Oil Revenue Transparency:

A Strategic Component of U.S. Energy Security and Anti-Corruption Policy

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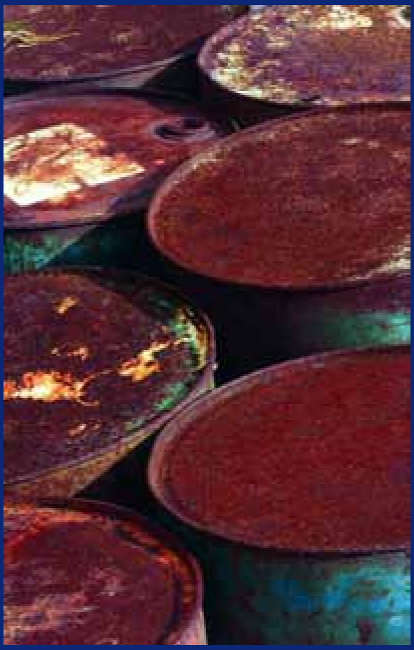

A Report by Global Witness
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Table of Contents

List of Abbreviations

BRIC	Brazil, Russia, India, and China
CNOOC	China National Offshore Oil Corporation
CNPC	China National Petroleum Corporation
EITI	Extractive Industries Transparency Initiative
EIU	Economic Intelligence Unit
FCPA	Foreign Corrupt Practices Act
GDP	Gross Domestic Product
GNP	Gross National Product
IFI	International Financial Institution
IMF	International Monetary Fund
JDZ	Joint Development Zone
KBR	Kellogg, Brown, & Root
NEITI	Nigeria Extractive Industries Transparency Initiative
NGO	Nongovernmental Organization
NYSE	New York Stock Exchange
OPEC	Organization of Petroleum Exporting Countries
SEC	Securities and Exchange Commission
Sinopec	China Petroleum and Chemical Corporation
PSA	Production Sharing Agreement
UNDP	United Nations Development Programme

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Global Witness campaigns to achieve real change by highlighting the links between the exploitation of natural resources and the funding of conflict and corruption. Through a combination of covert investigations and targeted advocacy, Global Witness works to change the way the world thinks about the extraction and trading of natural resources, and the devastating impact their unsustainable exploitation can have upon development, human rights, and stability. Global Witness was co-nominated for the 2003 Nobel Peace Prize for its work on conflict diamonds and was awarded the Gleitsman Foundation Prize for international activism in May 2005.

ON THE COVER:
Nigerian gunman on boat: Dave Clark/Getty Images;
oil drums, fuel pump, and fire images: iStockphotos.com.

Oil Revenue Transparency: A Strategic Component of U.S. Energy Security and Anti-Corruption Policy

Executive Summary

A global drive towards energy revenue transparency is moving forward today. This initiative presents a low cost, high-impact opportunity for both the United States and international oil companies to combat corruption, improve investment climates, and contribute to the development of poor nations. The U.S. can also enhance its energy security by incorporating energy revenue transparency as a key component of its international energy policy. Furthermore, the U.S. should engage China, India, Russia, and Brazil as key partners in the setting of energy revenue transparency as a global standard.

Energy revenue transparency depends on the following three principles: **"publish what you pay"**—oil, gas, and mining companies disclosing the revenue payments they make to governments; **"publish what you earn"**—governments disclosing the revenues they receive from extractive companies; and **"publish what you spend"**—governments publishing their budget expenditures. Together, these steps form a package that enables citizens to hold their governments to account for the use of energy revenues, thereby increasing a government's legitimacy and credibility. Energy revenue transparency has already translated into concrete benefits. Following implementation of the Extractive Industries Transparency Initiative (EITI) in both countries, Nigeria saved $1 billion in the oil and gas sector in 2004–5, and Foreign Direct Investment increased 160% in Azerbaijan from 2002 to 2005.

By contrast, lack of financial transparency in the oil, gas, and mining sectors is significantly harming U.S. interests worldwide. Six of the top ten oil-exporting countries to the United States rank at the bottom third of the world's list of most corrupt countries, according to Transparency International. Over half of the world's resource-rich countries are not democratic, according to Freedom House, and many are slipping further backwards as ruling elites in these countries buy off their opponents with record-high oil profits. Meanwhile, the populations of a great many oil-rich countries are not benefiting. In Equatorial Guinea over 50% of the population live on less than $1 per day, and over half of the citizens of Indonesia—which has been a major oil-producing country—live below the poverty line. In such contexts of corruption, opacity, and poverty, energy revenues supplied by U.S. companies can easily be diverted to fund groups wishing to harm U.S. interests. Insurgent groups in both Nigeria and Iraq, two of the largest oil-exporting nations to the U.S., steal hundreds of thousands of barrels of oil per day, commonly target U.S. citizens, and use stolen oil revenues to fund acts of terrorism.

A sound U.S. energy policy cannot be built on such a shaky foundation, where U.S. energy security is seriously undermined by a reliance on corrupt, impoverished regimes. Such non-transparent countries have much higher risks of instability and violent unrest, often leading to disruptions of energy supply. U.S. energy security—a reliable energy supply at affordable prices—is seriously impacted by unstable situations such as Nigeria, where up to 800,000 barrels of oil are lost every day because of attacks by rebel groups angry at

Energy revenue transparency is needed to help stop dictators like Nigeria's Sani Abacha, who stole over $4bn in oil revenues and helped cause rebellion. *Robert Grossman, Africaphotos.com* the corruption of oil revenues and the secrecy of government budgets, made up mainly of oil revenues. Taking transparency policy steps beyond EITI in Nigeria, particularly budget transparency, would go a long way toward eliminating the causes of the rebellion. Even with alternative energy developments, the demand for oil is forecast to increase over the next 25 years, and therefore fostering better, more transparent investment climates in oil-producing countries is of growing strategic importance.

To this end, the U.S. should employ a series of targeted, low-cost policy measures, which would also save U.S. taxpayer money by reducing oil-rich countries' dependence on foreign aid. **First and foremost, the U.S. should pass a law establishing a regular reporting mechanism** whereby extractive industry companies would publicly report all payments made to foreign governments on a country-by-country basis. The passage of such a law would be the most significant policy measure with the broadest impact on energy revenue transparency worldwide. The U.S. should further work together with other key stock exchange regulators in Europe and Asia to initiate similar mechanisms in those regions and help ensure a level playing field on transparency for all corporations and governments. Further key policy options include high-level U.S. diplomatic engagement on and funding for EITI; and diplomatic initiatives aimed at preventing oil-related corruption.

Energy revenue transparency further presents a critical tool for combating the 'resource curse' of high-level corruption leading to deep poverty and the squandering of oil wealth. For example, in an ongoing case, middleman James Giffen has been charged under the Foreign Corrupt Practices Act (FCPA) with channeling $78 million in fees from Mobil (now ExxonMobil) and Texaco (now ChevronTexaco) to the president and oil minister of Kazakhstan in the 1990s for oil and gas contracts. According to U.S. prosecutors, this scheme "defrauded the Government of Kazakhstan of funds to which it was entitled from oil transactions and defrauded the people of Kazakhstan of the right to the honest services of their elected and appointed officials." If it were clear that companies were transparently reporting all of their payments to the government, this would have allowed them to clear corruption allegations, improve their public image, and contribute to economic development.

While raising the bar and setting a global standard of transparency, the **U.S. should actively engage Brazil, Russia, India, and China (BRIC countries) as partners in the transparency process.** This is an important step in order to level the playing field for all companies on transparency. While some corporations argue that the U.S. cannot introduce transparency requirements because U.S. companies would be undercut by non-transparent BRIC competitors, several emerging issues argue more strongly in favor of moving forward with transparency by engaging with China. Importantly, the majority of oil-exporting countries favor engagement with the international community and multilateral institutions and are still willing participants in the setting of global standards. Furthermore, oil-producing nations still need the higher oil extraction potential of Western multinationals, a technological gap where BRIC companies still lag behind significantly.

Progress on energy transparency to date has been mixed. The launch of the EITI by British Prime Minister Tony Blair in September 2002 started an international process in which company payments to governments and government receipts are disclosed, audited, and publicly examined in countries that voluntarily signed up to the process. So far, EITI has made significant progress in two countries, Azerbaijan and Nigeria, where independently audited reports have been published. But almost no improvements have been made in the other over 40 resource-rich countries that are not full participants in EITI. Other piecemeal efforts have also had an initial impact on transparency but must go further. These include a series of helpful but not well-acted-upon G-8 statements on transparency, pilot energy transparency legislation in Sao Tomé and Timor-Leste, and the IMF's Guide on Resource Revenue Transparency. Transparency of budget expenditures, meanwhile, has been much slower to progress, with civil society groups across the developing world clamoring for government spending to be open to full public scrutiny and ensure that oil revenues are used for development. Finally, transparency of oil, gas, and mining contracts, which helps ensure that none of the parties is getting unfairly treated and that full public oversight is observed, has not been widely implemented.

Overall, energy revenue transparency limits the scope for oil-related corruption through fiscal accountability. Global Witness, a founding member of Publish What You Pay, a global coalition of over 300 nongovernmental organizations (NGOs) calls on the U.S. to lead the way and help set a global standard of **energy revenue transparency**—a standard that **has already received support from Republican and Democratic voices alike**—by taking a series of low-cost policy measures. Doing so would not only help U.S. energy security and build more stable investment climates in countries with major U.S. foreign direct investment, but would also help fight corruption and contribute to economic development in "resource-cursed" countries. Energy revenue transparency is a win-win policy for U.S. energy security and economic development abroad: it is now time to make it a reality.

Recommendations:

To the U.S. Government:

1. Enact U.S. legislation to introduce a statistical reporting requirement for all oil, gas, and mining companies to publicly disclose revenue payments to all governments, on a country-by-country basis.

2. Engage at a senior diplomatic level with strategic oil- and gas-producing countries to help influence them to sign on to the Extractive Industries Transparency Initiative (EITI), including such countries as Algeria, Angola, Indonesia, Libya, Qatar, Russia, and the UAE. Further engage in preventive diplomacy with new oil-producing countries such as Madagascar and Cambodia, to ensure revenue and budget transparency is institutionally enshrined before oil-related corruption becomes entrenched.

3. Engage major oil-consuming countries outside the Western world, such as China, India and Brazil, and encourage them to give their support to the EITI and other global standards.

4. Increase the U.S. contribution to EITI from $1 million to at least $5 million per year, to reflect the importance of this strategic initiative. This should include support to civil society to help monitor EITI implementation.

5. Make the monitoring of oil, gas, and mining revenue transparency a priority in U.S. embassies abroad, even if this means increasing the number of Foreign Service officers assigned as Petroleum Attachés in oil-producing countries.

6. Use U.S. leverage as a Board Member of the International Financial Institutions (IFIs) to ensure that revenue transparency is fully incorporated into the lending policies of the World Bank, IMF, African Development Bank, the Inter-American Development Bank, and Asian Development Bank. Also ensure incorporation of transparency requirements into the U.S. Export-Import Bank and Overseas Private Investment Corporation.

7. Together with the UK, Norway, and other governments, ensure that EITI is strengthened and implemented effectively, with a particular view that the validation process is implemented in a timely manner.

8. Use its good offices to ensure open and accountable mechanisms for awarding oil concessions, to make certain that the best-qualified companies do not lose access to oil deposits because of corrupt acts by rivals.

To the International Monetary Fund and World Bank:

9. Comprehensively incorporate resource revenue transparency into all Bank and Fund activities. Fully apply the Guide on Resource Revenue Transparency by requiring that Guide-related issues be addressed in a separate section of every IMF Article 4 consultation report in resource-rich countries.

10. Take increased steps to make Fiscal Reviews of Standards and Codes a regular and required part of IMF activities in resource-rich countries.

To Oil Companies, both international and national:

11. Within countries of operation, work as a consortium with other oil companies to convince the host government to sign on to and implement EITI as a means of improving the investment climate.

12. Disclose revenue payments in a disaggregated fashion to governments on a country-by-country basis in all areas of operation.

To the United Nations:

13. Adopt a UN General Assembly resolution which calls for global standards on oil, gas, and mining revenue and expenditure transparency.

A lack of transparency in oil revenues can ultimately lead to civil unrest, war and human suffering on a vast scale, such as in Angola. *Global Witness.*

1. Energy Revenue Transparency: Serious Implications for U.S. Energy Security

A. The Resource Curse and a Lack of Transparency

The 'resource curse' of oil-related corruption leading to poverty and instability rather than economic development continues in a great many oil-rich nations today. Despite global oil prices reaching record highs over the past year, the populations of many oil-rich countries are still not benefiting. In Nigeria over 90% of the population lives on less than $2 a day, in Venezuela poverty has increased over the past 25 years despite $600 billion in oil revenues during that period, and over half of oil-rich Equatorial Guinea's citizens survive on less than $1 per day.[1]

A chief cause of these disparities is government corruption enabled by a lack of transparency in the oil, gas, and mining sectors.[2] Governments in numerous resource-rich countries are notoriously reluctant to publicly disclose how much revenue they receive from their extractive industries or how they spend these revenues. In all, 26 of the world's 36 oil-rich countries rank among the bottom half of the world's most corrupt countries.[3] Moreover, over half of the world's resource-rich countries[4] are not democratic and many are slipping further backwards towards autocracy, as the elite ruling classes buy off their opponents with the surging oil profits.[5] Iran and Ecuador, for example, have lowered their Freedom House world ranking of political freedom over the past 10 years despite an oil bonanza in each of those countries.[6]

Corruption and kleptocracy on this scale lead to political instability, drive up oil prices, and present significant risks to U.S. investment. As citizens in oil-producing countries become disgruntled with governments and foreign investors whom they believe to be corrupt, they foster political unrest and threaten oil supplies.

Such insecure political climates have led to violent disruptions of energy supply in several nations. Between 500–800,000 barrels of oil a day are lost from Nigeria alone—the U.S.' fifth largest importer of crude oil—due to attacks by rebel groups angry at the corruption of oil revenues and the secrecy of government budgets, made up mainly of oil revenues.[8] While the West believed it could rely

Poverty amidst oil wealth. Oil and gas operations in the Niger River Delta region of Nigeria - the fifth largest exporter of crude oil to the U.S. *Robert Grossman, Africaphotos.com*

> Much of the new supplies of oil and gas are concentrated in countries that lack open and transparent regimes. The main challenge... is the need to create, through joint efforts, the proper environment to realize the potential. ... Governments that create transparent and non-discriminatory regulatory environments, favorable investment climates... contribute substantially to [overall sustainability of the energy sector development].[7]
>
> **E. Anthony Wayne**
> **Then-Assistant Secretary of State for Economic and Business Affairs**
> **May 2006**

on opaque, corruption-laden regimes such as Iraq for a secure oil supply in the 1980s, Iraq's turning against the U.S. at the end of the Cold War and the subsequent loss of 518,000 barrels a day in crude oil imports proved otherwise.[9] As President Bush stated in 2006, "Some of the nations we rely on for oil have unstable governments, or agendas that are hostile to the United States. These countries know we need their oil, and that reduces our influence, our ability to keep the peace in some areas. And so energy supply is a matter of national security. It's also a matter of economic security."[10] Simply put, non-transparent, unaccountable, autocratic governments are unreliable sources of oil over the long term.

The U.S.' Top 15 Oil Importing Countries and Corruption

Country	Rank in terms of U.S. crude oil imports	Oil barrels/day exported to the U.S. – June 2006	Corruption Index rank, by Transparency International (out of 163 countries)	Economist Global Business Environment grade
Canada	1	1,799	150th most corrupt	Very good
Mexico	2	1,734	86th most corrupt	Good
Saudi Arabia	3	1,549	86th most corrupt	Moderate
Venezuela	**4**	**1,008**	**23rd** most corrupt	**Very poor**
Nigeria	**5**	**996**	**14th** most corrupt	**Very poor**
Iraq	**6**	**617**	**2nd** most corrupt	**
Angola	**7**	**525**	**14th** most corrupt	**Very poor**
Algeria	**8**	**474**	**75th** most corrupt	**Poor**
Ecuador	**9**	**282**	**23nd** most corrupt	**Poor**
Russia	**10**	**216**	**35th** most corrupt	**Moderate**
Colombia	11	211	105th most corrupt	Moderate
Kuwait	12	201	116th most corrupt	Good
United Kingdom	13	185	151st most corrupt	Very good
Equatorial Guinea	**14**	**114**	**9th** most corrupt	**
Libya	**15**	**110**	**54th** most corrupt	**Very poor**

** country not ranked in EIU survey

Sources: U.S. Energy Information Administration, "Crude Oil and Total Petroleum Imports Top 15 Countries," 14 August, 2006, available at www.eia.doe.gov; Economist Intelligence Unit Global Business Environment report, 1 August, 2006, available at www.eiu.com; Corruption Perceptions Index 2006, Transparency International, available at www.transparency.org.

B. The Five Main Components of Energy Revenue Transparency

To combat the twin problems of the resource curse and worsened energy security, a growing global movement towards energy revenue transparency has arisen over the past decade. Oil revenue transparency helps improve investment environments through five main measures. **The most significant of these measures would be through U.S. legislation introducing a reporting requirement for corporations to regularly report payments** made to all foreign governments for oil, gas, and mineral extraction on an annual and quarterly basis. This would aid efforts to end corruption, make oil-producing countries and their energy supplies more stable, and enable citizens of these countries to hold their leaders to account for the misuse of their abundant natural resource wealth. Through a reporting standard on a country-by-country basis, a level playing field for all corporations and governments can be ensured.

A second transparency policy measure is the Extractive Industries Transparency Initiative (EITI), which serves to improve investment climates through the audited disclosure of revenue payments. In this process, all oil companies operating in an EITI implementing country, including state-owned companies and non-western companies, first disclose all payments to governments, including production sharing agreement payments, taxes, royalties, and signature bonuses. Then governments disclose the revenues they receive, and the two sets of figures are independently audited and publicly examined by civil society.

The involvement of all segments of society at each stage of the revenue transparency process is critical. Transparency can allow citizen action groups, the media, and parliamentarians to be part of the process to build confidence in the accuracy of the revenue figures and that corruption is not taking place. Close civil society involvement helps build national consensus, promote accountability, and improve political stability.

A third key transparency measure is the setting up of transparent oil funds and/or resource transparency legislation. In this process, oil-producer governments can help to ensure that oil monies are spent for social and economic development and that windfalls can be used in years of low oil

How Lack of Transparency Leads to Corruption and Poverty: Equatorial Guinea

Equatorial Guinea (EG) is a case study in how not to manage oil wealth. The country exports 420,000 barrels of oil per day, mainly to the U.S. However, EG is a country that has systematically mismanaged public assets, coupled with its serious human rights abuses and total lack of political freedom. With a population of less than 500,000, the country is buoyed with export earnings from oil of over $7 billion per year. Despite these enormous windfalls, 60% of Equatorial Guinea's population lives on less than $1 a day and over half its people cannot access potable water.[19]

A chief cause of the poverty? A lack of oil revenue transparency and gross mismanagement of oil revenues. When asked by a BBC correspondent what the country was doing with its oil money, President Teodoro Nguema Obiang responded that oil revenues were a state secret.[20] Global Witness recently reported that President's son made the 5th most expensive home purchase in the U.S. in 2006, buying a $35 million property in Malibu, California, (see p.8) despite officially earning a salary of only $5,000 per month.[21] Not surprisingly, personal control over state assets is extreme: government ministers reveal that the president is also first auditor of the country and must personally sign off on any government expense over $1,900.[22]

In 2004 a U.S. Senate investigation revealed that Obiang had transferred over $35 million from government accounts to suspicious offshore corporations,[23] while the IMF reported in 2006 that $718 million of the government's revenues are still held in offshore accounts.[24] Today, there is an ongoing investigation by the Securities and Exchange Commission into oil companies operating in the country for possible collusion in corruption.[25] According to Transparency International, Equatorial Guinea is perceived to be the world's ninth most corrupt nation.[26] While the country publicly stated its intention to join EITI in September 2004, no progress has yet been made in implementation as of the time of writing.

revenue. Oil funds help stabilize spending over time, allowing governments to save for the future by promoting greater economic development expenditure in non-oil sectors. Through a transparent fund, Norway, for example, helps ensure equitable distribution of income in good and bad economic cycles through a $160 billion fund that pays out over time.[11] National oil funds, if they are set up with transparency requirements, further increase citizens' confidence in government by seeing further transparent management of the oil revenues, and by benefiting when oil windfalls are used for social sector spending in times of economic downturn. Non-transparent state oil funds in Kazakhstan and Turkmenistan, on the other hand, have not contributed to accountability and better public financial management.

Audited revenue disclosure and oil funds can pave the way for **the fourth energy transparency measure: budget expenditure transparency.** Budget transparency is a step beyond oil revenue transparency that helps build full confidence among potentially disruptive groups that oil monies are being comprehensively accounted for and well spent by the government. For example, despite good progress on the revenue transparency side with EITI, civil society groups in Azerbaijan cite continued corruption in the country. They have called for budget expenditure transparency as a means to significantly further reduce poverty and eliminate corruption.[12] Enabling greater transparency of national and local government budgets would also eliminate a significant underlying grievance among rebels groups in Nigeria—the secrecy of unaccountable government budgets. Oil-producer governments and donors can partner to establish transparency of budgets, either through special aid arrangements or the conditioning of aid in certain regions on the critical issue of budget transparency.

Contract transparency is a fifth key component of oil transparency. Fulfillment of the public's right to access oil, gas, and mining contracts, or at least provisions affecting the public interest, would help civil society determine whether governments have struck deals with extractive sector projects that are in the public interest and whether the promised revenues actually materialize. Other than its fiscal implications, contracts are also of public interest because they can override environmental and social protections or otherwise undermine the rule of law in a host country. For example, the Production Sharing Agreement (PSA) between Russia and Shell Corp. for the massive Sakhalin II project was, upon being leaked to NGOs, found to be extremely unfavorable to the Russian government on both economic and environmental terms.[13]

Contracts are currently published or withheld in an ad hoc fashion and thus far, instances and reason for disclosure vary and have occurred both before and after the project's construction and completion. The International Monetary Fund's Guide on Resource Revenue Transparency recommends that all extractive sector foreign investment contracts should be published.[14] The U.S. Congress passed legislation that states that assistance by International Financial Institutions for the extraction of natural resources should be contingent on the recipient government having systems for disclosing "such documents as Host Government Agreements, Concession Agreements, and bidding documents."[15]

C. Oil, Corruption, and the Security of Energy Supply

A lack of transparency in the oil, gas, and mining sectors is also harming U.S. national security interests worldwide. According to Transparency International, six of the U.S.' top ten oil importing countries rank at the bottom third of the world's most corrupt countries.[16] In such contexts of opacity and corruption, oil revenues supplied by U.S. companies can easily be diverted to fund groups wishing to harm U.S. interests. Insurgent groups in both Nigeria and Iraq steal hundreds of thousands of barrels of oil per day and regularly target foreign nationals including U.S. citizens. Iraqi Deputy Prime Minister Barham Salih recently stated that militants acquire most of the $1.5 billion stolen every year from the country's main oil refinery. Citing "a system and an administration which encourage corruption," he said that "most of this money is channeled to terrorists who are using it to target us and target our nation."[17] Moreover, according a classified U.S. government report cited in the New York Times, the insurgent and terrorist groups likely generate enough funds to support not only their own activities, but also those of other terrorist organizations outside of Iraq.[18]

The 'resource curse' is also proving to be detrimental for U.S. energy security. With climbing oil prices and instability in the Middle East, energy security is rapidly becoming one of the most central foreign policy issues of the new century. While energy security means different things to different countries,[27] to the U.S. it mainly constitutes the security of supply—a stable, reliable energy supply at affordable prices.[28] While there is growing awareness of the U.S.' "addiction to oil," policies to promote alternative energies will not displace both global and U.S. demand for crude oil as the chief source of energy for the next 25 years.[29] In fact, even with alternative energy developments, the U.S. is forecasted to increase oil imports to 60% of its total demand by 2025.[30]

The 14th largest oil exporter to the U.S., Equatorial Guinea. Where has its oil wealth gone? Perhaps a clue: President Teodoro N. Obiang's mansion in Potomac, Maryland (top). Meanwhile, the majority of citizens in the country live on less than $1 per day (below). *(top): Global Witness. Credit (below): Robert Grossman, Africaphotos.com*

Now more than ever there is a global scramble to secure oil reserves in new locations from West Africa to Siberia—a scramble that not only includes U.S. supermajors such as ExxonMobil and ChevronTexaco, but also Chinese, Indian and other new companies trying to ensure a steady oil supply to their rapidly industrializing home countries. According to the International Energy Agency, even in a scenario with worldwide adoption of policies leading to a significant reduction in fossil-fuel demand, by 2030 the volume of Middle East and North Africa hydrocarbon exports would still grow significantly, and global energy demand would still be 37% higher than today.[31]

Despite a salary of only $5,000 per month, Equatorial Guinea's Minister for Environment Teodorin N. Obiang, bought this $35 million estate in Malibu, California in 2006. He is also the President's son. *Copyright© 2002-2006 Kenneth & Gabrielle Adelman, California Coastal Records Project, www.Californiacoastline.org*

With energy security growing in significance over the coming years, fostering better, more transparent investment climates in oil-producing countries is quickly assuming a new, more prominent role. "Western governments need to keep in mind that governance issues, the transparency of operations, and political stability matter in every oil-producing country…It's a concern everywhere. [Reforms] don't just produce benefits for the citizens, but they create a more stable investment climate,"[33] commented Richard Karp, then of the American Petroleum Institute, in 2005. The U.S. will have to devise a more comprehensive strategic energy security policy, and oil revenue transparency should be a key component of the policy—one which is also mutually beneficial to other nations.

According to the Economist Intelligence Unit, **the top 15 U.S. oil importers have an average business environment grade of *poor-average,*** not including the highly corrupt nations of Equatorial Guinea and Iraq, which were not surveyed by the EIU.[34] As recent studies have shown, when personal connections between owners of firms and the government are widespread, the quality of a country's investment climate deteriorates.[35] The U.S. current investment environment in oil-producing nations is highly worrisome and, if left as is, will constitute an increasing threat to U.S. energy interests over the coming years.

A sound U.S. energy policy cannot be built on such a shaky foundation. As leading energy expert Daniel Yergin recently argued, "The investment climate itself must become a key concern in energy security…The IEA [International Energy Agency] recently estimated that as much as $16 trillion will be required for new energy development over the next 25 years. These capital flows will not materialize without reasonable and stable investment frameworks, timely decision-making by governments, and open markets."[36] Senator Richard Lugar, Ranking Member of the Senate Foreign Relations Committee agreed in a recent publication: "It is in our interest to work with the oil-producing countries toward better investment climates, greater political stability… and other measures that will enhance the security of supplies."[37]

Overall, U.S. energy security would be significantly enhanced by oil revenue, budget, and contract transparency. Nevertheless, there are other important reasons why greater U.S. action on transparency is a win-win situation.

Western governments need to keep in mind that governance issues, the transparency of operations, and political stability matter in every oil-producing country…It's a concern everywhere. [Reforms] don't just produce benefits for the citizens, but they create a more stable investment climate.[33]

commented Richard Karp, then of the American Petroleum Institute, in 2005

2. An Opportunity to Combat Corruption and Contribute to Development

Energy revenue transparency also presents a low-cost, high-impact opportunity for G-8 governments and energy companies to combat corruption and boost economic development. While a lack of fiscal transparency is a key general source of corruption, getting transparency right in the energy sector is particularly important to fighting corruption because of the high monetary stakes involved in the oil, gas, and mining sectors. Twenty-five of the world's thirty-three oil-rich countries have "low" or "medium" UNDP human development ratings, with bad governance being key factor in preventing them from moving up in the ratings.[39] At the same time, the governments of most of these countries receive over 40% of their income from oil revenues.[40] Oil could therefore be a tremendous engine for economic development if revenues are accounted for and spent in a transparent manner.

Not only does energy-related corruption lead to poverty, but, in the words of large-scale investors, it also leaves "extractive companies particularly exposed to the risks posed by operating in these environments...[and] vulnerable to accusations of complicity in corrupt behavior."[41] Lack of oil revenue transparency poses two sets of risks for extractive companies. Firstly, it encourages a climate where public officials feel empowered to demand bribes from oil companies in return for allowing them to operate unhampered. Even companies that would rather not pay bribes may feel compelled to as the price of access to that country. Competition between companies is thus no longer based on merit, but on the ability of a company to pay higher rewards to well-connected public officials than its competitors: this is a situation which naturally favors more unscrupulous companies.

Second, lack of transparency may lead citizens to assume that companies are colluding in the theft of state revenues by corrupt public officials, even if this is not the case. Far from earning recognition for their financial contribution to the economic wellbeing of the host country, by way of royalties, taxes and other payments to governments, companies can become the objects of popular resentment which may lead to mass protests, even violent attacks, which hamper their ability to operate. In such an environment, international investors can pull out funds due to a company's tarnished public reputation, such as when Talisman was forced to pull out of its Sudan oil operations in 2003 after public outcry and divestment campaigns.

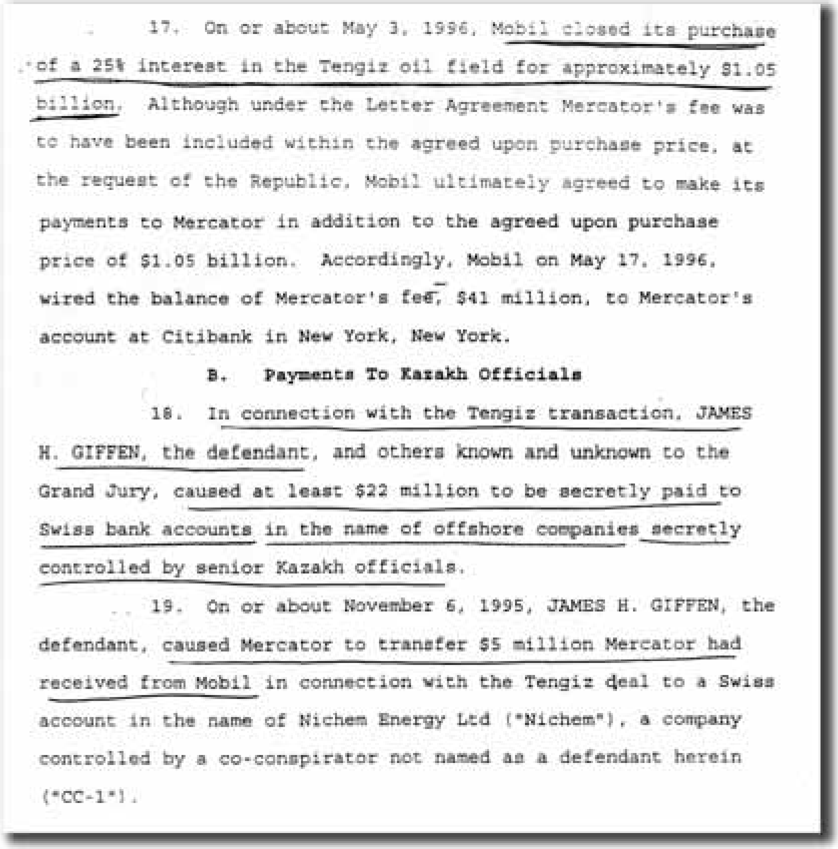
Lack of energy transparency has led to corruption scandals in a number of oil-producing countries in recent years, both tainting energy companies and seriously retarding economic development. The Central Asian nation **Kazakhstan**, which produces over 1.2 million barrels of oil per day, is a case in point. In 2003, the largest-ever foreign corruption investigation in U.S. legal history uncovered a major international

Non-transparent oil and gas revenues often get spent by dictators on lavish projects, such as in Turkmenistan. This statue of the late President actually rotates to face the sun. *Global Witness.*

70 Institutional Investors worth $12.3 trillion Support Energy Revenue Transparency

- As institutional investors representing US$12.3 trillion we actively support the development of international mechanisms to address payments transparency.
- We are concerned that extractive companies are particularly exposed to the risks posed by operating in these [corrupt] environments. ... This is a significant business risk, making companies vulnerable to accusations of complicity in corrupt behaviour...
- We believe that improved transparency about both payment and revenue flows is an important contributor to good governance... In light of the G8 discussions on corruption and increased international attempts to create transparency about revenue flows, we believe that the corporate sector has an important opportunity... by taking action to protect its own long-term interests.
- Reform will give the extractive companies in which we invest an opportunity to be seen as contributors to, and not just beneficiaries of, economic development and reconstruction." [38]

- *A consortium of 70 institutional* investment groups, October 2006.

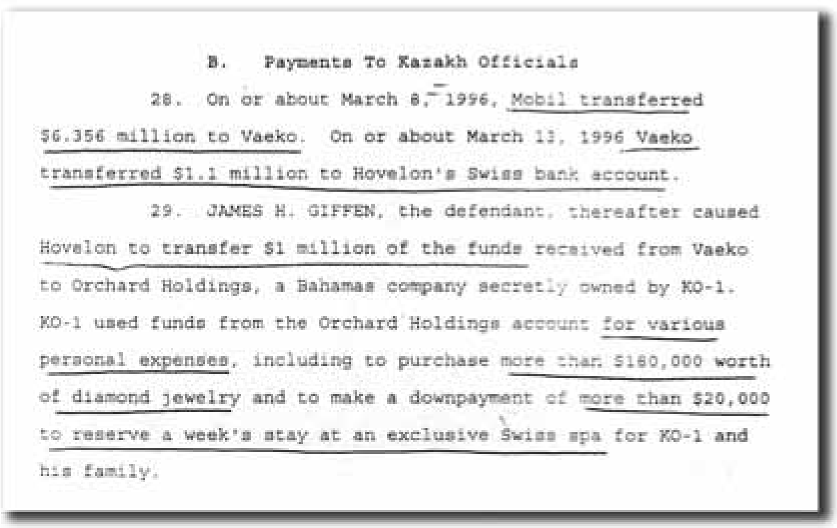


17. On or about May 3, 1996, Mobil closed its purchase of a 25% interest in the Tengiz oil field for approximately $1.05 billion. Although under the Letter Agreement Mercator's fee was to have been included within the agreed upon purchase price, at the request of the Republic, Mobil ultimately agreed to make its payments to Mercator in addition to the agreed upon purchase price of $1.05 billion. Accordingly, Mobil on May 17, 1996, wired the balance of Mercator's fee, $41 million, to Mercator's account at Citibank in New York, New York.

B. Payments To Kazakh Officials

18. In connection with the Tengiz transaction, JAMES H. GIFFEN, the defendant, and others known and unknown to the Grand Jury, caused at least $22 million to be secretly paid to Swiss bank accounts in the name of offshore companies secretly controlled by senior Kazakh officials.

19. On or about November 6, 1995, JAMES H. GIFFEN, the defendant, caused Mercator to transfer $5 million Mercator had received from Mobil in connection with the Tengiz deal to a Swiss account in the name of Nichem Energy Ltd ("Nichem"), a company controlled by a co-conspirator not named as a defendant herein ("CC-1").



B. Payments To Kazakh Officials

28. On or about March 8, 1996, Mobil transferred $6.356 million to Vaeko. On or about March 13, 1996 Vaeko transferred $1.1 million to Hovelon's Swiss bank account.

29. JAMES H. GIFFEN, the defendant, thereafter caused Hovelon to transfer $1 million of the funds received from Vaeko to Orchard Holdings, a Bahamas company secretly owned by KO-1. KO-1 used funds from the Orchard Holdings account for various personal expenses, including to purchase more than $180,000 worth of diamond jewelry and to make a downpayment of more than $20,000 to reserve a week's stay at an exclusive Swiss spa for KO-1 and his family.

Alleged corruption in Kazakhstan: Excerpts from the U.S. federal indictment against James Giffen, who allegedly channeled $78 million from Mobil and Texaco to Kazakh officials for oil and gas contracts.

corruption scandal that "defrauded the Government of Kazakhstan of funds to which it was entitled from oil transactions and defrauded the people of Kazakhstan of the right to the honest services of their elected and appointed officials."[42] The scheme was based around Kazakh President Nursultan Nazarbayev and Oil Minister Nurlan Balgimbayev demanding that international oil companies such as Chevron (now Chevron-Texaco) and Mobil (now ExxonMobil) pay a series of fees to middleman James Giffen on behalf of the Republic of Kazakhstan. This arrangement, the indictment alleges, helped Giffen to skim money from the deals and send some US$78 million in kickbacks to President Nazarbayev and others through dozens of overseas bank accounts in Switzerland, Liechtenstein and the British Virgin Islands. The case is set to go to trial in February 2007.[43] Another US$1 billion of Kazakh oil money has also been uncovered offshore and out-of-sight under Nazarbayev's direct control in a secret fund in Switzerland. Ironically, the only reason that such information has emerged is because President Nazarbayev inadvertently revealed the true state of affairs whilst trying to discredit a presidential rival.[44] Despite the country's vast oil wealth, Kazakhstan ranks 79th in the world on the UN Human Development Index. Today, 19% of the population lives below the poverty line and one in three people die before age 60.[45]

Unfortunately, the Kazakh case is not the exception. In **Nigeria**, for instance, Kellogg, Brown & Root (KBR), a subsidiary of the U.S. oil servicing company Halliburton, is currently under investigation for allegedly paying over $170 million in bribes for a multi-billion dollar natural gas contract in Nigeria. The ongoing investigation now involves separate inquiries by the U.S. Department of Justice, as well as the governments of France, Nigeria, and the U.K.[46] Furthermore, in **Chad** in August 2006, President Idriss Deby accused oil companies Petronas and Chevron of having not paid taxes and demanded they leave the country. Several days later, Deby said the companies could stay if they settled $500 million in back taxes. Although Petronas and Chevron initially denied owing anything, after several weeks they reached a settlement with the government of

Chad to pay $280 million.[47] Other cases in Angola, Congo-Brazzaville, where hundreds of millions of dollars went missing in the 1990s, tell a similar story.[48]

On the other hand, if oil and gas revenue transparency measures were in place in Chad, Kazakhstan, or Nigeria during the Halliburton scandal, the alleged corruption could have been prevented, and oil companies would have been able to clear themselves of association with the corruption scandals. First, a revenue disclosure scheme would have made all payments to the Kazakh government public and open, thereby making it more difficult and unnecessary for middlemen such as Giffen to operate. Oil companies would not compete for investment opportunities on the basis of bribes, but actual performance promised.

Second, a budget transparency mechanism would have made the location and expenditure of all Kazakh oil revenues public, thus allowing for a public paper trail of the money and going a long way in preventing the setup of offshore secret Swiss bank accounts. The oil companies would not have been associated with the Giffen corruption scandal, the people of Kazakhstan would have seen greater government spending on education and health, and economic development in the country would have improved. On a positive note, Kazakhstan has agreed to sign up to EITI mainly as a result of the encouragement of key partner governments including the U.S., U.K., Germany, and Japan.[49]

How Resource Transparency Enables Development: Botswana

Having gone from a low-poor to an upper-middle income country in 35 years as a result of natural resource wealth, Botswana is the exception rather than the rule, and is a case study in how fiscal transparency can be an engine for development. Botswana is rich in diamonds, a resource that is similar to oil and gas in leading to a “resource curse” and fueling civil wars in many nations. Real (PPP) per capita GDP in Botswana rose from $4,690 in 1991 to $8,170 in 2002, driven by diamond-led economic growth.[50] According to a recent Save the Children report, “Transparency in tax and royalty receipts has put the onus on the government to widen the circle of beneficiaries beyond public officials, politicians and the diamond industry’s narrow employment base.”[51] Furthermore, the U.S. Department of Commerce reports that the "government adheres to transparent policies and maintains effective laws to foster competition and establishes clear rules for operation."[52] Simple and transparent tax legislation increased diamond revenues and led to the establishment of a savings fund, which has boosted foreign exchange reserves.

As a recent Save the Children report concludes, “Botswana has managed so well that it had an average of 12.3 per cent annual growth in GDP per capita over 20 of the 35 years since the country’s diamond cache was discovered. The population has benefited directly from this through strong social investment – Botswana has the second highest public expenditure on education in the world as a proportion of GNP. Key to this success has been the transparency of revenues streams to the government and its wise management of this income.” [53] Nevertheless, Botswana still faces numerous challenges, including high unemployment, nearly a quarter of the population living on less than US$1 a day, and little effort to diversify the economy. Notably, its diamonds are mined on an industrial scale and are relatively easy to secure. This is not the norm in Africa, where many diamond-rich countries have artisanal diamond mining sectors, are extremely poor, and the majority of people do not benefit from the diamond wealth.

A. Transparency Boosting Economic Development

Such corruption scandals are at odds with a handful of other nations where transparent fiscal management have quietly boosted GDP in recent years. Botswana, for example, which produces diamonds, grew from being one of the world’s poorest countries at independence in 1966 to being classified as an upper-middle income country today, boosted by 12.3% per capita GDP growth over 20 of the past 35 years (see box). This is largely due to stringent resource transparency requirements by the Botswanan government, with Transparency International citing Botswana as the most transparent country in Africa (see box).[54]

Since implementing EITI in 2003, Azerbaijan has also experienced good progress in both development and poverty reduction. As Azerbaijan’s President Ilham Aliyev commented in May 2006, “We are very determined to use oil wealth to develop a strong economy, and not to depend on oil and oil prices in the future. To achieve that, we need to have a high degree of transparency in accumulating and spending oil wealth. Azerbaijan is a leading country in the EITI, which has a main goal of having transparent accounting.”[55] Statistics bear out Aliyev’s comments in large degree. GDP growth per capita increased from 10.4% in 1999–2000 to 25% in 2004–2005,[56] and following its participation in EITI, Azerbaijan has had the world's 12th most improved business environment score from 2001–05 to 2006–10, according to the Economist Intelligence Unit.[57] Furthermore, foreign direct investment in Azerbaijan increased by 160% from 2002 to 2005.[58] Nevertheless, Azerbaijan should complete its revenue transparency process by disaggregating company payments to the government on a company-by-company basis as is done in Nigeria.

Opacity Harms Growth: Major Non-transparent Oil Producers and their GDP Growth Rates

Country	Oil Production (Mb/d)	GDP per capita average growth rate, 1975-2003	Corruption Perceptions Index rank, by Transparency International (out of 163 countries)
Nigeria*	2.27	-0.5	14th most corrupt
Venezuela	2.53	-1.1	23rd most corrupt
Iran	4.00	-0.3	53rd most corrupt
Iraq	2.00	-9.6	2nd most corrupt
Angola	1.42	-1.1	14th most corrupt
Saudi Arabia	9.35	-2.4	86th most corrupt
Botswana**	30.4**	5.1	125th most corrupt

* Nigeria was non-transparent during this period, as it only joined EITI in 2003 and conducted its first audit in 2005. Interestingly, after it joined EITI, its per capita growth was estimated at 7% in 2005.
** Botswana is dependent on another natural resource – diamonds – rather than oil. The figure listed here is for millions of carats for 2003.
Sources: U.S. State Department 2006 Background Note on Nigeria, available at www.state.gov. Corruption Perceptions Index 2006, Transparency International, available at www.transparency.org. Human Development Report 2005, UNDP, pp. 266-9, available at www.undp.org. Oil Market Report, International Energy Agency, 12 September 2006, available at www.omrpublic.iea.org. CIA World Factbook, available at www.cia.gov. "An Mbendi Profile: Botswana Diamond Mining Overview." Available at www.mbendi.co.za.

3. Engaging China and India on Transparency

The U.S. should raise the bar and help set the transparency standard now, but simultaneously engage Brazil, Russia, India, and China (BRIC countries) and the extractive companies based in those countries as partners in this process as soon as possible. Some companies make the argument that the U.S. cannot introduce transparency requirements because it would make U.S. multinational oil companies less competitive internationally against Chinese companies.

However, key emerging issues in the energy field argue much more strongly in favor of moving forward with transparency with China, in which Chinese and other non-western companies become partners in setting an international business standard of transparency. Numerous policy-makers and scholars are increasingly arguing that China and India should be new partners in helping ensure global energy security and planning jointly for global strategic energy reserves, for example as new members of the International Energy Agency (IEA).[59] Partnering with China and India on transparency initiatives would be a logical step in that same direction and help further enhance U.S. energy security. The three arguments for why this partnership makes sense are as follows:

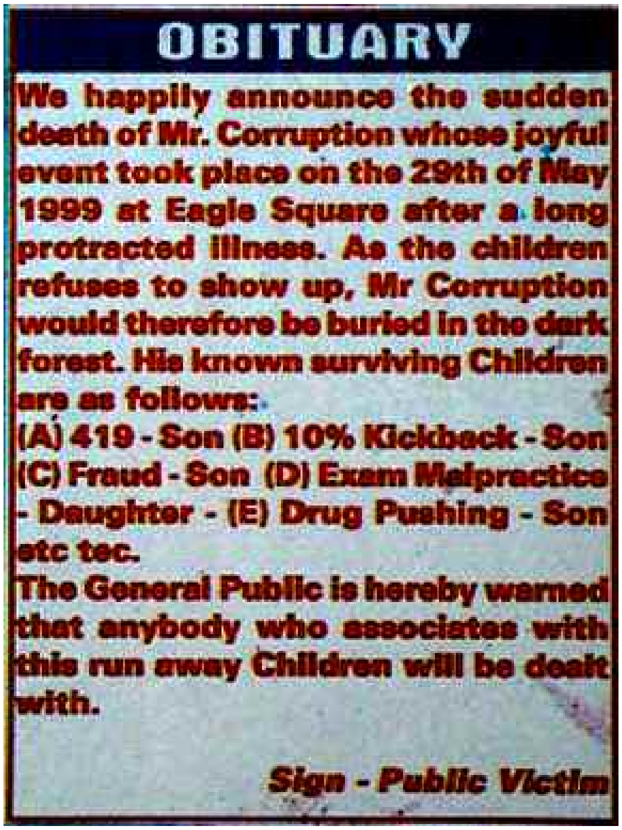
First, the approval of international institutions and Western states for government policies are important to the majority of oil-exporting nations, particularly for reputational reasons. The likelihood of oil-producing nation X kicking out all Western oil corporations and substituting them with Chinese companies is, with a very limited number of exceptions, very low. Such countries do not want to be seen as pariah states and value engagement with the wider international community. Even if oil-producing countries in the developing world are not dependent on foreign aid, the power of international institutions and G8 countries remains high insofar as it provides oft-sought legitimization for government policies. Thus Equatorial Guinea, with theoretically the second highest per capita GDP in the world and no need for lending programs, was one of the first countries globally to ask for the IMF to review its fiscal standards and codes in 2005. The IMF's advice still carries significant meaning in such countries.

Most oil-producing powers want to continue strong relationships with the West, and take their advice very seriously. In Kazakhstan, for example, the Government's signing up to EITI was due in large part to a key letter from a consortium of Western embassies and international financial institutions recommending that step to Prime Minister Akhmetov.[60]

Major Non-Western International Oil Companies and their Operations

Company	Acronym	Size in annual revenues (US$Bn)	Size in market value (US$BN)	Countries of operation	
Chinese Companies					
China Petroleum and Chemical Corporation	Sinopec or SNP	$70.32	$57.05	Angola, Iran, Sudan. Other countries have not been listed	NYSE and Shanghai
China National Petroleum Corporation	CNPC	$83.56	Not given	Indonesia, Kazakhstan, Peru, Sudan, Venezuela, exploring in Burma and 15 other nations	Hong Kong
PetroChina (Wholly owned subsidiary of CNPC)	PTR	$46.95	$172.23	Includes all CNPC operations except Mauritania, Syria, Russia, Sudan	NYSE
China National Offshore Oil Corporation	CNOOC or CEO	$6.69	$34.66	Mainly in offshore China. Also operates in Australia, Burma, Canada, Indonesia, Morocco, Nigeria	
Indian Companies					
Oil and Natural Gas Corporation	ONGC	$13.27	$36.52	Australia, Burma, Iraq, Iran, Ivory Coast, Libya, Russia, Sudan, Syria, Vietnam	National Stock Exchange of India
Indian Oil Corporation (mainly downstream company, currently expanding to upstream and natural gas)	IOC	$30.13	$14.62	Gabon, Iran, Libya; Subsidiaries in Sri Lanka, Mauritius, UAE	
Others					
Petrobras (Brazil)	PBR	$58.43	$99.82	Angola, Argentina, Bolivia, Colombia, China, Ecuador, Equatorial Guinea, Iran, Libya, Mexico, Nigeria, Paraguay, Peru, Tanzania, Turkey Uruguay, United States, Venezuela	NYSE
Petronas (Malaysia)	Petronas	$0.61	$4.79	Algeria, Angola, Argentina, Australia, Cambodia, Benin, Cameroon, Chad, China, Egypt, EG, Ethiopia, India, Indonesia, Iran, Mauritania, Morocco, Mozambique, Myanmar, Niger, Pakistan, Philippines, South Africa, Sudan, Thailand, Turkmenistan, Vietnam, UK, Yemen	Kuala Lumpur Stock Exchange
Lukoil (Russia)	LKOD	$35.08	$65.12	Azerbaijan, Kazakhstan Uzbekistan , Egypt, Iraq, Iran Columbia, Saudi Arabia	London Stock Exchange
For comparison					
ExxonMobil	XOM	$263.99	362.53	Exploration and production in 33 countries, natural gas sold in 25 countries, fuel sold in nearly 100 countries	NYSE

Annual revenue figures are for 2005. Market value figures are as of February 2006. **Sources:** “The Forbes Global 2000: Largest Companies in the World,” Forbes Magazine, March 2006, available at *www.forbes.com*; Annual reports for Sinopec, available at *http://english.sinopec.com*; for CNOOC, available at *www.cnoocltd.com*; for CNPC, available at *www.cnpc.com.cn/english/*; for PetroChina, available at *www.petrochina.com.cn*; for ONGC, available at *www.ongcindia.com*; for Indian Oil, available at *www.iocl.com*; for Petrobras, available at *www2.petrobras.com.br/ingles*; for Petronas at *www.petronas.com*; for Lukoil at *www.lukoil.com*; for ExxonMobil at *www.exxonmobil.com*



Despite some progress, transparency still has far to go in ending corruption. A public notice from Nigeria. *John C. McCall and Christey Carwile, 2002. Other Africas.*

Chinese companies including CNPC also operate in Kazakhstan, and will be subject to EITI transparency requirements when implementation is more fully underway.

A second reason to bring in Chinese and other BRIC companies to the transparency standard is that oil-producing nations still need the higher oil extraction potential of Western multinationals. The technological gap between oil majors and Chinese and Indian companies has been closing in recent years, but it is still quite significant, particularly in deep off-shore oil and gas extraction.[61] For example, oil blocks that were purchased in June 2006 by Chinese companies in Angola with record signature bonuses of $2.2 billion will actually be operated by Total.[62]

Third, Chinese energy exploration can in fact contribute to energy security, as Chinese companies mostly focus their oil exploration in areas and markets where U.S. companies do not concentrate. As international energy expert Daniel Yergin argues, "From the viewpoint of consumers in North America, Europe, and Japan, Chinese and Indian investment in the development of new energy supplies around the world is not a threat but something to be desired, because it means there will be more energy available for everyone in the years ahead as India's and China's demand grows."[63] By drilling in mostly alternative markets, the Chinese are helping develop the overall global energy supply. For example, the largest Chinese international energy investment is currently in Sudan—the Chinese company CNPC pumped out 16.4 million metric tons of crude oil in Sudan last year[64]—a country against which the U.S. has sanctions and thus does not have U.S. energy investments. In countries with Western investment, Chinese companies most often purchase oilfields that Western multinationals had already worked over in previous years. An influential *Foreign Affairs* article recently argued, "China's hunt for resources may have less dire consequences for developed nations such as the U.S. than is often assumed…China typically picks up secondary deals or moves into markets from which the U.S. is absent; thus in many place the two countries are not really in direct competition."[65] For example, the oilfields that were purchased in June 2006 by Chinese companies in Angola (Blocks 17 and 18) had already been worked over by ExxonMobil and BP in previous years. ExxonMobil stayed out of the bidding process for these blocks.[66]

There are exceptions, and the BRIC oil companies do at times compete with Western firms,[66] but pursuing revenue transparency with BRIC countries is sound policy, given the interrelationship of the economies of China and the U.S. If China were to adopt transparency standards in all of its resource extraction operations, the benefits of transparency would spread to the many areas of the world where Western firms do not operate.

4. Progress on Energy Revenue Transparency To Date: Mixed

Progress to date on energy revenue transparency has been mixed, and the overall picture is still one of drops in the bucket rather than a half-full glass. While the EITI and other voluntary initiatives have made headway in a handful of oil-rich countries since 2002, much more needs to be done overall to institute transparency in the vast majority of resource-rich nations. The World Bank and IMF have taken some limited steps, a small number of pilot countries have enacted legislation on transparency, and the G-8 has made supporting statements.

Launched by British Prime Minister Tony Blair in September 2002, **EITI has been significant in getting companies and civil**

society groups to work together in helping transparency move forward in countries that voluntarily signed up to the process. EITI has made significant progress in two countries (Azerbaijan and Nigeria), where independently audited and reconciled reports have been published. Concretely, the Nigeria Extractive Industries Transparency Initiative (NEITI) recently announced that it saved the country about $1 billion in the oil and gas industry in 2004 and 2005 as a result of the checks it initiated.[68] But much remains to be done in the other 51 resource-rich countries. Of the 21 countries that have signed on to EITI, only ten have formulated a work plan, and a further eight have not taken the first step of appointing an official to lead the EITI process.[69] Moreover, 33 resource-rich countries—including all OPEC members excluding Nigeria—have not signed up to EITI. Several steps would help lift the EITI process and are detailed below.

Quotes on Revenue Transparency in the U.S. National Energy Policy Development (NEPD) Group report from 2001:

The NEPD Group recommends that the President direct the Secretaries of State, Energy, and Commerce to:

> support more transparent, accountable, and responsible use of oil resources in African countries to enhance the stability and security of trade and investment environments. ...
>
> promote a more receptive environment for U.S. oil and gas trade [in Africa]... addressing such issues as transparency, sanctity of contracts, and security. ...
>
> deepen their commercial dialogue with Kazakhstan, Azerbaijan, and other Caspian states to provide a strong, transparent, and stable business climate for energy and related infrastructure projects.
>
> improve the energy investment climate for the growing level of energy investment flows between the United States and [Venezuela and Brazil].

Other piecemeal efforts have also had an initial impact on transparency, but must go further. First, several G-8 communiqués have supported resource revenue transparency.[70] These statements, while providing useful rhetorical support, have not been followed through with meaningful action. The International Financial Institutions (IFIs) have also made some progress in helping transparency cause, but need to go further. Most significantly, the International Finance Corporation of the World Bank and European Bank for Reconstruction and Development have made revenue transparency a requirement of all their lending projects in the extractive sector.

These are excellent first steps, but the other IFIs have yet to follow suit—including the World Bank, the African Development Bank, the Inter-American Development Bank, and the Asian Development Bank—as well as export credit agencies including the U.S. Export-Import Bank. The International Monetary Fund (IMF) also issued the Guide on Resource Revenue Transparency in June 2005, which is an excellent resource book but is not yet implemented widely across the IMF. Furthermore, World Bank President Paul Wolfowitz's recent anti-corruption drive in the Bank has provided positive rhetorical support, but it must be followed with transparency requirements mainstreamed into all Bank activities.

Finally, a small number of pilot cases have shown that transparency can work without risk to companies or governments. In June 2004, for example, the Nigeria/Sao Tomé Joint Development Authority enacted a regulation requiring transparent bidding and revenue disclosure of all companies operating within the Joint Development Zone (JDZ). While the implementation of the JDZ has proven somewhat more complicated than at first anticipated, it nevertheless shows that transparency can help in promoting improved development.[71] A small number of countries have also enacted model proactive oil transparency legislation to help stop corruption before it starts, including Timor-Leste.[72] Although more work must be done in each country to ensure that the laws are implemented, these are useful models which can be used on a wider international scale.

In addition, companies including Newmont Mining have exhibited leadership by publishing what they pay in the countries where they operate, and Canadian oil company Talisman Energy received a significantly higher score in terms of its revenue payments transparency and supportive disclosure measures than other oil and gas companies in the 2005 "Measuring Transparency" report.[73] While these and other 'better practices' among companies, IFIs, and governments should be highlighted, the reality is that transparency is not yet mainstreamed into global standard practice, and much more meaningful policy action needs to be taken.

5. Policy Options and Conclusion

Now is the time for the U.S. to make transparency a key element of a reinvigorated energy policy. Other key actors, including the U.K., Norway, the World Bank, the International Monetary Fund and the European Bank of Reconstruction and Development have already made important strides in taking oil transparency measures forward and should continue to ramp up their efforts. The U.S. should play a lead role, however, particularly given the U.S. nationality of many of the largest international oil companies and the U.S.' geo-political weight. Doing so would save U.S. taxpayer money by making resource-rich countries use their oil, gas, and mining revenues for development, and make them less dependent on foreign aid.

Revenue transparency is a non-partisan issue that has received support from Republican and Democratic voices alike (see box), giving all the greater reason to take forward its policy implementation. The steps that the U.S. has taken thus far on energy transparency have been helpful but should go significantly further. For example, the joint letter signed by the U.S., U.K., and other embassies to the government of Kazakhstan in 2005 was instrumental in getting that government to sign on to EITI.[77] Furthermore, President Bush's discussion of EITI with Kazakh President Nazarbayev is helping to move EITI implementation at a faster pace on the ground. As Presidents Bush and Nazarbayev remarked in September 2006 in a joint statement, "We pledge our support for efforts under the Extractive Industries Transparency Initiative (EITI) to ensure that companies in the petroleum and mining industries observe international standards of transparency and accountability."[78]

Four targeted policy measures should make up the U.S. energy revenue transparency strategy.

- **The first and foremost element should be U.S. legislation on the statistical reporting of oil, gas, and mining revenue payments.** This should include public reporting to the U.S. government by extractive companies to all governments on a country-by-country basis, as a small additional element to the information that is already routinely disclosed by these companies through SEC filings and their foreign equivalents. The U.S. should take the lead on this issue, but other major securities market regulators should follow suit, including the U.K., Hong Kong, Japan, and India, so as to level the playing field for all companies.

Companies often disclose revenue payments to governments but these payments are not reported by country. This would be a simple addition to existing disclosure, which should not be unduly burdensome since companies need country-by-country financial data for their own internal accounting purposes. Nonetheless, this form of disclosure would be a powerful tool for increasing transparency because even the most opaque of oil-producing countries, which may impose strict confidentiality requirements on U.S. oil companies, typically waive these requirements for disclosures that are required by regulators in a company's home jurisdiction.

On a positive note, the U.S. has supported EITI implementation in Kazakhstan. Here Energy Secretary Samuel Bodman meeting with Kazakh President Nazarbayev in March 2006. *U.S. Deparment of Energy.*

More than any other measure, this would introduce transparency as an international standard to be practiced widely. While EITI covers a small handful of oil-producing countries, a legislative statistical reporting requirement and the other relevant regulation bodies would be comprehensive—able to capture all payments made to all governments by every major oil and gas company listed in the U.S. and other global securities exchanges. Full revenue payment disclosure is already normal guideline practice in the Alternative Investment Market in the U.K., as well as among several individual oil and mining companies, including Talisman Energy and Newmont Mining.

- **As a second key policy measure, the U.S. should provide higher-level diplomatic and financial backing to the EITI,** which would provide the single most important boost to the EITI process at present if done in concert with other governments. If embassies and high-level officials from the U.S., U.K, and E.U. made significant diplomatic overtures on EITI in Yemen, Equatorial Guinea, and Indonesia, for example, implementation of the initiative would move at a much more rapid pace. To this end, the U.S. could make a constructive role by doubling the number of Foreign Service officers assigned as Petroleum Attachés in oil-producing countries. The U.S. and other EITI board members should also ensure that EITI candidate countries are validated yearly. In addition, an annual contribution to EITI implementation of $5 million per year would help move the process forward. Significant technical assistance to civil society groups to monitor EITI implementation and governments would greatly aid the initiative.

- **Third, the U.S. should condition aid packages on budget expenditure transparency** in key corruption-prone countries. This recommendation was recently made by the International Crisis Group in reference to Nigeria,[80] and it would be equally effective if applied to other countries such as Azerbaijan,

Energy Revenue Transparency: A Non-partisan Issue

From the Heritage Foundation Issues 2006 Report:

"The Heritage Foundation and the conservative movement advocate... free markets, business and governance transparency, and political accountability. If applied across the board, these principles will allow significant increase of the oil supply. ... The U.S. and international financial institutions that the U.S. influences need to promote political accountability, such as transparent parliamentary controls over oil and gas revenues and expenditures, transparent national oil funds... Such approaches prevent theft, fraud, and abuse and enhance political stability and economic development in energy-producing countries."[74]

From the Congressional Black Caucus Foundation 2005 report on West Africa:

"Good governance of oil-generated revenues is so critical for American security. It is not only prudent but necessary that the U.S. engage Gulf of Guinea nations in its quest to secure its energy supply..., incorporating the democratic principles of good governance, corporate responsibility, transparency, accountability... Oil companies... should make public annual audits conducted by reputable international firms relating to activities in West Africa to augment participation in the concept of "publish what you pay" initiatives. ... Governments of West African oil-producing nations should publish information on all oil revenues and participating oil companies."[75]

From the Council on Foreign Relations 2006 Independent Task Force report on U.S. oil dependency:

"The Task Force recommends that the United States, in conjunction with its allies or international agencies, play a stronger role in pressing for the use of mechanisms that could improve the proper management of hydrocarbon revenues. ... Such actions are in the U.S. interest, both because stably governed countries are better able to attract the investment needed to maintain and increase hydrocarbon production, and because it supports the long-standing American goal of encouraging progress toward democracy and good governance. ... The best example of this approach is the Extractive Industries Transparency Initiative."[76]

Angola, and Equatorial Guinea. Transparency of both national and local budgets is a critical element of public accountability in the U.S. and Europe, and the international community should use its leverage in promoting this often-overlooked element in resource-rich developing nations.

- **Fourth, the U.S. and key European governments should undertake oil corruption preventive diplomatic initiatives** that focus on curbing kleptocracy before it starts. Timely diplomatic pushes have worked well in new oil-producing countries such as Sao Tomé and Principe and Timor-Leste in helping stem corruption, and would be excellent policy initiatives in up-and-coming oil producers such as Madagascar, Liberia, and Cambodia. These initiatives should include contract transparency provisions for proper public accountability.

The U.S. policy measures should be further supported by actions by other international institutions. First, EITI should be mainstreamed into all international financial assistance programs, including those of the World Bank, IMF, bilateral aid agencies, and multilateral development banks. Mainstreaming means that all the non-humanitarian lending and technical assistance provided by these institutions to resource-dependent countries should be designed to require the transparency and public accountability of natural resource revenue management.

Furthermore, a UN General Assembly resolution on resource revenue transparency and EITI and integration of resource transparency into the EU Common European Energy Policy would act as significant supporting elements to the transparency framework. In addition, companies should promote revenue transparency more actively in countries of operation, and EITI stakeholders must actively speak out when civil society transparency campaigners are threatened. Finally, the IMF needs to ensure that its Guide on Resource Revenue Transparency—an excellent reference document—is implemented across its programs and reporting schemes in all resource-rich member states. As a leading shareholder in the World Bank and IMF and a permanent member of the UN Security Council, the U.S. should use its vote to ensure that these measures are taken.

Overall, oil revenue transparency today receives some high-level rhetorical support but remains a low-level, piecemeal-approach issue in terms of policy action despite its clear benefits. Four years after its launch, EITI is only being implemented in a small handful of countries, with most of the largest oil producers still left out of the game. Moreover, systematic corruption continues to take place in oil-rich nations from Equatorial Guinea to Iraq to Angola. This opacity not only fuels instability and retards economic growth, but is also a chief cause of today's record high oil prices. In such contexts of corruption and opacity, energy revenues supplied by U.S. companies can easily be diverted to fund terrorist groups wishing to harm U.S. interests.

The U.S. should take the lead in addressing these issues through a coordinated policy approach to energy revenue transparency. Doing so would not only help U.S. energy security and build more stable investment climates in major U.S. oil-importing countries, but would also help fight corruption and contribute to economic development in "resource-cursed" countries. Oil revenue transparency is a win-win policy for U.S. investment and poverty reduction: it is now time to make it a reality.

Endnotes

1 *UN Human Development Index 2005,* available at *www.undp.org*; Benn Eifert, Alan Gelb, and Nils Tallroth, "Managing Oil Wealth," International Monetary Fund, 2003, available at *www.imf.org*.

2 While the focus in this report is on the oil and gas sectors, the transparency problem equally applies to the mining sector. For more information, see *www.publishwhatyoupay.org*.

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70 The Evian 2003 "Fighting Corruption and Improving Transparency Declaration" highlighted intensified but voluntary transparency measures; the 2004 Sea Island declaration on "Fighting Corruption and Improving Transparency" emphasized budget transparency as well as revenue transparency; the 2005 Gleneagles communiqués on Africa and Governance promised greater support for EITI implementation focused on Africa; the 2006 St. Petersburg "Plan of Action on Global Energy Security" and declaration on "Fighting High Level Corruption" which promised to support EITI implementation for greater fiscal transparency. See G8 Evian Declaration, "Fighting Corruption and Improving Transparency" (2003); Sea Island Declaration, "Fighting Corruption and Improving Transparency" (2004); Gleneagles declarations "Africa" and "Governance" (2005); all available at *www.g8.gov.uk*. See also the G8 St. Petersburg declarations on "Energy Security" and "Fighting High Level Corruption" (2006), available at *http://en.g8russia.ru/docs/11.html*.

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Summary

The time has come for a global drive towards energy revenue transparency. Energy revenue transparency limits the scope for oil-related corruption through fiscal accountability. This initiative presents a low cost, high-impact opportunity for both the United States and international oil companies to enhance energy security, improve investment climates, and contribute to the development of poor nations. Global Witness, a founding member of Publish What You Pay, a global coalition of over 300 nongovernmental organizations, calls on the U.S. to raise the bar and enact the following key policy measures on energy revenue transparency:

- U.S. legislation establishing a reporting standard for extractive industry companies to publicly report payments made to governments on a country-by-country basis;
- High-level U.S. diplomatic engagement on and funding for the Extractive Industries Transparency Initiative (EITI) and on budget expenditure transparency;
- Key diplomatic engagement with China, India, Russia, and Brazil in the setting of energy revenue transparency as a global standard.

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