coming Clean on Oil, Mining and Gas Revenues, Global Witness, March 2004.

Rough Guide to Transparency and Natural Resource Revenues

This guide was written by Katherine Astill of CAFOD's Public Policy Unit. If you have any questions about this guide, please e-mail kastill@cafod.org.uk.

To arrange press interviews, please contact Patrick Nicholson on 020 7326 5559, 07979 781015 or e-mail pnicholson@cafod.org.uk.

For more information about Publish What You Pay, see www.publishwhatyoupay.org or contact the Publish What You Pay co-ordinator on 020 7031 0204, coordinator@publishwhatyoupay.org.

For all of CAFOD's policy papers visit www.cafod.org.uk/policy