TRANSPARENCY OF EXTRACTIVE INDUSTRIES: HIGH STAKES FOR RESOURCE-RICH COUNTRIES, CITIZENS, AND INTERNATIONAL BUSINESS

HEARING

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TRANSPARENCY OF EXTRACTIVE INDUSTRIES: HIGH STAKES FOR RESOURCE-RICH COUNTRIES, CITIZENS, AND INTERNATIONAL BUSINESS

Thursday, October 25, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Present: Representatives Frank, Waters, Watt, Scott, Green, Cleaver, Moore of Wisconsin; and Baker.

The CHAIRMAN. The hearing will come to order. This committee has under its jurisdiction the American relationship with the international financial institutions. It has been a subject in which I have long had a very strong interest and the last time the Democrats were in power I chose to chair the subcommittee which had jurisdiction over the international financial institutions.

For much of this year, we have been dealing with some housing issues and some other domestic issues which demanded attention, but this whole set of issues involving development and particularly our moral responsibility to try to reduce poverty in the world have been very much on our mind. We are now going to be focusing—we have already begun in the latter part of this year and next year—on development issues. And we will be dealing with such questions as debt relief.

We had a hearing on the question of whether or not there is, in certain World Bank documents, a bias against improved social conditions for working people. We will have next year the request I believe for an increased allocation for the International Development Association, and we will be raising some policy concerns in conjunction with that. And we ultimately are supportive of that, many of us on the committee, but not without some policy considerations being addressed.

This hearing today is on one of those subjects which is quite important, but not generally well known. It is one of those that is important to discuss because it is counterintuitive. Intuition says that if a particular country is lucky enough to have physical resources that are valuable in world commerce, that's a good thing, and it certainly ought to be. There is considerable evidence that this does not in practice work out as it should in many cases.

Now this is an area where we do not have direct policy control as we do in the subprime area or in housing or securities regulation. But the United States is a major factor in the World Bank and the regional development banks in our own domestic—in our own bilateral foreign aid programs, and we think it is very important to focus attention on this issue, and it's important for this reason: Some problems are very difficult to resolve.

Some things are intractable. If you have abject poverty and no source of revenue to alleviate it, that's a tough issue. Here we have a situation in which we are talking about countries when we deal with this by definition that are potentially quite wealthy, that are wealthy as entities, that have a great source of wealth. And the question is, how do we encourage policies that make sure that this resource is a positive rather than a negative? And as I said, it's counterintuitive, and I hope that people will be paying attention as we hear from our witnesses about how this has gone bad.

And what is both discouraging and encouraging about this issue is that it is a case where people's mistakes are the problem. If you are dealing with inherent problems, that can be harder to deal with. If you are dealing with physical shortages, if you are dealing with terrible problems of climate, it's often hard to figure out how to deal with them. But when the problem is, as it is here, that human decisions are the source of the problem, and that's clearly the case, we have the resources. We have resources that by any rational reckoning ought to be a great boon for the people in the country in which these resources are located, but in many cases, bad public policy, i.e., lousy decisions, corrupt decisions, incompetent decisions by people in charge have had a counter effect. And our job is to try to talk about the policies that counteract that, and then, to the extent that the United States can, encourage their adoption.

I would just close by saying this: This is particularly an area where this committee will be engaged in international cooperation. It is our intention to seek out members of parliaments in other countries who share our jurisdiction and our interest in fighting poverty. Several of the members are very interested in this. So this is part, it's still the early part, but it will become very much a part of this committee's agenda over the next year and beyond to do what we can to think about, help evolve and encourage the adoption of public policies that maximize our ability to reduce poverty. And this is one, as I said, where what ought to be a boon to people has in some cases been either neutral or, sadly, the opposite. And it's one that we think should be amenable to the kind of processes that we engage in.

The gentleman from Texas wanted to make an opening statement.

Mr. GREEN. Thank you, Mr. Chairman. I really do appreciate your having this hearing, and if I may, I'd like to compliment the staff. This three-page report is quite revealing and well put. It does not draw unnecessary conclusions, but it gives the reader an opportunity to really extrapolate and synthesize ideas with reference to how a blessing not properly utilized—and these are my words—can become a curse.

That has just—this phenomenon of resource curse and the paradox of plenty is in my opinion something that merits much more study. I assure you, Mr. Chairman, that I'm going to look closely into this. Because when I read this report and realized that having natural resources can in a sense—not properly utilized—can in a sense be a barrier to the democratic process developing properly in a country, because you don't have the tax base that you might ordinarily have, meaning the populace contributing to the taxes. As a result of their not contributing to the taxes, they don't show the interest in democracy that they might ordinarily show. And by not showing the interest in democracy that they ordinarily would show, authoritarianism has an opportunity to flourish.

Now I'm not advocating that we increase taxes. I want to make that clear. But the connectivity that is made between taxes and democracy is quite interesting as it relates to this report. It also makes it clear to us that these natural resources can create a talent drain, which is most revealing in that the natural resources will tend to attract the talent from—that could go into other industries—agriculture, for example, and manufacturing. And when these industries lose that talent to the natural resource industry, then they don't flourish. They don't develop as they properly should. Workers are displaced. They are working only with these natural resources. Manufacturing is declining. Agriculture is declining. And it creates additional problems for workers. You get poor governance as a result.

So I am exceedingly complimentary, hopefully, of the persons who put this together. And I am very much concerned about how we can effect policies that will create the transparency such that countries that have these great natural resources will use them efficaciously and hopefully democracy will have an opportunity to flourish.

Mr. Chairman, I thank you for the opportunity, and I yield back the balance of my time.

The CHAIRMAN. I thank the gentleman. I thank him particularly for correctly noting the high-quality work we have gotten from our staff here.

We have to vote, and I apologize. I will explain. We are taking a very important vote today on a new version of the Children's Health Insurance Program. Sadly, the fires in California are raging, and some Members have gone back to the fires, and other Members think it's inappropriate for us to be having a vote on a day when people are back with the fire. So we will be harassed today. I apologize for this. We can't control that.

Do either of the other members wish to make an opening statement? We would be able to accommodate that. If not, we will take our—well, I take it back. If you don't mind, we'll have time. We have 15 minutes. We can take the first opening statement. We will then recess and come back.

So, Professor Karl, do you want to begin, please? This is our first witness. Professor Terry Lynn Karl, who is a Professor of Political Science, and the Gildred Professor of Latin American Studies at Stanford University. Professor, please begin.

STATEMENT OF TERRY LYNN KARL, PROFESSOR OF POLITICAL SCIENCE, AND GILDRED PROFESSOR OF LATIN AMERICAN STUDIES, STANFORD UNIVERSITY

Ms. KARL. Thank you, Mr. Chairman, and members of the committee, for giving me this opportunity to speak with you. Twenty-five years ago, the Venezuelan founder of OPEC remarked to me that oil was the excrement of the devil—el excremento del Diablo. Perhaps he envisioned the resource curse at that time.

Today we know that states that are dependent on extractive industries eventually become among the most economically troubled, the most authoritarian, and the most conflict-ridden in the world. While this is not the case for all extractive states, it is especially true for oil exporters. This holds across all regions—Asia, Africa, Latin America, and the Middle East.

I would like to make four brief points to you. First, the lack of transparency in the extractive industries is a central explanation for the resource curse. Oil, gas, and mining are the most profitable but among the least transparent economic activities in the world. Simply stated, most companies do not publish what they pay governments, and most governments do not disclose what they earn and what they spend. This means that huge amounts of money are virtually untraceable and are not subject to any oversight at all, a perfect recipe for corruption. As one OPEC minister of finance explained to me, "People rob in my country because there's absolutely no reason not to."

For this reason, corruption in oil-exporting countries is significantly greater than the world average. Corruption raises the transaction costs of doing business. It negatively influences the foreign direct investment. It lowers the productivity of expenditures, and it perversely affects investment decisions. In this respect, it is absolutely devastating to poverty alleviation.

Lack of transparency is also transmitted through the acceleration of price volatility, and especially oil price volatility. This has grown exponentially in the last decade. Today, the information available to companies, countries, and traders is so poor that responses to this information have little relationship to market fundamentals. Instead, as we saw this week, the mixture of rumors, inaccurate forecasts, currency changes, and geopolitical fears is what drives oil prices. A sound U.S. energy policy simply cannot be built on a shaky foundation like this, nor can sound economic policies to alleviate poverty be adopted in weak states experiencing these absolutely rapid fluctuations.

Oil price volatility is twice as variable as all other commodities. This exerts a strong negative influence on countries that are dependent on petroleum. Few developed countries could successfully manage this kind of volatility in their central revenues, and developing states simply cannot.

Second, building transparency to overcome the resource curse is difference, because both companies and governments have a short-term interest in opacity. For the companies, confidentiality shapes how they account for their costs, what profits they report to host governments, how much profit taxes they must pay, and whether they can offer large signature bonuses or side payments to enhance their competitive advantage over other companies.

For exporting governments, secrecy also affects the kinds of contracts they're able to enter into and whether their revenues are ultimately traceable or not. Moreover, leaders in exporting countries gain all kinds of political advantage from an opaque, no-tax-and-spend state. Because revenues are not extracted from their own populations, their people feel no sense of ownership of the state's money. This leaves rulers especially free to turn the state into a honey pot, distributing riches to cronies, patronage networks, or the military. And this is much to the detriment of poverty alleviation.

But this has a long-term cost. Because taxation encourages the flow of information as well as demands for representation and accountability, living from resource rents denies leaders the crucial knowledge they need for development, while building support only through the distribution of handouts.

Fourth: While building transparency is not easy, it is the necessary starting place for overcoming the resource curse, because it is a prerequisite for other economic and technocratic solutions. Prescriptions for overcoming the resource curse, which includes sterilization of revenues through stabilization funds, diversification, privatization, and other polices rest on transparency. The examples of Norway and Alaska are especially popular. But such prescriptions are aimed solely at the policies of extractive states. Thus they fail to recognize that transparency is a two-way street. Furthermore, the success of all these policies rests on knowing what revenues are raised, how they are divided, and how they are to be spent.

Finally, legislation aimed at escaping the resource curse must be conceived of as part of a larger social pact for change in the extractive industries. Pushed by a number of high-profile energy scandals and the morally reprehensible prospect of devastating outcomes in the new exporters of West Africa, countries and companies are under increasing pressure to change their practices. But companies that see advantages in transparency are afraid of moving first, and they're afraid of being undercut by others. If disclosure requirements were mandatory for all companies registered in the United States, whether U.S. or foreign, this would level the playing field.

Let me conclude by being clear. Transparency is not the solution to a looming fossil fuel crisis with its tremendous threats to world stability and peace. Nor can it alone resolve this paradox of plenty. This will require what I call a social fiscal pact, a coordinated big push by all stakeholders to design new laws, norms, and practices that put openness, order, and fairness into extractive industries. But if the brewing crisis over natural resources is not more justly and efficiently managed, the lives of millions of people, the stability of markets, and the health of our Earth will be further jeopardized. As the founder of OPEC would then say, he would unfortunately have been proved right.

Thank you.

[The prepared statement of Professor Karl can be found on page 40 of the appendix.]

The CHAIRMAN. Thank you, Professor. We're going to break and vote and come back. I apologize for the interruption, but, you know, that's the way we live. And we will come right back. There's only the one vote, and then we will resume the testimony. Thank you.

[Recess]

The CHAIRMAN. We will reconvene. Our next witness is Mr. Ian Gary, a senior policy advisor for extractive industries at Oxfam America.

STATEMENT OF IAN GARY, SENIOR POLICY ADVISOR FOR EXTRACTIVE INDUSTRIES, OXFAM AMERICA

Mr. GARY. Thank you, Chairman Frank, and members of the committee. Thank you for the opportunity to address you today on the issue of transparency and the extractive industries. I speak today representing Oxfam America, an international development organization that supports poor communities facing the impacts of these projects around the world.

We are also proud members of Publish What You Pay, a global campaign pushing for policy changes to end the secrecy that surrounds this sector. While some progress has been achieved, much more remains to be done, including the development of mandatory disclosure rules, as Professor Karl has mentioned.

If you care about the poor, you should care about extractive industry transparency. Revenues from extractive industries are a significant source of government income for more than 50 developing countries. These countries are home to approximately 3.5 billion people, 1.5 billion of whom live on less than $2 a day. Too often, as has been noted, extractive industries' revenues are squandered, fueling corruption and social conflict. Secrecy exists despite the fact that we are speaking of public resources, nonrenewable resources that are sold by the government on behalf of the population. For example, I was recently in Cambodia, where new oil discoveries have raised the hopes that oil wealth will lift the country out of poverty. However, there is no public information about contracts the government has signed with Chevron and other investors, nor is there any information about payments the government may have already received.

Of course, transparency alone will not solve all the problems of resource-rich states. Respect for human rights, an open and participatory budget process, independent media, and a vibrant civil society are all vital aspects of systems of government oversight. But easily accessible information on revenues and contracts is a necessary and achievable first step towards proper management of this mass of wealth.

I would like to turn now to examine briefly the role of the international financial institutions, something I know is of particular relevance to this committee. For too long, the IFIs have been willing enablers of the system of secrecy. The World Bank and other regional development banks and export credit agencies have been instrumental in facilitating investment and directly financing projects in the developing world, and they have indicated they plan to increase funding in the sector. While these investments have been profitable for the corporate sponsors and the World Bank, too often they have had predictably regrettable outcomes for the poor.

A 2004 independent review of the World Bank and extractive industries concluded that the Bank should not finance projects where good governance conditions are lacking. And in many countries, these basic conditions are lacking. In response to the review, the

Bank pledged to undertake a limited set of reforms, including a new International Finance Corporation policy supported by the United States which requires from January 1st of this year disclosure by private sector clients of revenue payments to host governments.

While this is a significant step forward, implementation has been poor, and there is very little information on what is being required of clients or where it can be found.

The IMF has an important role to play in its surveillance of the fiscal affairs of member states, and has undertaken important research and standard-setting exercises on this issue. Its 2005 publication, updated this year, "The Guide on Resource Revenue Transparency," has the IMF taking a strong public stand in favor of transparency. The good practices described in the guide are viewed as voluntary by the IMF, and the institution has not consistently highlighted these issues in surveillance programs and country dialogues. At the same time, there are examples, such as the case of debt relief conditions for Congo-Brazzaville, where the World Bank and IMF work together to condition debt relief on implementation of transparency reforms.

Both the World Bank and IMF have been active supporters of the international effort known as the Extractive Industries Transparency Initiative, EITI. Fifteen countries are officially candidates implementing this program, but no country has yet published externally validated reports. EITI may make progress in some countries where political will to tackle the problem is strong and lasting, and requires the active involvement of civil society. But the initiative is weakened by its voluntary nature and will not capture many countries where problems are most severe. EITI also allows contracts to stay secret and allows lump sum reporting rather than individual company reporting, which is more desirable.

Oxfam America believes we need to move beyond a voluntary approach to extractive industries transparency. All companies and the investment community would benefit from a level playing field created by mandatory disclosure regulations. Furthermore, it would enable companies to address the risk to reputation arising from the lack of transparency.

This committee and Congress as a whole has a real opportunity to address the secrecy that is at the heart of the resource curse Terry Karl described. I commend the committee for organizing this hearing and would be happy to answer any questions you may have.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Gary can be found on page 31 of the appendix.]

The CHAIRMAN. Thank you very much. Next, Father Patrick Lafon, who is the former secretary general of the Catholic Bishops Conference of Cameroon.

STATEMENT OF FATHER PATRICK LAFON, FORMER SECRETARY GENERAL OF THE CATHOLIC BISHOPS CONFERENCE OF CAMEROON

Father LAFON. Thank you, Chairman Frank, Ranking Member Bachus, and members of the committee. I'd like to begin by thank-

ing you for the opportunity to address you on a subject that is quite literally a life-and-death issue for hundreds of millions of Africans and others in the developing world. This issue is transparency in the extractive industries.

The Catholic Church in Cameroon and in the West and Central African regions has been involved in issues of oil and poverty for more than a decade. We decided to adopt a hands-on approach in the 1990's when the Chad Cameroon oil and pipeline project was being planned. Before this, oil was a taboo subject in Cameroon, but when we realized that after 25 years of the exploitation of oil there wasn't much to show for it except the fat bank accounts of a few individuals, we as the Catholic Church decided to get involved not only in Cameroon but across the region. In 2002, all the Catholic bishops of the Central African region issued a statement calling on oil companies to "contribute to transparency and the fight against corruption by publishing oil revenues they pay to our national governments."

Beyond policy statements, we have taken practical measures to try to improve the outcomes of oil projects in favor of the poor. We decided to set up a monitoring program for the Chad Cameroon oil project to see whether the governments and the oil companies were doing what they said they would do. This particular oil project has not resulted in much improvement in the situation of the common man in Cameroon. Also, in the case of Cameroon, the World Bank did not use the leverage it had to require a revenue management law for the use of all oil revenues in Cameroon as it had done in Chad.

The Church is answering the cries of the people of Central Africa for more justice in the use of oil revenues. Lack of transparency can breed corruption and has done so. Angola, Cameroon, Congo, Brazzaville, the Democratic Republic of the Congo, Equatorial Guinea, Gabon, Nigeria, Sao Tome Principe, and Chad are among some of the most promising oil, gas, and mining exploration areas. But they are also some of the world's most corrupt countries.

One has only to consult the Transparency International Corruption Perceptions Index to verify that this is so. Since the mid-1990's, several countries in sub-Saharan Africa have experienced strong revenue growth from the petroleum industry. In most cases, however, this new wealth has not contributed to the economic development but has been used, as we mentioned, for the enrichment of the leaders of these countries as well the associated elite.

Cameroon is a case in point. Not all of the oil revenue gets into the state budget. And according to the IMF, the state oil company, the SNH, finance extra budgetary spending. EITI audit data and analysis by the IMF highlights a difference of about $286 million in reported oil revenues from 2001 to 2004. The IMF and the World Bank have confirmed that such discrepancies never pass through the treasury into the budget. Money is distributed directly from the SNH, the state oil company, without any legislative control, to serve unclear priorities. In Cameroon and throughout the region, transparency is being hindered on account of contract opacity. Confidentiality clauses are seriously hampering the ability of the Church and of civil society in their desire to hold governments to account.

Rampant corruption and poverty is leading increasingly to conflicts in the region which threaten the oil supplies that everyone needs. This means that the proper management of public affairs is in everyone's interest.

Clearly, revenue disclosure and accountability in resource-rich West and Central Africa still has some road to travel. The Catholic Church and its allies in the region stand ready to use information that is disclosed to foster government accountability. We have already been able to make some progress as the Church in the region. In Congo-Brazzaville, members of the Catholic Church's Justice and Peace Commission are leading the charge on revenue and contract transparency, and some information and contracts have been disclosed. At the same time, Brice Mackosso, a lay member of the Commission, and a human rights activist, Christian Mounzeo, were detained for months last year and falsely convicted of a crime for their activism on the issue.

In order to complete the transparency agenda, we recommend that governments, oil and mining companies, and international financial institutions:

One, opt for a mandatory rather than voluntary approach to transparency;

Two, implement disaggregated—that is company-by-company reporting of revenues paid to governments;

Three, ensure that all extractive industry revenues are part of national budges;

Four, abolish confidentiality clauses in contracts;

Five, publish information on the extractive industries on a regular basis; and

Six, investigate questionable bank accounts belonging to third world dictators.

Thank you for you kind attention, and I'll be happy to answer any questions.

[The prepared statement of Father Lafon can be found on page 58 of the appendix.]

The CHAIRMAN. Thank you, Father. Next, we are going to hear from Mr. Paul Mitchell, the president of the International Council on Mining and Metals.

Mr. Mitchell, thank you.

STATEMENT OF PAUL MITCHELL, PRESIDENT, INTERNATIONAL COUNCIL ON MINING AND METALS

Mr. MITCHELL. Thank you, Mr. Chairman, and committee members for the opportunity to talk to you today on this very important topic. I should say two things in the opening: First, I represent the mining industry and not the oil and gas industry, so if you could make that distinction, please. But second, while being an international body, we also represent a number of important U.S.-based corporations: Alcoa, Freeport, McMoRan, and Newmont amongst them, as well as the National Mining Association.

I want to cover in my remarks three topics if I could, please. First is to give you an overview of the socioeconomic performance of mining-dependent economies. Second, to cover what the key influencing factors are that influence the different outcomes. And

third, to give you some points on actions that we believe would encourage more positive outcomes in a broader range of countries.

In terms of the performance of mining economies, I am referring to some work that the International Council on Mining and Metals commenced: a research project that we commenced in 2004 with the World Bank and the U.N. Commission on Trade and Development, to better understand the socioeconomic performance of mining-dependent economies.

The purpose was to identify the more successful economies, so that policy lessons could be defined and, as I say, adopted more broadly. We identified, globally, 33 mineral-dependent economies. The chief criterion was that 20 percent or more of merchandise exports over a period of 38 years, up to 2003, were composed of minerals and ores.

We then assessed the performance of those 33 economies using six variables, and compared the respective countries to their global income group and their region. So, for instance, Chile was compared to all upper-middle economies, and the Latin American region.

The six factors that we used covered economic growth, non-mineral gross domestic product growth—to assess the diversification of the economy, and four socioeconomic factors. Now, the most striking finding from that research was that the performance of these mineral-dependent economies was very, very mixed. Forty-five percent of them had done relatively well, but the remainder—a slight majority, right around 55 percent, had performed relatively weakly. The better performers included Chile, Botswana, and Malaysia, while the poorer performers included countries such as Bolivia, Liberia, and Papua New Guinea.

I have outlined completely in my testimony, in table one, the respective performance in each of the 33 countries. It is important to recognize that at that time, unlike the present time—the period that we looked at, 1980 to 2003—was a period of generally very low mineral prices. It presents a different perspective.

The key messages that come from this are that we believe, obviously, that there is plenty of room for improvement in the socioeconomic performance of resource-dependent economies, but the key variable is the quality of national governance. It is fundamentally important—it, not resource-dependency, is the greatest influence on socioeconomic outcomes of the countries concerned.

So, then moving on to the second: what are the key success factors? The key single success factor is host countries' commitment to economic and institutional reform. Successful countries have progressively built adequate institutional policy frameworks, generally over a period of some decades, which have coincided with an increase in mineral investment in the countries concerned.

An appropriate governance framework has three components: policies to encourage resource investment, and here a sound macroeconomic and legal framework is of fundamental importance. Secondly, policies to encourage social cohesion and investment security, and here we agree with my colleagues that resource transparency and the extractive industry's transparency initiative are both important and positive steps.

And then, generally, other policies to encourage effective and equitable use of increased economic activity. The final aspect is policies to foster effective use of resource revenues, which can be summarized, as a clear understanding of the priority development needs in countries and effective, coordinated and accountable use of development funds.

So, what is the way forward? The modern world has changed dramatically in recent years, and there are a number of changes that are particularly relevant to reform. Developing countries are now much more important than they have been historically. They make up more of both 50 percent of metal production and the sources of minerals production from mines. The sources of investment has diversified substantially; major mining companies are now domiciled in China, India, Russia, Chile, and Kazakhstan amongst other developing countries, as well as traditional sources of investment, such as the United States.

Demand has grown very, very rapidly in a context of constrained supply, and thus now there is a scramble for resources and host countries are able to choose their investment partner, whereas historically, they fought to attract any investment interest at all. This is a very challenging environment in which to foster governance reforms.

Most research shows that reform is likely, under conditions of economic need, as distinct from the buoyant economic conditions that we are currently experiencing. Nevertheless, there is leverage because the public good and the good of corporations are generally served by positive economic outcomes in resource-dependent economies. The challenge is how to bring about reform. Here, the key leverage point is national governments in host countries. They decide who gets access to resources, and under what conditions.

Those governments, those host governments, need support from two important groups: international agencies to develop capacity, and civil society to ensure accountability. In regard to the former, the World Bank has a crucial role. It is the development agency with the greatest experience in developing countries' mineral governance capacity. Therefore, we believe that it must be strongly encouraged to participate in the resources sector, because that sector is the only significant source of private investment in the world's poorest countries.

In other words, all other major economic sectors ignore poor countries. So, the Bank's participation is essential, if it is to fulfill its poverty alleviation mandate. It is of great concern to us that many of the banks' country offices are shying away from participation in the extractive industries at the moment, because of political and other challenges that face them. Our final problem is that companies also have an important role.

Their role is to make the case for good practice by demonstrating superior outcomes on the ground, and I am pleased to say that an example is the International Council on Mining and Minerals, which commits member companies to public disclosure of their performance in accordance with the global reporting initiative, and independent verification of that reporting. This is a significant step in improving public accountability and public trust.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Mitchell can be found on page 62 of the appendix.]

The CHAIRMAN. Thank you, Mr. Mitchell. Finally you volunteered, Mr. Baker, and then we will have to go vote again. After the vote, we will come back and begin the questioning.

David Baker is the vice president for environment and social responsibility for the Newmont Mining Corporation.

Mr. Baker, please go ahead.

STATEMENT OF DAVID BAKER, VICE PRESIDENT FOR ENVIRONMENT AND SOCIAL RESPONSIBILITY, NEWMONT MINING CORPORATION

Mr. BAKER. Thank you, Mr. Chairman, and members of the committee. The Newmont Mining Corporation is a U.S.-based corporation with its headquarters in Denver, Colorado. We are the second largest gold producer in the world. We operate on five continents. We have operations in Ghana, in Peru, in Indonesia, in Australia, in New Zealand, and of course, in the United States. I am going to talk briefly about our experience with the Extractive Industries' Transparency Initiative.

Established in 2003, the EITI, or the Extractive Industry Transparency Initiative supports improved governance in resource-rich countries through the verification and full publication of company payments and government revenues from oil, gas, and mining. The initiative works to build a multi-stakeholder partnership in developing countries, in order to increase the accountability of governments. The activities of the EITI are premised on good governance being a pre-condition for converting large revenues form the extractive industries into economic growth and poverty reduction. When transparency and accountability are weak, the extractive industries may instead contribute to poverty, corruption, and conflict.

As a founding participant, and a proud founding participant of the "Publish What You Pay" campaign, Newmont became a founding member of the Extractive Industry Transparency Initiative, along with Ghana in 2003. Prior to 2003, in Indonesia, Newmont had been publishing its payments to government through press releases in the local media. This was driven by the perception in the local communities that the company was not paying its royalties and taxes.

The company continues to put out regular media releases stating what it has paid to the government. Public notification of tax and royalty payments to the government, using media releases, community newsletters, or Web sites is also a regular practice by Newmont in Peru and Bolivia. The practice of issuing media releases stating taxes and royalty payments to the governments was adopted by Newmont in Ghana in 2006, when our Ahafo mine went into production. We put out media releases in Ghana right now, on a quarterly basis. In addition, the investment agreement between the government in Ghana and Newmont is a public document, and this is so that any taxation arrangements that have been made between the company and the government are made available to the public.

So, why does Newmont choose to do this? Well, aside from giving the company an opportunity to explain what we do and why we do

it, and the amount of money that we do provide to the government, it has also provided an opportunity to support and encourage citizens to exercise their democratic rights and question the government's use of this money in these taxes and royalties.

Aside from having published payments to Ghana, Newmont has been working with the government in Ghana and other mining companies to establish a local process of tracking and reporting the extractive sectors' payments to government, and the disbursements of these funds from the government. This has included several joint meetings between the Ghanaian ministers and the Ghanaian chamber of mines. The challenges that the Ghanaian government and the industry face are reflected in many countries around the world, in particular, mining communities often complain that there is mining happening in their "backyards," but don't feel they gain any substantive benefits from the mining company's presence. Newmont is also a member of the International Council on Mining and Metals, and Newmont has been involved in the development of the comprehensive understanding of this issue, that information and results of the work that Mr. Mitchell just provided.

The question is how can the mining industry contribute to the reduction of poverty? This initiative found, and I think it is very, very important to make sure that we focus on this—that the poorest country's mining can be an opportunity for an early stage, or to jump start or catalyze the development that other industries do not offer. Mining is often the only industry that will actually go into some of these countries, and it provides a unique opportunity because of that.

And this is particularly true of gold mining, as it often requires relatively little in terms of physical infrastructure, and does not require a domestic market as the gold is mostly exported. But the most important finding of the study that Mr. Mitchell just talked about, from a mining perspective, is that the industry cannot achieve this by working alone. The key is to strengthen the focus on managing and utilizing the generated government revenues transparently and effectively at the national, regional and local levels, to achieve the full economic and social development potential of the resource development.

Significant effort is required to strengthen economic management, governance and sound and participant institutions at the local and regional levels. Newmont is committed to continue to work with Ghanaian, and other governments, in instituting and implementing the Extractive Industry Transparency Initiative, and to encourage other governments to participate in the EITI.

Thank you very much.

The CHAIRMAN. We will reconvene—I think we will have at least an hour or so before a motion can again be made to adjourn. So, let's wait for Professor Karl. Why, thank you all. There are a couple of levels here. There are policies that people would like to see implemented at the World Bank. Let me set those aside.

Let me ask our first three witnesses; I have asked the other two to comment: What specific policy changes would you like to see the U.S. Government adopt? Professor Karl?

Ms. KARL. Well, I think I ended my testimony by saying that I actually think that there needs to be mandatory policies based on disclosure, and that we really need to know—

The CHAIRMAN. And who should disclose what?

Ms. KARL. Companies need to disclose what they are paying governments.

The CHAIRMAN. Okay, let me stick with that one.

Ms. KARL. The reason for that—

The CHAIRMAN. I don't want to know the reasons. I want to know what the policies are. Some of us are persuaded by the reasons. What other specific policies would you recommend? Is that the only one? It is a big one, I don't mean—

Ms. KARL. No, that is not the only one.

The CHAIRMAN. Well, what else?

Ms. KARL. There are other policies that are really important. I think the United States should use its leverage in international financial—

The CHAIRMAN. Separate from that, though. Let me make the distinction. There are things we would like other people to do. At this point, we are a legislating committee. I want to begin with what I can pass out of this committee, and make people do it. We will get to our using our influence. We can mandate—it is debatable whether we should or shouldn't—greater disclosure. Are there other policy changes, wholly within the control of the U.S. Government, that you would recommend? Then I will get to the international influence issues.

Ms. KARL. I think that we also should have a policy that the types of environmental and rights protections that we practice in the United States, should be practiced abroad.

The CHAIRMAN. That we should require our—

Ms. KARL. We should require that. I think that is particularly important right now in the case of Burma.

The CHAIRMAN. Okay, let me move on. We have a limited amount of time. Mr. Gary, do you agree or disagree? Would you like to add that?

Mr. GARY. Well, I would agree with those, and I would add that one important change that could be made is that the United States could require companies who want to be listed on the stock exchanges—

The CHAIRMAN. That is very important.

Mr. GARY. Or register in the United States, to disclose—

The CHAIRMAN. Okay, that is very important, because we anticipate that one of the legitimate objections would be, "If you do this unilaterally, you put others at a disadvantage." So that occurred to me, yes. We do have the ability to impose requirements on companies that are not American companies, but wish to do business in America. I would add that. Any others?

Mr. GARY. Well, in addition to that, I think that there are ways that we could promote what we call "a cocktail," or "a big push," as Professor Karl described, requiring our own export credit agencies, such as the Overseas Private Investment Corporation and the Export-Import Bank, to have the same disclosure requirement that the International Finance Corporation has.

The CHAIRMAN. Okay, fundamental policy changes. I understand there are difficulties as to how you do it, and how you don't put our people at a disadvantage, and if we are the only ones who do it, then we may not accomplish much if our people just get pushed out of the way. So disclosure is the posting of what these companies are paying to the government, and also adopting appropriate environmental policies. Is there anything else in disclosure?

Mr. GARY. Well, I think from our point of view, the main elements of disclosure are regarding the financial flows that go to the governments—

The CHAIRMAN. Okay, money to the government—

Mr. GARY. Also, environmental impact information, social impact information is also valuable.

The CHAIRMAN. We have to be specific. What are we requiring? Social impact information? But clearly, you would like to see a binding requirement, as much as we could extend it on the disclosure of financial flows.

Mr. GARY. I think that is the most important thing.

The CHAIRMAN. Father, any further—

Father LAFON. Yes, I don't know if this is relevant here, but I ended my testimony by making an allusion to questionable bank accounts. Every time we have raised this question—

The CHAIRMAN. In the United States, you mean?

Father LAFON. Yes, in the United States. Every time we have raised this question in Europe, the answer has been, "We have all kinds of laws that—

The CHAIRMAN. So, that would be some amendment—

Father LAFON. I don't think people should be allowed to take huge sums of money from their countries, and come and bank them here. The countries are suffering. If—

The CHAIRMAN. Well, these are connected, because you have to run your sources. But that is a reasonable thing for us to look at too, it to try and better track the money. Let me now ask Mr. Mitchell and Mr. Baker. How would you respond in terms of those efforts?

Mr. MITCHELL. Mr. Chairman, the U.S. Government is already actively involved in the Extractive Industry Transparency Initiative. We think that is a good thing. Personally, we think that it would not make a lot of difference for that level of support to have legislative force.

The CHAIRMAN. Would it do any harm?

Mr. MITCHELL. Well, it could. I will get to that if I could. The principle reason is because, as I tried to outline, to achieve positive outcomes requires concentration on a broader range of factors than just revenue transparency. Mr. Gary has mentioned a couple. Frankly, I am not sure that they are the ones that our research has found vehemently important by the characteristic aspects of economic and legal reform. They are difficult processes that most countries have required decades to achieve.

The CHAIRMAN. I understand that, but there are also limits on what—

Mr. MITCHELL. There are—

The CHAIRMAN. Mr. Mitchell, I am sorry, but we only have 5 minutes.

Mr. MITCHELL. Okay, well—

The CHAIRMAN. No, Mr. Mitchell, the rules are, I have to be able to direct you to the subject I want to talk about, and I don't want—

Mr. MITCHELL. The potential negative, if I could say this—

The CHAIRMAN. Mr. Mitchell, repetition of your testimony won't be helpful. I am trying to go beyond it. Now the question is, what can our government directly do, as internal improvements in other countries are harder for us to do? What harm would come from what they are proposing?

Mr. MITCHELL. I would like to answer that. The range of sources of investment for the extractive industries has diversified greatly in recent years. Some of those sources of investment, some of those countries do not care about good economic outcomes in host countries, or revenue transparency, or human rights, or good environmental outcomes—or any of those things that the U.S. Government thinks is important. So, therefore, placing additional impediments on U.S.-based countries could disadvantage—

The CHAIRMAN. Okay, that is what I thought. So—

Mr. MITCHELL. That would not only harm U.S.-based countries—

The CHAIRMAN. Right.

Mr. MITCHELL. But it would harm the host—

The CHAIRMAN. Okay, so here is the question.

Mr. MITCHELL. Yes.

The CHAIRMAN. What we would then think about doing—I don't know if we would be successful, but that efforts to require complete disclosure should be part of an effort to have this down in a multinational basis, and that would include the American Government, as suggested by Mr. Gary—people want to list on the stock exchange, or others. If we were able to do a multi-national "push" to get more disclosure, would that be harmful?

Mr. MITCHELL. That would certainly be beneficial.

The CHAIRMAN. Thank you. Mr. Baker, anything to add to this?

Mr. BAKER. I don't have much in addition, but I just simply say that you have to be very cautious. I think the intent of the EITI is to actually get countries to publish, and to recognize those expenditures—

The CHAIRMAN. The recipient countries—

Mr. BAKER. The recipient countries, not just the companies. I think an unintended consequence could be that the initiation of some of this reformation, which is done right now on a voluntary basis through the EITI and "Publish What You Pay," may not have an opportunity to actually initiate that in some country.

The CHAIRMAN. I don't understand, if they want to volunteer to do it, then—

Mr. BAKER. Well, there could be countries that, because if it was mandated for a company to report, countries could simply say, "We are not going to have you do business in our country."

The CHAIRMAN. I understand that. That just gets back to the multi-national aspect, and I think that is fair. I do have to say that I see a conceptual difference between legally requiring the people who are paying the money to say that they are paying it, as opposed to having the recipients voluntarily announce that they are receiving it.

The incentive voluntarily to announce you are receiving money from—that someone may think you shouldn't have received isn't overpowering. But I do agree, and I think that we will have to balance this, but clearly, there is going to be some effort, multi-nationally. Let me give myself another 30 seconds to pose a question and ask you in writing. If we are going to do it multi-nationally, who do we need? Is it Europe, is it Japan, is it China which would be more discouraging? I would be interested if you would follow up in writing, if we're going to do this multi-national effort—Professor, you wanted to say something?

Ms. KARL. Well, I think that there is a great deal of support in Europe, and particularly in the European parliament, and other places, for mandatory disclosures in Europe as well, and I think we should lead in that effort, but I know that they would support it—

The CHAIRMAN. I understand that you do. Please, let us not say things that we don't know. The question is not who is willing. If the U.S. and the E.U. would be together to do it, do we have to worry about China? Is there other major—

Mr. KARL. That would be sufficient in—

The CHAIRMAN. You think the United States—

Ms. KARL. Yes, because China is registered in either the London Stock Exchange or—

The CHAIRMAN. Oh, so the U.S. and the E.U.—

Ms. KARL. Yes, so is Petrobrass, so are the larger foreign firms—

The CHAIRMAN. If we were to require this of companies who were both U.S. or E.U. domiciled, but also companies that wanted substantially to be able to do business here, would that resolve it?

The gentleman from Louisiana is recognized.

Mr. BAKER OF LOUISIANA. Thank you, Mr. Chairman. Looking at the scope of the recommendations, where the government entity is natural resources dependent, where significant economic accomplishment is achieved by extraction or exportation of mineral resources and where infrastructure needs are deficient in light of current social environment; my first observation is that it must be talking about Louisiana, and it would be helpful to have some of these transparency provisions made applicable to us. On a more important note, in achieving the disclosure—which I understand is desirable in ferreting out inappropriate conduct—it is not going to be successful having a unilateral declaration on U.S. interests only.

It is very clear to me that the recipients of this generosity are not likely to want to disclose—even from their own host state, or country, or political environment, for it to be made known that you are the recipient of millions of dollars of foreign assistance—to the detriment of your own constituents. It is not a helpful thing. So, I think all of the prejudices that exist toward reform can only be achieved if we do this through international exchange cooperation. The chairman indicated the New York/London marriage as an example. I think it must be broader in scope. NASDAQ is taking to Dubai, NYSE is with Euronext, the Hong Kong Exchange, at least in China.

There needs to be, I think, a high-level exchange leadership led effort to bring about this level of discussion, which shortcuts—not to the purpose of this hearing or this report, but to national accounting convergence. I think there are grand opportunities for

that to occur. Mr. Mitchell, would you care to respond to the suggestion started by the chair that I have amplified on? If the goal is to really make people sit up and fly right, isn't universal disclosure requirements coming at the listed exchange level—for the principal major exchanges of the world, a beneficial way to approach this?

Mr. MITCHELL. Thank you for the opportunity to respond. The answer is definitely, yes. There is no doubt that credit transparency and revenue flows, and a number of other aspects, would be beneficial in terms of public trust accountability and positive outcomes. If it were possible to get broad participation of the many sources of capital that you have mentioned, that would be a good thing as well. But the other thing that we need to all be mindful of is that many of these extractive industries, particularly in the oil and gas sector, or start-out enterprises, do not rely on the private capital markets for access to funds. That is also the case in the mining industry, in particular in relation to the Chinese interests, many of which are state-owned or state-financed. So, they would not be captured, and they need to be to make this thing workable.

Mr. BAKER OF LOUISIANA. How would you remedy that?

Mr. MITCHELL. It is with great difficulty. It needs to become an international norm, in terms of the way that business is done. The key leverage point is national governments, is the host governments—

Mr. BAKER OF LOUISIANA. Let me interrupt if I may. Would not the effect of listed corporations on a multi-national exchange list have a direct and adverse consequence, even to those who are self-funded in a state-owned venture? At some point, they are going to have to ask the international capital markets for equipment purchases, for expansion, for pipelines—for whatever the resource might be. We may not get them up front, but at some point along this capital process, they will intersect us and have to disclose. It might not be as immediate as the effect on the exchange.

Mr. MITCHELL. As I said, I think it would be beneficial, but it would not capture all sources, because—

Mr. BAKER OF LOUISIANA. Let me jump to one more point before my time expires. My question is regarding a suggestion I have not seen, but understand is being discussed, concerning contract disclosure. I am very concerned that if we go beyond the trail of cash, into the proprietary information of a contractual performance obligation, it would be extraordinarily detrimental to all business interests concerned. I am concerned because that would likely lead to the exclusion of high technology from the communities most in need of that type of assistance, and you would wind up getting something less than the world's best technology being deployed in your country, if you get it at all.

Mr. MITCHELL. I agree with you that propriety contracts are in a different category and should be treated as such, and there are things that are business intellectual property matters, and that should be rightly protected.

Mr. BAKER OF LOUISIANA. Mr. Chairman, I have a unanimous consent request for a statement by the International Council on

Mining and Metals, and a World Bank support group analysis to be included as part of the record.

The CHAIRMAN. Without objection.

Mr. BAKER OF LOUISIANA. Thank you.

The CHAIRMAN. The gentlewoman from California is recognized.

Ms. WATERS. Thank you very much, Mr. Chairman. I'd like to thank you for holding this hearing. I'd like to thank all of the participants in initiating this effort. I see a whole list of organizations here who are involved in this transparency initiative.

And I'm very grateful for it, because for years I have been terribly frustrated with the plight of Africa and the fact that the continent is so incredibly rich in resources and so incredibly poor.

I have struggled through the civil wars of Angola where monies have been drained off in those wars—very rich country with diamonds, gold, and oil. I have served through the problems of Nigeria and, you're right, with Mr. Abacha's money being deposited here in American banks. And it goes on and on and on. At one time, I thought that what we needed was to develop expert teams that would make themselves available to the government to help negotiate the mining contracts and arrangements, and, also, have teams that would help to develop systems and support government in developing ways by which to manage the profits from the mining efforts.

Well, you know, it sounds good. But it is just so very complicated and there are so many reasons why the inhabitants of these countries are not the beneficiaries of the vast resources of those countries, and, it does not simply lie with the fault of those who go there to mine. Yes, many of the mining operations do exploit, but it's not simply them, It's not simply the government that may be corrupt. It's just a combination of very complicated reasons why we have such riches in so many countries and the people are so poor. And it's very, very frustrating.

So when my staff brought this to me, the transparency of extractive industries, high stakes for resource risk countries, citizens in international business, I was excited just to see something, anything, anything that would get us engaged in this discussion. So I will support any effort for disclosure. I will support any effort to get rid of the corruption. I will support any effort to try and find ways by which we can assist these governments in putting together the necessary systems to realize the benefits of those profits.

So all I can say is thank you for being here and for initiating this possibility. Already I can see that my chairman is excited about the possibility of doing something with this. Since he has been the chairman, he has already developed good relationships with the European parliament. He has traveled there and he has an opportunity to talk with them about it. And, of course, if I can see anything done before I retire in this business, I will be eternally grateful to all of you.

Thank you very much.

The CHAIRMAN. I thank the gentlewoman.

We will be back. I apologize, but I do think when we come back again, the way it works, we'll be able to finish the questioning. So, you'll have to give us another 15 minutes or so, and then we have our three members here. So you should be able to be done then and

this is very important to us. It i's having a real impact, so we thank you for your patience.

[Recess]

The CHAIRMAN. I apologize. Presumably we'll wait for Mr. Mitchell, and we will be able to finish at this point.

Thank you. The gentleman from Texas is recognized.

Mr. GREEN. Thank you, Mr. Chairman. And I would like to extend my apologizes to the witnesses. I know you question how we can possibly get anything done in this environment, but believe it or not, we managed to do some things, and there are some folks who think that we do to much. So we have to balance it out, I suppose.

I thank you again for being here. I am going to ask Mr. Baker and Mr. Mitchell to please address this concern because I appreciate the position you have of not wanting to see us go too far. The question becomes what would you recommend that we do, and I'd like you to start with the IMF/World Bank, IFC, if you have comments on those.

What would we do to help to end some of this corruption?

I made a note that opacity enables cupidity, and cupidity engenders corruption. So it's the opacity that is the genesis of this.

What would you do to help us achieve the transparency that would end some of the cupidity that breeds the corruption?

What would you recommend we do?

Mr. MITCHELL. Thank you for the question.

The other important source of leverage or point of leverage in all of this apart from the stock exchanges around the world is national governments in host countries. The United States has a lot of influence there and can condition it to aid programs. It's development assistance and things of that nature contingent upon host countries adopting appropriate behavior. So that's an important point that the United States itself can do.

But the second point is that the World Bank, in particular, in our view must be strongly encouraged to participate in government strengthening programs in resource-dependent economies. They are the major sources of investment in poor countries. It is absolutely viable in terms of the bank's poverty-reduction mandate that the bank be actively engaged in government strengthening in those countries.

Mr. GREEN. Would you recommend that the World Bank require the transparency process?

Mr. MITCHELL. The World Bank does do that for the IFC's own investments, currently. But I agree with Mr. Gary.

Mr. GREEN. Well, my notes indicate that they do it occasionally, not consistently.

Mr. MITCHELL. It's a policy that is meant to be applied universally, but he is correct that the manner in which it is done is not transparent in itself.

Mr. GREEN. Would you encourage us to encourage the World Bank to develop the consistency that you seem to connote would be important?

Mr. MITCHELL. Yes. I would encourage the Bank to do that in terms of return investments, encourage the Bank to be strongly—

Mr. GREEN. Let me do this, because we're going to have another vote. I want my colleague to have an opportunity to ask his questions so that we don't continue to hold you over. So let me go to Mr. Baker.

Mr. Baker, your comments please in terms of the World Bank, IFC and the IMF.

Mr. BAKER. Well, I appreciate the opportunity, but I think Mr. Mitchell has really articulated quite well some of the things that could be done. I don't believe I can add anything material to that, but thank you.

Mr. GREEN. Well, you are a business person and I assume you find it repugnant to know that there are business people who are engaging in processes that end up corrupting governments.

Is that a fair statement?

Mr. BAKER. That's an absolutely fair statement, yes.

Mr. GREEN. Okay, then tell me, as a business person, how would you have us address the businesses? The chairman mentioned in "a universal fashion" and I think he covered it quite well. But how would you have us address businesses such that there is a consequence for engaging in these practices in these foreign countries, maybe in our own country as well. I can see some room for improvement here. But tell me how would you as a business person want us to do it, such that we don't impede the flow of commerce, such that we don't create economic upheaval, but we do accomplish our goal.

Mr. BAKER. Well, that's a good question. I appreciate that. I think that one of the things that's important is the whole consequence you talked about of accountability and in making these companies accountable, because there are organizations that we see around the world that don't operate to the same level. And I think that one of the things that may be of benefit is to have a reward, possibly, for behaviors that are appropriate as opposed to punishment for behaviors that are inappropriate.

Mr. GREEN. So, some sort of tax incentive, if you are doing the right thing then we'll give you a tax break. Is that an example, or would you want to give me a better example?

Mr. BAKER. No, I suppose that could be an example. I don't have any other really specific examples other than that I'm sure there are a number of ways that there could be some sort of reward or recognition of that. I suppose a tax could be one of those or some sort of tax modification. I know that would probably not be very popular, overall, but it's just one of the options.

Mr. GREEN. Thank you. My time has expired.

Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. Thank you. We have to go out for a time. The gentleman from Missouri.

Mr. CLEAVER. Thank you, Mr. Chairman.

The fact that some of the richest nations on earth are the poorest has always troubled me, but even if we are able to get greater transparency of extractive industries, my concern is in Tanzania, for example, where my family is; they live in and around Arusha.

The truth of the matter is, even if there is transparency, there are very few computers, very few televisions, very few telephones, and even though it's not resource rich as is Kenya, for example,

there are extractive industries there. And so, my concern is how can we, Mr. Gary, go into third world countries where technology is third world and get information out to the public, whereby they can make intelligent decisions on whether or not they support their government and whether or not they are being ripped off, which I believe they are in many, many ways.

Mr. GARY. Thank you for the question.

I think a key point to make is that just disclosing information in an incomprehensible and difficult to access manner is not going to achieve what we want. In some of these countries like Tanzania and other countries around the world, we are looking at ways to use radio and other popular communications.

Father Lafon is here representing the Catholic Church. They had a statement on corruption read in every parish in Cameroon. Traditional ways of getting out the information and using those traditional structures, like the churches, is one of the key ways to do this. And that's why I mentioned the importance of an independent media. In countries that are closed, like Equatorial Guinea, just disclosing information will have no discernable effect, because there are no independent journalists. The church is harassed, etc.

But, in countries like Ghana, Nigeria, and Tanzania, where you have a vibrant press and you have local radio in local languages, that kind of information can get out and we would encourage institutions like the companies as well as the international financial institutions when they do disclose to disclose it in a way that's comprehensible in local languages.

Mr. CLEAVER. Father Lafon, do you believe that there is a way, including what Mr. Gary has said, to get information to people in a place. Cameroon is far more advanced, technologically. People in the United States, Tanzania people there, call it Tanzania, but they get information to people. I mean, it would be infinitely easier in Cameroon than it is in Arusha or even Dar es Salaam.

Father LAFON. Yes, thanks a lot. I'll just add one thing to what Mr. Gary has said.

We as a church, as he said, we use our parishes to pass on information. We have in our church at the national level a national justice and peace commission dealing with these issues: oil; the democratization process; and so on. And these have offices also in dioceses all over the country. And through this means, we pass on information. And I believe these exist in other countries as well.

As you mentioned, we have relatively free press in Cameroon. There is certainly a vibrant, independent press in terms of numerous newspapers which we use. In other countries where there is not possible, I guess they would have to start somewhere by using the churches, which is what we do in Cameroon in addition to the papers. But certainly it's necessary to get the information one way or the other out to the people.

Mr. CLEAVER. One final question: Do any of you consider flowers as an extractive industry? Or just minerals?

Ms. KARL. Yes, extractive industries by their definition are nonrenewable. And the reason we're focusing on extractive industries, I believe, is that once you spend the capital from oil, gas, or mining, it is gone. It can never come back and you've lost that opportunity to move into some poverty alleviation and development.

With flowers, with coffee, with other things, you can replant. You have an ability to recreate that particular industry, so the argument is not that the only poor countries are extractive countries. That's not the argument at all. We all know that Haiti is the poorest country in the Americas and that there are no extractive industries there. But the argument is that these resources are gone, once they're used, and the development opportunity that they represent is gone, so that we need to focus much more on making sure that that development opportunity is used to alleviate poverty.

Mr. CLEAVER. I don't want to digress or take the hearing past where it's supposed to be.

One of the things I would ask you to consider, because you are the intelligentsia on this issue, Professor, I think I agree with you for the most part, except that in some places in Africa, in Africa in particular, but it's also South and Central America, the flowers that we use in hotels every day that are grown in those countries use water, which is not renewable.

As we are seeing in the United States, a crisis has developed. And I would suggest that a crisis is developing in Africa the same way. And so while you can plant flowers, it's difficult to sweet talk them into growing without water. And so it is not as renewable as it might sound. That's just a pet peeve of mine, because I've seen water in Africa shooting out of water hoses to water plants for people in the Western world, and the people there are walking miles, women are walking miles to get water to cook with, so that they can eat.

Thank you, Mr. Chairman.

Father LAFON. Sorry, just to add, one of the reasons that we focus also on the extractive industries is their capacity to generate quick money, and a lot of money, as well as because of that their capacity to generate conflict, civil wars in our countries.

Mr. CLEAVER. Pardon my digression.

The CHAIRMAN. The gentlewoman from Wisconsin.

Ms. MOORE OF WISCONSIN. Thank you, Mr. Chairman.

The CHAIRMAN. Let me note that the gentlewoman has been designated as our representative from this committee to a panel of members here who work with Paul Menteri for the World Bank, so she's particularly well-suited to be in that liaison position.

Go ahead.

Ms. MOORE OF WISCONSIN. Thank you for that, Mr. Chairman.

I am very interested and we've talked interested and we've talked a great deal about the role of transparency in terms of ameliorating the problems with these extractive industries. But I am wondering what role does transparency have, notwithstanding corruption and all the other problems, in ameliorating the so-called Dutch disease?

These countries, even if there were transparency, even if there were proclamations about how much the governments are going to pay, even if there were not corruptions, even if they do or don't rely on the capital markets, the volatility of these minerals is such that the countries could still be poor. And so just sort of following in the vein of the chairman's questions, what specifically can we do? And I'm going to direct my questions first to Mr. Mitchell.

What can we do specifically with the host countries to ensure that their oil industry doesn't crowd out other development?

Mr. MITCHELL. Thank you. The question I think in short the answer is—and my colleagues may disagree with me, I'll say that—but I don't believe the transparency of revenue flows has a significant role in controlling the Dutch disease. The Dutch disease is primarily the appreciation of exchange rates, which makes other tradable activities in the economy uncompetitive. This is a good illustration, though, of the fact that the reform process is much broader than transparency.

Ms. MOORE OF WISCONSIN. Okay, so what can we do?

Mr. MITCHELL. You need to encourage sound macro-economic management in the countries concerned.

Ms. MOORE OF WISCONSIN. Okay, now I'm going to give an example, Mr. Mitchell, of the Democratic Republic of Congo, the mining contract review process. Using that as an example, because I know that you know something about that, Freeport Marin is the parent company of Phelps Dodge, who has an ownership interest in the Timki mine. It is proceeding with operations, securing international financing, and the underlying contract is not providing a share of the profits to the Congolese people. I guess I'll let you respond. I won't make my judgment.

Using that as an example, how could the Congolese government execute a contract with them to avoid the Dutch disease?

Mr. MITCHELL. They couldn't. At a contract specific level, you need a much broader approach to a macroeconomic management at a contract-specific level. But in response to that specific issue, the company should be paying a fair tax rate, that tax payment to the government should be disclosed. But most importantly the government should be using that money productively to address priority development needs within the country.

And whether or not there is a "profit-sharing element" to the contract may be irrelevant, provided that the taxation is fair and internationally competitive. It is being paid, and as I said, importantly, it is being well used by the government agencies involved. Again, this is a good example. Many countries, taxes paid, taxes collected, but it is not well-used by the host governments. That's a key element as well.

Ms. MOORE OF WISCONSIN. Anybody else have any suggestion about what we can do with Wall Street and those folks that are registered on our stock exchange in terms of the volatility of these assets in stabilizing poor countries?

Professor Karl.

Ms. KARL. Yes, I think I see the Dutch disease and the volatility a bit differently than Mr. Mitchell. And that is that transparency is absolutely critical for good macro-economic management. If you don't have transparency, if you don't have budgetary transparency, you cannot manage a macro-economy. So that even though transparency won't deal with the exchange rate problem that he mentioned; and I do think that's correct, it will deal with a larger macro-economic issues.

The second thing I would say is that volatility, which I believe you have rightly pointed to as an absolutely essential issue here, volatility is being fueled by the lack of transparency.

Ms. MOORE OF WISCONSIN. Okay.

Ms. KARL. And this is very important, because these minerals and oil have always been more volatile, but what is happening in the recent period is that the volatility has exponentially increased. Because of the secrecy that surrounds these kinds of industries, and what that secrecy does is it makes it very difficult for market fundamentals to work for supply and demand to work. And it means that you get further and further away from market fundamentals.

The example I gave in my testimony was the rise in the price of oil last week to $90 a barrel. That is actually not a rise in price driven by market fundamentals. It is a rise in prices driven by speculation, forecasting that I believe is incorrect, a number of other things that are related to the quality of information. When information is poor, markets cannot function well. And when information is poor, you cannot manage a macro-economic environment, which is why I actually believe the transparency is the first step for a variety of these problems, even though it won't specifically address the currency reevaluation.

Ms. MOORE OF WISCONSIN. Thank you.

The CHAIRMAN. Let me follow up on that.

Professor, maybe I didn't fully understand on the transparency. I was thinking of it perhaps too narrowly in terms of the payments, but when you talk about transparency, are you talking about the volume of work? Obviously, for it to be affecting volatility, are they hiding the amount that they're digging? What are we talking about here?

Ms. KARL. Transparency in the industries is a problem across the board. So, for example, we have no idea what the real reserves are of OPEC countries. We don't know. We don't know what the reserves are really in Saudi Arabia. We don't know. My argument about transparency in terms of company payments is part of a larger concern I have with transparency in these industries in all kinds of ways.

The CHAIRMAN. I understand our right to say, tell me how much you're paying, because we're worried about potential bribery. But, you know, what's the basis on which we demand that proprietary entities tell us what their reserves are.

Ms. KARL. I don't think that is what I was suggesting. What I'm suggesting is that by starting with disclosure of payments, you are beginning to create a norm of transparency and rules and practices of transparency that I actually believe will spread.

The CHAIRMAN. But what incentive?

Ms. KARL. Where do they need to spread?

The CHAIRMAN. No. I don't see the lack of transparency that contributes to volatility. The volatility issue is the reserves? Or is it the level of activity? What is it that they're not transparent about?

Ms. KARL. The volatility and the price volatility means that any time you hear that there is a strike in Venezuela, or any time you hear that Turkey might invade north of Iraq which might interrupt a pipeline or supplies or something, then the price of oil flies up.

The CHAIRMAN. I understand that, but I don't see a connection, certainly no connection between getting people to tell how much they might be bribing somebody and that. So, to get deeper, you

would have to be talking about them disclosing what their reserves were. Well, there would be two levels: one, the reserves; and two, the level of actual activity. I mean, are they digging out more than they tell us or less than they tell us? I'm serious. Is that part of the problem?

Ms. KARL. Well, I think the payments would tell us those kinds of things. If we see what payments are going to companies and we know what the price of oil was and the transparency of the payments is disclosed in a particular way so that we know what we know what fields they come from, what time they came from, etc., then we will know more.

The CHAIRMAN. It may be though, because what we're assuming is at least to some extent now, the payments aren't just based on the actual price of oil, but there's some extra and some illegitimacy in those payments. But I still want to know, are you proposing that we require anything beyond the disclosure of the payments?

Ms. KARL. No.

The CHAIRMAN. Okay. I'm skeptical that we are going to get much in terms of volatility, but if it happens, it happens.

Do any members have any further questions? If not, I will tell you that this has been very useful and you are going to see much of what you said reflected as we go forward. We will continue to be in touch.

If anybody on the panel has any further thoughts they would like to contribute to us, please feel free to do so. And I think we will, after today, probably be constrained as we instruct these other countries as to how to do better. We will not instruct them on how to conduct their parliamentary procedures, based on today.

This hearing is adjourned.

[Whereupon, at 12:50 p.m., the hearing was adjourned.]

A P P E N D I X

October 25, 2007

House Committee on Financial Services
Opening Remarks
By Rep. Maxine Waters

Hearing: "Transparency of Extractive Industries: High Stakes for Resource-Rich Countries, Citizens and International Business"

Thursday, October 24, 2007
2128 Rayburn, 10:00AM

I would like to thank Chairman Barney Frank and Ranking Member Spencer Bachus for organizing this hearing on the impact of extractive industries on development in resource-rich developing countries.

The Resource Curse

Throughout my career, I have taken an active interest in foreign policy towards the countries and peoples of Africa. I have always noted with dismay that many African countries are desperately poor countries despite being rich in natural resources. The tendency for countries that are rich in oil, gas, and mineral resources to experience slower growth, higher levels of poverty, and more civil strife than countries that are not resource-rich has come to be known as the "resource curse."

Liberia is a good example. Liberia is endowed with a wealth of diamonds. These diamonds should have been a blessing for Liberia's impoverished people. Instead, they fueled a civil war that lasted fourteen years, took the lives of 270,000 Liberians, and displaced almost one million more. The civil war finally ended two years ago with the election of Liberian President Ellen Johnson Sirleaf, the first woman head of state in Africa.

I am hopeful that the restoration of democracy will lead to a brighter future for the people of Liberia. However, 75 percent of Liberia's population still lives on less than $1 per day, and Liberia owes $3.7 billion to foreign countries and multilateral financial institutions. It is not hard to understand why the Liberian people might think they have been cursed with diamonds.

Other resource-rich countries have also experienced poverty, authoritarian rule, and civil strife. The government of Sudan has exported billions of dollars worth of oil to China and purchased over $80 million in arms, ammunition, and aircraft equipment from China, while committing genocide against its own people. Angola is rich in oil, and Sierra Leone is rich in diamonds, and both are recovering from civil wars. South Africa is rich in gold, platinum, and coal, and it is recovering from decades of oppression under the brutal system of apartheid.

Of course, Africa is not the only part of the world where countries rich in resources have experienced poverty, dictatorship, and conflict. When President Bush embarked upon the Iraq War to remove the dictatorial regime of Saddam Hussein, we were told that Iraq could finance its own development because it possessed a wealth of oil. Yet, over four years later, Iraq is in a state of civil war. Meanwhile, 3,837 Americans have died while the United States continues to spend billions trying unsuccessfully to rebuild the country.

Causes of the Resource Curse

There are a number of possible causes of the resource curse. Some analysts claim that resource-rich countries would benefit from their resources if only their leaders did not steal the profits. Others argue that the problem is much deeper.

One theory is that resource extraction is capital-intensive. It requires a significant financial investment, but it does not create a comparable number of jobs. Consequently, the profits from resource development are not broadly shared. Agriculture and manufacturing, on the other hand, are labor-intensive. Therefore, the benefits of development in these sectors are shared by a much larger portion of the population.

Another theory is that the exportation of resources increases the value of the local currency. This, in turn, crowds out other industries and makes agricultural and manufactured products more expensive and less competitive compared with foreign products. This results in declines in income and job losses in agriculture and manufacturing, leaving the resource extraction industry to dominate the economy. This phenomenon is known as the "Dutch disease."

Yet another theory is that governments that benefit from resource revenues have no incentive to be responsive to their people. When governments are forced to tax the population to raise revenue, they are held accountable by the population for their use of public money. Even dictatorial governments risk revolt if they tax the population but do not provide public services in return. However, when a government can raise revenue without taxation, political leaders can enrich themselves without doing anything for the population.

Responses to the Resource Curse

One way to address the problem of the resource curse is through revenue transparency requirements. Oil, gas, and mining companies should be required to report all of the revenues they pay to resource-rich developing countries. Such reports should include all payments made to government agencies and national and local elites, including bribes and other payments to individual politicians. These reports should be made public, so they will be available to the local population. They should also be made public in the developed world, where the resources are purchased and consumed.

Revenue transparency would allow the people of resource-rich developing countries to hold their governments accountable for the use of public revenues, just as other populations hold their governments accountable for the use of public tax funds.

Unfortunately, requiring transparency is easier said than done. Countries experiencing the resource curse usually lack oversight capabilities. Meanwhile, oil, gas, and mining companies fall under the jurisdiction of several different regulatory systems, including the United States, the European Union, and China. However, if transparency requirements are effectively enforced, they could allow some countries to escape the resource curse.

Conclusion

I look forward to the testimony of the witnesses on the causes of the resource curse, as well as their suggestions for reforms to enable the people of resource-rich developing countries to benefit from their resources.

Testimony of Ian Gary, Oxfam America

**"Transparency of Extractive Industries:
High Stakes for Resource-Rich Countries, Citizens and International Business"**

House of Representatives Committee on Financial Services

October 25, 2007

Chairman Frank, Ranking Member Bachus and Members of the Committee: Thank you for this opportunity to testify on the issue of transparency in the oil, gas and mining industries in resource-rich countries. This is an issue that directly affects U.S. interests through energy security, as well as having a strong impact on economic development in poverty-stricken nations. I speak today representing Oxfam America, an international development and humanitarian relief organization that has been addressing the impact of the extractive industries in poor communities around the world for the last 10 years. Oxfam America is also a member of the global Publish What You Pay[1] coalition of over 300 organizations which, since 2002, has sought to highlight many of the problems Prof. Karl has mentioned and to bring about policy changes to end the secrecy that surrounds the extractive industries. While some progress has been achieved, much more remains to be done, including the development of mandatory disclosure rules for the extractive industries. Oxfam America believes Congress could have a significant role to play in this regard.

If you care about the poor, you should care about extractive industry transparency. Revenues from extractive industries are a significant source of government income for more than 50 developing countries, including many where Oxfam works.[2] These countries – such as Nigeria, Angola, Chad, Mali, Ghana, Peru, Ecuador and Azerbaijan – are home to roughly to approximately 3.5 billion people, 1.5 billion of whom live on less than $2 a day.

I have conducted research in many of these countries and have seen the stark contrasts between the rich minority and the impoverished majority. In southern Chad, for example, where Exxon and partners have invested over $4 billion in an oil export project, villages surrounding the project lack electricity, even though high-voltage lines feeding the oil installations go through their farmlands. Many villagers in southern Chad have lost land to the oil project and, at the same time, have seen little in the way of new social spending by the government using oil revenues.[3]

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[1] www.pwypusa.org

[2] The estimate of the number of resource-rich developing countries comes from the IMF's *Guide on Resource Revenue Transparency*, 2007, Appendix 1. Countries are considered resource rich if there is: (1) an average share of hydrocarbon and/or mineral fiscal revenues in total fiscal revenue of at least 25 percent during the period 2000–05 or (2) an average share of hydrocarbon and/or mineral export proceeds in total export proceeds of at least 25 percent during the period 2000-05.

[3] For more on the Chad-Cameroon project see, Ian Gary and Nikki Reisch, *Chad's Oil: Miracle or Mirage?*, 2005, Catholic Relief Services and Bank Information Center; The Chad-Cameroon Oil & Pipeline

When properly managed and developed with the participation of affected communities, these extractive industry revenues should serve as a basis for poverty reduction and economic growth. For example, the current oil boom in Africa's Gulf of Guinea is likely to generate over $350 billion in government revenues from 2002-2019.[4] This pales in comparison to U.S. development aid to the region of $4.2 billion in 2006.[5] Too often, though, these revenues are squandered, fuelling corruption, conflict and social divisiveness. Nigeria has received close to $500 billion in oil revenues in more than 50 years of production, but the average Nigeria still lives on less than $1 a day.[6]

These negative consequences of the "resource curse", if left unaddressed over time, affect the stability of supply and prices for the U.S. and other importing nations. For example, by 2005 the U.S. was receiving more than 18% of its oil imports from sub-Saharan Africa.[7] Instability in Nigeria or other exporters sends price shocks through the oil market and affects U.S. consumers, companies and the economy as whole.

The Importance of Extractive Industries Transparency

The best way to ensure that natural resources strengthen the economic and political compact between state and citizen is to ensure transparency. Oxfam America believes transparency is a key ingredient for systems of accountability in resource-rich states and that, without it, incipient democratic institutions are undermined. In many countries, basic facts about payments to the government and contracts between the government and foreign investors are shielded from legislators and the public. This is despite the fact that these non-renewable resources are sold by the government on behalf of the population. For example, I was recently in Cambodia where new oil discoveries have raised hopes that oil wealth will lift the country out of extreme poverty. However, there is no public information about contracts the government has signed with Chevron and other investors, nor is there any information about signature bonuses or other payments the government may have already received.

If citizens know how much their government is earning from oil, gas and mining companies, then they can demand more investment in education, health care and other social services. Of course, transparency alone will not solve all the problems of resource-rich states. Respect for human rights and democratic processes, an open and participatory budget process at the national and local levels, independent media and a vibrant civil society are all vital aspects of systems of government oversight. But easily accessible and comprehensible information on revenues and contracts is a necessary – and achievable – first step in developing systems of proper management for oil and mineral wealth.

Project: A Project Non-Completion Report, Environmental Defense, ATPDH, CED, April 2007; and the project web page at the Bank Information Center, http://www.bicusa.org/en/Project.26.aspx

[4] PFC Energy West Africa Petroleum Sector Oil Value Forecast and Distribution, December, 2003.

[5] "Development aid from OECD countries fell 5.1% in 2006", OECD, March 2007 http://www.oecd.org/document/17/0,2340,en_2649_201185_38341265_1_1_1_1,00.html

[6] Calvert, Scott. "In Nigeria, Rich Promise Unfulfilled", *Baltimore Sun*, December 17, 2006.

[7] U.S. Energy Information Administration CITE

Even where some information is being disclosed, it is often too complex, practically inaccessible because of language and other barriers, or insufficiently detailed to be useful to the public at large. As Oxfam America's recent report on Mali's gold revenues has shown, multiple and complex revenue streams are difficult for citizens and governments themselves to monitor. Over 25 different types of taxes, royalties and other payments are collected from mining companies.[8]

In addition to the disclosure of revenue payments from companies to governments, and the disclosure of government receipts, extractive industry contracts need to be revealed to legislators and the public. Contracts contain the terms for many company payments (royaties, production sharing agreements, etc.) and thus need to be disclosed in order to allow independent verification that what has been paid is what is owed. It is standard practice that contracts in the extractive industries are shielded by confidentiality clauses. The IMF has stated that, after signing, contracts should be disclosed and that no competitive advantage is lost by companies or governments that disclose contracts.[9] The former head of the World Bank Groups Oil, Gas, Mining and Chemicals Department, Rashad Kaldany, has said that, "Countries have no justification for secrecy… All of these agreements will be made public in [the] future."[10] In resource-rich countries where contracts are kept hidden, in essence the country has a tax code which is largely secret. In addition to affecting fiscal terms and revenue generation, contracts should be disclosed because they often shape other policies such as environmental regulation, corporate social responsibility and other aspects.

The U.S. Government has come out in favor of revenue and contract disclosure in the context of World Bank financing, and is also participating in the Extractive Industries Transparency Initiative.[11] Furthermore, the U.S. Congress has stated its position in favor

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[8] *Hidden Treasure? In Search of Mali's Gold-Mining Revenues*, Oxfam America, February 2007.

[9] IMF, *Guide to Resource Revenue Transparency*, 2007, pg. 14. "In practice, however, the contract terms are likely to be widely known within the industry soon after signing. Little by way of strategic advantage thus seems to be lost through publication of contracts. Indeed, it could be argued that the obligation to publish contracts should in fact strengthen the hand of the government in negotiations, because the obligation to disclose the outcome to the legislature and the general public increases pressure on the government to negotiate a good deal."

[10] "The Curse of Oil", *The Economist*, December 20, 2005.

[11] U.S. Treasury / Executive Director Position – Board Statement at Final Discussion of Extractive Industries Review World Bank Management Response, August 3, 2004. "Transparency and Disclosure – We agree with Management's support for transparency of revenues from EI operations to governments and for disclosing EI payments to governments. However, we believe Management should set a higher standard that encompasses – but goes beyond – the Extractive Industries Transparency Initiative (EITI). This standard should include a commitment by recipient governments to budget transparency (revenues and expenditures) necessary to assess credibly whether EI-related public revenues are allocated for purposes associated with the public good. Assistance should be predicated upon the government of the country having in place, or credibly committing to establish, a functioning system for accounting for revenues and expenditures in connection with the extraction and export of natural resources originating from public lands. The government should also have in place, or credibly commit to establish, a functioning system for the independent auditing of such accounts and the widespread public dissemination of the audited results.

of revenue disclosure through provisions inserted in the FY06 and FY07 Foreign Operations Appropriations Bill regarding the U.S. position at the World Bank.[12] Congress should build on this foundation to position the U.S. as a leader in the global movement for extractive industry transparency.

The Role of the World Bank, Regional Development Banks and Export Credit Agencies

I would like to turn now to examine briefly the role of the International Financial Institutions, something I know is of particular relevance to this Committee.

For too long, the IFIs have been willing enablers of the system of secrecy. The World Bank, and other regional development banks and export credit agencies, have been instrumental in facilitating investment and directly financing extractive industries projects in the developing world and they have indicated they plan to *increase* funding in the sector. In fact, International Finance Corporation financing of extractive industries project grew 60% from FY 2005 to FY 2006 and the IFC has stated its intention to double investment in African mining projects in 2007.[13] Regional Development Banks have also become significant supporters of extractive industries projects, with the European Investment Bank financing over $1.1 billion in projects in 2006, surpassing the World Bank Group in financing of the sector. The Inter-American Development Bank has funded such controversial projects as the Camisea gas project in Peru and plans to fund PetroEcuador, the Ecuadorian state oil company.[14] Earlier this month, the African Development Bank approved $100 million for a copper-cobalt mine in the Democratic Republic of Congo – this in the midst of a review of mining contracts in the country.[15]

While these investments have been profitable for the corporate sponsors and the Multilateral Development Banks, too often these projects have had predictably regrettable outcomes for the poor. A 2004 independent review of the World Bank in the extractive industries sector – the Extractive Industries Review – concluded that the Bank should not finance projects where good governance conditions are lacking – and in many countries these basic conditions *are* lacking. In response to the review, the Bank pledged to undertake a limited set of reforms, but it has yet to complete the reform agenda, including reporting on the development impact of its investments on a project-by-project basis.

Furthermore, there should be an *ex ante* presumption of disclosure of such documents as Host Government Agreements, Concession Agreements and bidding documents, allowing for redaction of, or exceptions for, commercially proprietary information."

[12] See, for example, H.R. 3057, Sec. 585 (c), FY 06 Foreign Operations Appropriations Bill, signed into law on 11/14/2005.

[13] "IFC continues push for Africa's minerals", September 24, 2007, Bank Information Center, http://www.bicusa.org/en/Article.3507.aspx

[14] Bank Information Center, "IDB to invest US$1.5 billion in Ecuador's PetroEcuador", 14 October, 2007, http://www.bicusa.org/en/Article.3535.aspx

[15] Bank Information Center, "AfDB approves funding for controversial Tenke mine in the DRC", 4 October 2007, www.bicusa.org/en/Article.3520.aspx

One commitment made is a new International Finance Corporation policy that requires, from January 1st of this year, disclosure by private sector clients of revenue payments to host governments and, in some cases, information contained in contracts or host government agreements.[16] Since 2004, the IFC has said it has asked all clients to voluntarily commit to payment disclosure and that all clients have complied. The World Bank has also been an active supporter of the Extractive Industries Transparency Initiative (EITI) in many countries.

While this is a significant step forward, implementation of the new requirement has been spotty at best and there is very little information on what, exactly, is being required of clients or where it can be found. IFC staff have said that a survey of the period from October 2004 to December 2006 has shown that all clients have agreed with the request and that the IFC has collected, but not published, the information it has received. A study by the Bank Information Center released in August, 2007, concluded that "the World Bank Group has not implemented a comprehensive, consistent program to ensure revenue transparency in all its EI activities."[17] For projects approved since January 1, 2007, there is no publication by the IFC regarding how its new requirement is being implemented by clients. The IFC says that it will survey its clients at the end of 2007 and may publish information on its website regarding how the policy is being followed. In addition, the IFC says that violation of this requirement would constitute of violation of the investment agreement between the IFC and its corporate client.

Regarding the IFC's policy regarding disclosure of contract information, there is even less information and it is unclear whether there is an example of such information being disclosed since the adoption of the IFC's new policy. In some cases, such as the IFC's current consideration of the Peru LNG / Camisea II gas export project, IFC staff have expressly stated that they *will not* require disclosure of contract financial terms, even though these would clearly be in the public interest.

Beyond the IFC's new revenue and contract disclosure policies, the World Bank Group has yet to use all the instruments at its disposal and is missing important opportunities to promote transparency. According to the Bank Information Center study, the World Bank and IFC are "often not incorporating revenue transparency through their support for the

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[16] IFC Policy on Social and Environmental Sustainability, 2006, states: "When IFC invests in extractive industry projects (oil, gas and mining projects), IFC assesses the governance risks to expected benefits from these projects. In the case of significant projects (those expected to account for ten percent or more of government revenues), risks are appropriately mitigated, and for smaller projects, the expected net benefits of projects and the risks to these from weak governance are reviewed. Where the balance of benefits and risks is not acceptable, IFC does not support such projects. IFC also promotes transparency of revenue payments from extractive industry projects to host governments. Accordingly, IFC requires that: (i) for significant new extractive industries projects, clients publicly disclose their material project payments to the host government (such as royalties, taxes, and profit sharing), and the relevant terms of key agreements that are of public concern, such as host government agreements (HGAs) and intergovernmental agreements (IGAs); and (ii) in addition, from January 1, 2007, clients of all IFC-financed extractive industry projects publicly disclose their material payments from those projects to the host government(s).

[17] Heike Mainhardt-Gibbs, "Assessment of the World Bank Group's Revenue Transparency Implementation in the Extractive Industries", Bank Information Center, August, 2007.

development of EI-related infrastructure, institutions, investment processes, or policies." In some cases, World Bank technical assistance to a government to develop extractive industries or encourage investment in the sector serves only to increase government earnings and does nothing to ensure widespread benefits from this new found wealth. (World Bank technical assistance to Equatorial Guinea in the 1990s served only to increase the government "take" but did nothing to improve transparency in a country known for corruption and opacity.)[18]

Regarding policy lending and Country Assistance Strategies (CAS), the World Bank often does not make extractive industry transparency a key benchmark for country engagement, nor does it often incorporate greater transparency in the sector as a key element of a resource-rich country CAS. Finally, the World Bank Group often narrowly defines its engagement with the sector and fails to use its leverage to bring transparency to facilities associated with a project it finances. For example, in the case of the Peru LNG project under consideration by the IFC, the IFC has concluded that the upstream gas blocks in the Peruvian Amazon are not "associated facilities" and are not subject to the revenue disclosure requirement. The same decision was made for the West Africa Gas Pipeline financed by the IFC at the end of 2004.

Despite these many weaknesses, the World Bank Group is ahead of the Regional Development Bank policies and practices, if only in relative terms. No Regional Development Bank or export credit agency has implemented a revenue transparency or contract transparency disclosure requirement, nor have these institutions been actively supporting implementation of the Extractive Industries Transparency Initiative. As such, they are using public money to actively contribute to the system of secrecy in the extractive industries.

Ensuring transparency in World Bank and other publicly-financed projects is all the more urgent given the Bank's stated intention to significantly increase its support for extractive projects in poor and unstable countries.

The Role of the IMF

The IMF has an important rule to play in its surveillance of the fiscal affairs of member states and has undertaken important research and "standard setting" exercises on this issue. The IMF, through the 2005 publication (and 2007 revision) of the *Guide on Resource Revenue Transparency,* has taken a strong public stand on the importance of transparency of revenues and contracts in managing natural resource booms. In addition, the *Guide* provides valuable practical and technical information on fiscal issues in the sector for government policy makers and civil society groups.

The good practices described in the *Guide* are viewed as voluntary by the IMF. (It is true that some resource-rich countries are more easily able to ignore the IMF and World Bank, but, at the same time, many of these countries still desire the "good housekeeping"

[18] Ian Gary and Terry Karl, *Bottom of the Barrel: Africa's Oil Boom and the Poor*, pg. 46. Catholic Relief Services, 2003.

seal of approval that these institutions can provide.) Some Article IV Reports and Staff Reports do contain valuable information on country practices and, in some cases, revenue amounts and information on fiscal terms in contracts.[19] These reports, though, are often not available in common local languages or in accessible formats.

The IMF has also not consistently highlighted extractive industry transparency issues in Article IV reports, Reports on the Observance of Standards and Codes (ROSC) and country dialogues. Even in countries that have published reports under the EITI, the IMF reports have often not analyzed the content of these reports and what the data suggest regarding revenue management in the country. At the same time, there are few examples, such as the case of debt relief conditions for Congo-Brazzaville, where the World Bank and IMF worked together to condition progress on HIPC debt relief with implementation of transparency reforms. Unfortunately, strong coordination and common positioning between the two institutions on extractive industry transparency issues is all too rare.

The Limits of the Extractive Industries Transparency Initiative

Both the World Bank and IMF have been active supporters of the international effort known as the Extractive Industries Transparency Initiative (EITI).[20] EITI is a voluntary "multi-stakeholder" initiative involving companies, home and host governments and the active and independent participation of civil society groups. Fifteen countries are officially "candidate" countries implementing this program, but no country has published externally validated reports since validation procedures were adopted a year ago. EITI may make progress in some countries where political will to tackle the problem is strong and lasting, but the initiative is weakened by its voluntary nature and will not capture many countries where problems of secrecy, corruption and mismanagement are most severe. (For example, Angola is not a part of EITI and only one OPEC country, Nigeria, is an EITI candidate.)

EITI is also undermined by the fact that contracts can stay secret; that it allows "lump sum" or "aggregated" reporting rather than individual company reporting; and that it does not require the publication of audits of company and government accounts.

In addition, governments are not currently obliged to report officially to parliament on the actual extractive industry revenues received in the year for which they are doing an EITI report. Without that information, it is impossible to conduct a reconciliation, such as the recent case in Gabon. EITI reports should be reconciled with authoritative budget information because it is through the budget that the government is accountable to parliament and its citizens.

[19] See, for example, IMF Staff Reports on Equatorial Guinea, Nigeria and Chad for examples of this practice.
[20] www.eitransparency.org

Recommendations

This Committee, and Congress as a whole, has a real opportunity to address the secrecy that is at the heart of the "resource curse".

Oxfam America believes we need to move beyond a voluntary approach to extractive industries transparency. A "cocktail" of mandatory disclosure requirements that can capture the large majority of companies and producing countries is needed. All companies and the investment community would benefit from a level playing field created by mandatory disclosure regulations. Furthermore, mandatory rules would enable companies to address the risks to reputation arising from lack of transparency and move the spotlight from companies to host governments when it comes to providing social services and making good use of revenues generated by these industries.

Oxfam America believes Congress should explore legislative vehicles to make disclosure of revenues by U.S. and other companies to host governments a mandatory aspect of disclosure.

Finally, disclosure on websites should be seen as a minimal level of disclosure. Information should be disseminated widely, in local languages and presented in a comprehensible manner. Donor agencies and governments should support programs that build the capacity of citizens, parliamentarians, journalists and civil society groups to understand and use the information to increase accountability.

World Bank, Regional Development Banks and Export Credit Agencies

- The World Bank/IFC should strengthen implementation of its revenue disclosure requirement and, at a minimum, have a central web page where payment information or links to company disclosure of information can be found. The Bank/IFC should disclose the template describing what is being required of companies and/or a sample passage from an investment agreement describing the requirement.
- The World Bank should require full contract disclosure for any extractive industries project it finances.
- The World Bank should consistently give greater attention to extractive industry transparency issues in Country Assistance Strategies and require transparency before providing technical assistance programs in the sector.
- The World Bank should ensure that, in addition to revenue disclosure, countries have systems of open and participatory budgeting at the national and sub-national level so that citizens can influence spending priorities for extractive industries revenues.
- Regional Development Banks and Export Credit Agencies should, at a minimum, requiring revenue disclosure and contract disclosure for those extractive industry projects they finance.

IMF

- The IMF should mainstream the good practices outlined in the *Guide to Resource Revenue Transparency* in all of its country dialogues and surveillance operations.
- The IMF should increase disclosure of information it receives from governments on revenues and contract terms. It should also make key documents, such as Article IV Reports, ROSCS, Staff Reports, etc., available in languages other than English (French, Spanish, Portuguese, Russian, Arabic, etc.)
- The IMF should assist governments to reconcile EITI reports, where available, with government budgets.
- IMF reports on countries that publish EITI reports, in addition to congratulating governments on the *process*, should also inform the public on what can be concluded from the reports on the state of oil revenue collection in the country, and any recommendations that would come from such an analysis. The IMF looks closely at governments' budgets and has a great deal of expertise in this area. It would be enormously helpful to the implementation of the EITI if IMF staff routinely analyzed EITI reports and compared them with budget information it routinely has in its possession, as well as other relevant information it may have.

Once again, I commend the committee for organizing this hearing and would be happy to answer any questions you may have.

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TESTIMONY TO THE FULL COMMITTEE OF THE UNITED STATES HOUSE OF REPRESENTATIVES, COMMITTEE ON FINANCIAL SERVICES

HEARINGS:
"TRANSPARENCY OF EXTRACTIVE INDUSTRIES:
HIGH STAKES FOR RESOURCE-RICH COUNTRIES, CITIZENS AND INTERNATIONAL BUSINESS"

PROFESSOR TERRY LYNN KARL
Gildred Professor of Political Science and Latin American Studies
STANFORD UNIVERSITY

October 25, 2007

Thank you, Mr. Chairman and members of the Committee for giving me this opportunity to speak to you about transparency in the oil, gas and mining industries. Many years ago during the first oil price shock, the Venezuelan founder of OPEC, Juan Pablo Perez Alfonzo, remarked to me: "You should study what oil is doing to us. Oil is the devil's excrement." Perhaps he envisioned what I call "the paradox of plenty" an increasingly perverse development pattern rooted in the interaction between oil, gas mineral dependence and weak states – a problem inextricably intertwined with the lack of transparency in the extractive industries. It is no exaggeration to say that this "resource curse" poses a profound threat -- not only to attempts to alleviate poverty but also to the stability of global markets and the prospects for peace. In my remarks, I will make the case that a new "fiscal social contract" based on transparency is urgently needed – one that creates a wide range of incentives to change the behavior of all actors involved in energy and minerals, both foreign and domestic. As the largest consumer of energy in the world and a promoter of more open societies, the United States has the capacity, the self-interest, and the obligation to demonstrate leadership in this effort.

The Paradox of Plenty: Why Resource Rich Exporters are Poor

Resource rich countries are poor precisely because they are resource rich, a paradox that is especially true in most oil-exporters. The "resource curse" refers to the negative growth and development outcomes associated with mineral and energy-led development. In its narrowest sense, it is the inverse relationship between high levels of natural resource dependence[1] and growth rates, which few mineral exporters escape[2] and which is especially notable in oil-exporters. But in a broader sense, this paradox of plenty has come to refer to a number of other disturbing outcomes stemming from dependence on oil and/or mineral wealth as the leading sector in development.

[See Figure 1].

The picture is not pretty. Most policymakers seem to think that countries lucky enough to have "black gold" or other minerals can base their development (or their reconstruction) on the resources forming the backbone of the industrialized world. But the lived experience of almost

all late-developing oil-exporting countries and most mineral exporters to date tells us differently:[3]

- Countries dependent on extractive sectors, and especially oil-exporting countries, have exceptionally poor development outcomes given their resources. They have unusually high poverty rates when compared with countries dependent on the export of agricultural goods. Their infant mortality, malnutrition and life expectancy at birth is worse than in non-oil/mineral dependent countries of the same income level. Their health care and their school enrollments tend to be less than that found in their non-resource rich counterparts. OPEC countries spend less than the world average on education, and two to ten times more on their militaries than non-oil exporters.
- They suffer from exceptionally long dictatorships and include exceptionally few democracies. Once again, the poor quality of governance in the case of oil-exporting countries is especially compelling. Of the 25 countries that control 95 percent of all oil-reserves, only 5 (Canada, the U.S., Norway, Australia and the U.K.) rank at the top of World Bank governance indicators, but they only hold 5 percent of all proven reserves. To the contrary, 12 countries (Angola, Algeria, Iran, Iraq, Kazakhstan, Libya, Nigeria, Russia, Saudi Arabia, Venezuela and Yemen) rank near the bottom of these indicators – and they hold 68 percent of all proven reserves.
- Oil-exporting countries in particular are more prone to civil war, especially ethnic and secessionist wars, than their non-oil counterparts.

In sum, most countries that depend solely on extractive industries for their livelihood eventually become among the most economically troubled, the most authoritarian, and the most conflict-ridden in the world. This is true across regions – in the Middle East, Asia, Africa and Latin America. These results are not confined to already kindled hotspots like Iraq, Indonesia, Sudan, Chad, the Niger Delta and Colombia but also to countries attempting to manage serious domestic cleavages like Venezuela, Iran and Saudi Arabia. Today, at least 34 less-developed countries rely on oil and natural gas for at least 30 percent of their export revenues, and over one-third of these countries have annual per capita incomes below $1500.[4] Almost all the latter group and many of the former are potential or actual failing states.

How Lack of Transparency Encourages the Resource Curse

The lack of transparency in oil, gas and mining is one central explanation for this paradox. Oil, gas and mining are among the most profitable and least transparent economic activities in the world. Despite the fact that high quality information is the necessary underpinning of every well-functioning market, the price of oil is anything but the product of good information or efficient markets: estimates of proven reserves are unreliable;[5] oil production data does not accurately reflect supply;[6] there are no requirements for companies to report their payments to governments, and contracts are not disclosed. This opacity is compounded by the fact that oil has become a financial asset which attracts hedge funds and institutional investors who do not necessarily make their decisions on the basis of prevailing market fundamentals. Moreover, a significant percentage of oil transactions occur beyond the view of analysts and outside the sphere of regulated markets.[7] The information available to economic agents, including the companies, countries and traders, is so poor that the responses to this information, which determines future price formation, often has little relationship to actual economic conditions.[8] When added to the reality that the actions of a small number of very powerful and sophisticated players can cause prices to move in different directions, economic fundamentals become only one determinant in the price equation.

This lack of transparency transmits negative effects to extractive states through the acceleration in what is already the exceptional volatility of oil prices. Today, oil prices do not move exclusively in terms of supply and demand; instead, price spikes tend to occur in response to a mixture of rumors, inaccurate forecasts, currency changes and geopolitical fears (as we just saw this week when they reached an unprecedented $90 per barrel.).[9] This volatility has been exponentially increasing since the 1990s (on the downside and the upside), especially because the capacity to counter price spikes with timely information is almost non-existent. A sound U.S. energy policy simply cannot be built on such a shaky foundation.[10]

[Figure 2 here].

Nor can sound domestic economic policies to alleviate poverty be easily designed to cushion the effects of such rapid fluctuations. Even the most fiscally sophisticated states, possessing tools that are not available to Nigeria or Venezuela, would find this task difficult. Once again, oil represents the extreme case: oil price volatility is twice as variable as other commodities. Boom-bust cycles rob exporters of their development prospects by exerting a strong negative influence on planning, budgetary discipline and the control of public finances. Price fluctuations are also detrimental to investment and income distribution, compounding the difficulties of overcoming poverty.[11] While the volatility of oil prices affects every country, especially as the shifting cost of fuel works its way through a global economy, its impact is asymmetrical: a fifty percent increase in the price of oil might only cut the U.S. GDP by half a point, but the same changes will cause severe contractions or overheating inside oil-exporting countries, drastically changing their standards of living. This is evident even in the "best" case of Saudi Arabia, where oil reserves are (reputedly) the greatest in the world. Even here per capita income dropped from $28,600 in 1981 to a devastating $6800 in 2001, and it has only recovered to $16,505 in 2007 despite the high price of oil. This is not a formula for stability.

The volatility problem is compounded by the lack of information about projected revenues and past expenditures, making development disasters even more likely. Failure to be transparent about earnings and spending not only makes accountability extremely difficult; it also leads to the loss of fiscal control that was clearly manifest after the booms of 1973 and 1980 (and will surely be present in the current boom). This loss of fiscal control, in turn, produces huge problems in the absorption of petrodollars, overheated economies, widespread inefficiencies, extensive waste, spiraling subsidies, and eventually rampant over-borrowing likened to that of "drunken sailors in a bar."[12] This is not solely due to a lack of transparency; and factors like the "Dutch Disease" are also essential for understanding these poor outcomes.[13] But lack of transparency has seriously exacerbated the squandering of a unique development opportunity that can never be recovered. Because extractive industries are based on non-renewable resources, once the revenues they produce are misspent, they are gone forever. This helps to explain why petro-states like Algeria, Angola, Ecuador, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar Venezuela and Trinidad-Tobago experienced real per capita income plunges back to levels of the

1960s and 1970s when oil prices dropped throughout the 1980s-1990s. They simply lost decades of development.

Finally, sound policies to overcome poverty are unlikely to arise from a system that rewards the capturing of resource rents through unproductive activity (what economists call rent-seeking[14]) as well as corruption. Transparency International ranks energy and then mining near the top of its list of the most corrupt-prone sectors, following closely behind public works and arms trading. Opacity, which facilitates corrupt and unfair practices, is the glue holding together the current patterns of revenue extraction and distribution in mineral and energy exporters. Simply stated, most companies do not publish what they pay to states, and most exporting states do not disclose what they earn and what they spend. Indeed, concealing information, hiding output plans and price objectives, refusing to be transparent about how governments interact with those involved in the extraction of oil, and confidentiality clauses to obscure the content of signed contracts has too often been the name of the game, thus huge amounts of money are virtually untraceable and not subject to any oversight.

Once again, the oil-exporters stand out: corruption in these countries is significantly greater than the world average. Of the 15 leading oil exporters in 2007, 12 rank among the bottom two thirds of the world's most corrupt countries and 6 cluster at the bottom (along with the newer exporters of Chad, Sudan, Equatorial Guinea, and the Democratic Republic of the Congo.)[15] Many of their scandals are legendary:

- In Angola, the second largest oil-producer and the world's fourth largest diamond producer, a billion dollars a year representing about a quarter of its oil revenues disappeared from 1997-2002 – a sum almost equal to all of the social and humanitarian spending in the country over the same period. While President Dos Santos keeps large sums of money in secret bank accounts, 70 percent of Angolans live on less than a dollar a day.[16]
- In Kazakhstan, where President Nazarbayev has secreted over a billion dollars in a secret fund in Switzerland while three million of his people live on less than $35 a month. The largest foreign corruption investigation in U.S. legal history has uncovered kickbacks he

received to secure contracts in the Tengiz oil fields for Chevron, BP. ConocoPhillips, and ExxonMobil.[17]

- In Equatorial Guinea, where oil wealth has produced the highest per capita income in Africa but where the International Monetary Fund has been unable to detect "even a measurable improvement of living standards,"[18] Chevron, Exxon Mobil, Marathon Oil Corporation, and Amerada Hess paid revenues directly into a Riggs bank account under President Obiang's direct control.
- U.S. and British subsidiaries of ABB Ltd, pled guilty in July 2004 to paying bribes in exchange for confidential bid information and favorable recommendations from Nigerian government agencies overseeing seven oil and gas construction contracts.[19]

As Global Witness has so poignantly pointed out, *not one of these scandals could have happened if oil companies had been forced to disclose publicly their resource payments to oil -states, and if petro-states, in turn, were required to publish what they earn and spend.*

Corruption not only robs the poor; it facilitates the spilling of their blood.

- In Congo Brazzaville, for example, Elf Aquitaine covertly financed both sides of the civil war that helped to mortgage the countries future oil income in exchange for expensive loans, a war that killed an estimated 7-11,000 people.
- In Indonesia, Mobil Oil admitted to supplying food, fuel and equipment to soldiers hired to protect oil installations. These same soldiers were later implicated in massacres in the breakaway province of Aceh and reportedly used Mobil's equipment to dig mass graves, though Mobil has denied knowledge of any abuses.
- Regarding Burma, where oil revenues help to support the pariah regime in power, in a landmark human rights case, Unocal agreed to settle the claims in *Doe v. Unocal* and compensate villagers who sued the firm for complicity in forced slave labor, rape, and murder.
- In Iraq, Deputy Prime Minister Barham Salih has stated that over $1.5 billion is stolen every year from the country's main oil refinery and channeled to insurgents.

While the impact of corruption and rent-seeking on the moral fabric of a country cannot be quantified, economic costs can. Corruption raises the transaction costs of doing business in energy and mineral countries, negatively influences the amount of foreign direct investment,

lowers the productivity of infrastructure expenditures, and perversely affects decisions about which projects to undertake. It is also negatively correlated with foreign currency credit ratings, thereby damaging future development performance.[20]

Why Adopting Transparency is So Difficult

Escaping the perverse development problems associated with extractive industries and making more effective strides towards poverty alleviation requires the capacity to trace the flow of payments from companies to governments, within governments, and from governments to their people. This is primarily a political problem about untangling intricate webs of money and power. This is why the resource curse is so intractable and why international initiatives, combined with the actions of civil society and government reformists inside these countries, are so critically important for the establishment of more just patterns of development and more stable markets.

States dependent on extractive resources for their foreign exchange are different from most other states: they are "no tax and spend" states. Payments from extractive industries tend to substitute for direct taxation, thus rulers in these states have the political advantage of being able to tax their populations lightly or not at all. But this advantage comes with a cost: poor governance and weak state capacity. Systems of taxation encourage the generation and flow of information, demands for representation and decentralization of power, and accountability. Bargaining over what is to be extracted from populations not only forges the fiscal social contracts that necessarily underlie all effective states but also forces government agencies to become more efficient and accountable in their spending.[21] States dependent on extractive industries for their revenues, and especially petro-states, lose this vital link between taxation, decentralization, representation and capacity as a function of the way they raise their principal resources.[22] Instead, they tend to be dependent, over-centralized, and administratively weak.

This encourages opaque business practices on both sides. For each individual company, confidentiality shapes how it accounts for its costs, what profits it reports to the government, how much profit tax it must pay to governments, whether it can offer large signature bonuses or side payments to enhance its competitive advantage over other companies, and how it interprets

and indeed whether it can veto environmental or human rights standards. For exporting governments, opacity affects the kinds of contracts they enter into, the amount of revenues they receive, the amount of private gain for individuals, whether these funds are ultimately traceable, and the types of security or environmental standards they do or do not defend. But whatever the short-term advantages to some, secrecy on the revenue side causes long-term damage both markets and states and to both producers and consumers. As long as authorities have the power to permit one firm to enter their country ahead of others for a price or set up bonus bidding to require companies to compete on the basis of how large an up-front bonus they will pay, these practices ultimately discourage competition and result in lower revenues over time for the exporting countries themselves.

A different set of problems can be seen on the expenditure side. Here spending patterns follow an internal political logic that turns the state into a "honey pot" -- to the detriment of economic development and the alleviation of poverty. Since remaining in power depends on the distribution of resource rents in a politically astute manner and this is also the mechanism for linking subjects to the state, rulers of extractive states depend on ever greater spending on their patronage networks, whether this is religiously or ethnically defined or simply a military. This is especially true for petro-states. In Venezuela's former two party dominant system, for example, the vast amounts of money distributed through the party system made it worthwhile for 96 percent of the country to join a party (and one in seven Venezuelans was clever enough to belong to both parties!) – just as Sunnis once sought to become Ba'athists under Saddam Hussein or Iranians now seek to be part of the fundamentalist Conservative Alliance. Oil governments keep themselves in power by allocating monies in a fairly predictable pattern: buying off powerful groups and individuals so that they do not become a threat, permitting some degree of trickle-down, and building powerful coercive apparatuses to ensure compliance from recalcitrant subjects.[23]

What such regimes do not achieve, however, is viable development. Given the fluctuations and unpredictability of their central resource and the growth of their populations, this expenditure pattern is ultimately not sustainable. With the exception of those few countries with tiny populations and vast amounts of reserves, resources are simply too volatile and, eventually, too

inadequate. While they may serve to paper over conflicts in the short to medium term, the long-term result is too often instability, which subsequently boomerangs on the commodity markets, making prices even more volatile and stability even more fragile. In effect, state failures become market failures, and market failures hasten state failures.

Why Transparency is a Precondition to Technocratic Fixes

Avoiding market and state failures has become the rhetorical stance of all actors in the oil story, and the range of prescriptions offered is wide. According to economists, extractive states should diversify away from oil and use market mechanisms (including a liberalized trade and exchange regime, privatization and deregulation) to guarantee macroeconomic stability. To prevent the Dutch Disease, they ought to improve productivity in agriculture and industry and reform their financial sectors. They should "sterilize" their petroleum revenues by saving them in an oil trust fund abroad, thereby avoiding overheating by introducing them gradually into the economy. They should cut public spending and avoid popular public works programs with immediate payoffs. Finally, they should provide a stable environment of property rights and drastically limit their own role, possibly by privatizing the petroleum industry. And they should do all of this while improving their judicial systems to better fight corruption. In short, extractive states should simply remake themselves.

But such prescriptions do not take into account the fundamental realities described earlier: *what is often economically inefficient decision-making is an integral part of the calculation of rulers to retain their political support by distributing petrodollars to their friends, allies, and social bases.* Rather than avoiding the hasty industrialization, profligate overspending, and increased domestic consumption that has marked the OPEC countries (as development economists advocate), or checking the rising dominance of the state over the economy (as neo-liberals advise), or promoting judicial reform, financial transparency and "good governance" (as both U.S. AID and the World Bank urge), some political leaders seem to believe that they can ward off immediate political and economic problems by doing precisely the opposite. This is not because they do not understand their own interests; rather, at least in the short run, they understand them only too well.

Nor do such prescriptions take into account the responsibility of international companies in contributing to the resource curse. Lack of transparency, with its accompanying patterns of volatility and corruption, is necessarily a two-way street, and prescriptions that do not recognize this will necessarily be inadequate. This is why many of the solutions proposed for overcoming the resource curse, which seem so very promising, are unlikely to work on their own and instead, should be put forward as part of a larger process of political and legal reform. Virtually all of these proposals are solely economic and technocratic when the deeper problem is political, and they are only aimed at the extractive states themselves rather than the symbiotic relationship between these states and international companies.

Even a brief look at two of these proposals demonstrates the importance of prior attention to addressing deficits in information, monitoring and participation before they can be successful.

- ***"Sterilize" or remove revenues through natural resource funds*** " One solution frequently advanced is to prevent governments from relying on resource rents by putting those rents beyond their reach and into a natural resource fund. Whether modeled after Norway's State Petroleum Fund or the very different Alaska Permanent Fund, such funds are viewed as an important fiscal tool that can aid in planning and insulate countries from price volatility. However, these funds, as they have been constituted to date, have major drawbacks. Because they are generally not transparent, and the information regarding their allocations is not available to legislatures, the press, or NGOs, the types of accountability mechanisms that would ensure their proper functioning do not yet exist. Indeed, there is little point in talking about such funds in countries like Kazakhstan, Republic of Congo or Equatorial Guinea, where governments do not provide even the most basic information about their revenues from oil or gas. Furthermore, while these funds may look good on paper, they are almost always set up under the direct control of the executive and thus can constitute a type of parallel budget without controls.[24] This poses the danger of simply adding to fiscal chaos while becoming a second "honey pot." Finally, claiming that it is necessary to save resource rents is politically difficult in countries whose populations live in acute poverty. Explaining this necessity requires

information and open debate, and both are in remarkably short supply in most extractive states.

- ***Change Property Rights and Allocation Patterns:*** Another way to prevent too singular a reliance on revenues earned directly from oil is to change the patterns of property rights either of the production process or over the ensuing revenues, for example through direct distribution. Changing the ownership structure of the production process might mean inviting significant foreign participation (Kazakhstan) or permitting domestic private interests to take over – at least temporarily (Russia). But once again, the problem with these arrangements is political. Privatization raises the acutely partisan question of who gets to be the new owner, and it runs counter to strong nationalist notions that the state is the guardian by right of resource wealth – a legal and ideological position that is embedded in almost all resource rich countries. Furthermore, at least where oil rents are concerned, there is still no evidence that domestic private oil companies are any better equipped to manage petroleum than their state counterparts. Note that Norway's state company is a model while Russia's private companies are suspect in many ways. Direct distribution to the population, modeled after Alaska, has its own problems; it threatens to abandon cherished public goods, e.g., school systems and healthcare, while failing to create citizen engagement. Alaska itself is a prime example. The distribution of petrodollars to individuals has substituted for a broad-based tax system, a personal income tax, and even a sales tax -and the results are classic: chronic budget deficits, public works projects that remain unfinished, lower than average productivity, and a pattern of favoring consumption over investment. Why should this be any different in countries with less educated populations, less rule of law, and less participation?

The policies might well work if the state in question is Norway – not war-torn Angola, post-communist Kazakhstan, or ethnically divided Iraq. Norway, which is held up as the example of "best practices" in oil, has avoided the worst manifestations of the resource curse. But it did so only with difficulty and from the point of departure of an already high level of development, with a pre-existing merit-based, technically competent and honest bureaucracy, and a strong democracy. With information, monitoring and participation mechanisms already available, it was able to hold a broad debate over the appropriate utilization of oil revenues, reorganize its

Ministry of Industry, create the highly efficient Statoil, define explicit roles for public and private companies, sustain a diversified economy, rein in borrowing, and establish an oil fund invested abroad to sterilize excess revenues. It even protected the state's non-oil fiscal capacity by resisting the strong temptation to lower taxes and permit oil revenues to replace its normal revenue base. The result speaks volumes: in recent reports of the United Nations Human Development Index, Norway ranks the number in human development. But most extractive states are not Norway. This is precisely why transparency must be a first step. It is a *prerequisite* for the effective utilization of resource monies, not the end product [25] -- a type of fast track to stateness.

Towards a Fiscal Social Contract in the Extractive Industries

It is a lot quicker and easier to build a pipeline or a mineshaft than it is to build a state. But the resource curse, at heart, is the interaction of the wealth produced by natural resources with weak states. Escaping this problem depends, first and foremost, on access to information. For this reason the campaign for transparency has grown exponentially, pushed by a number of high profile scandals, the morally reprehensible prospect of devastating outcomes in the new exporters of West Africa, and, most recently, the sharp rise in oil prices. It has already shown some notable impacts. Building on notions of fairness, rights, and corporate social responsibility, these halting but initial actions are predicated on the belief that all stakeholders -- the companies, the people in exporting countries, the taxpayers in consuming countries, the governments in consuming countries and the international financial institutions – have an interest in turning the current "lose-lose" situation into a different set of norms and rules: a requirement that transparency about company payments and country resource incomes and expenditures should become standard operating procedures. This is a highly contested process; none of these initiatives have proceeded smoothly;[26] and some have not proceeded at all.

What is evident, however, is that voluntary revenue disclosure models are not enough. While virtually all knowledgeable observers agree that more transparency would improve country economic performance, the bottom lines of companies, and the health of markets, the companies, are afraid of moving first and being undercut by others. But if disclosure requirements were

mandatory for all companies registered in the U.S., this would cover the leading European companies as well as those from Canada, China, India, Brazil and Russia.[27] Governments insisting on confidentiality clauses would have few choices of whom to invite into their territory – and most of these companies tend to lack the combination of expertise, technology, and capital to successfully compete. Mandatory legislation would have the dual effect of removing the fear of being first and leveling the playing field. Thus, new legislation that creates mandatory disclosure requirements, both in the U.S. and Europe, is an imperative accompaniment to this transparency campaign.

It cannot be the only one. The resource curse is the manifestation of such long-standing and institutionalized patterns that it cannot be undone without a huge coordinated effort by all the stakeholders negatively affected -- including the governments and citizens of producing and consuming countries, international oil companies, and international financial institutions -- to design new law, norms and practices that put order and fairness into extractive industries. However grandiose or out-of reach a 'big push' to curb the resource curse may seem, half-hearted attempts or partial efforts that single out solely one stakeholder while letting others continue their past practices simply will not work. Because partial reforms run the risk of merely moving huge resource rents from one site to another and creating new grievances in the process, a more comprehensive approach is imperative. A gradually emerging fiscal contract, especially if parts are mandatory and backed by law, can begin to build accountability, perhaps slowing and even reversing the resource curse with its accompanying slippery slope into violence and war.

Certain recommendations flow from this analysis:

- ***For all governments*:** Both host and home governments should remove all obstacles, legal or political, to the transparent disclosure and monitoring of extractive industries. In the United States, this would include removing non-disclosure clauses in contracts, guarantees of freedom to publish revenue amounts, and full disclosure of payments.
- ***For producing governments***: Oil revenues should be included in the national budget. Information regarding revenue as well as expenditure allocations should be distributed widely within the polity through the press, the internet and a variety of consultative fora.

- ***For companies*:** Companies should publicly disclose, in a regular and timely manner, all net taxes, fees, royalties and other payments made to producing states, including compensation payments and community development funding. Companies should also pledge to respect internationally recognized environmental and health standards regardless of their enforcement inside oil-exporting countries.
- ***For international financial institutions*:** Transparency conditionality should be attached to all loans and assistance to oil states and to all Export Credit Agency assistance to energy corporations. Countries and companies that do not abide by these conditions should receive no further assistance and those that engage in "best practices" should be rewarded.
- ***For a non-governmental organizations*:** Both nationally and transnationally, these organizations should strengthen the capacity to collect and disseminate information, develop independent monitoring, and lobby governments, companies and international financial institutions. NGOs should also form "umbrella" coalitions that unite environmental, human rights, indigenous rights, scientific and other constituencies affected by petroleum arrangements.
- **For all stakeholders:** Violent tactics should be openly renounced, widely condemned and be replaced with bargaining that observes universally accepted human rights standards as defined in the Universal Declaration of Hunan Rights.

As the oil market moves from conditions of abundant and cheap supply to limited and more expensive energy, and struggles over resources deepen, the problem of rich states and poor institutions can only heat up – with terrible consequences only too easy to foretell. Transparency is not a stand-alone tool, and it is only a start. But if it is seen as a prerequisite to other types of state and market reforms, it promises real payoffs for managing expectations, reducing social tensions, and providing more stability. Whether more comprehensive agreements about the management of natural resources will emerge in time is an open question. Yet if the brewing crisis over natural resources is not more justly and efficiently managed, the lives of millions of people, the stability of markets, the prospects for peace and the health of our hearth will be further jeopardized. And the founder of OPEC will unfortunately have been proved to be right.

[1] Note that what is key is the dependence on exports, and not the mere presence of oil or minerals. Many countries have been oil or mineral producers, most notably the U.S. but they do not experience the resource curse because they are not living off the revenues from exports.

[2] Chile (copper) and Botswana (diamonds) are usually put forward as examples of the possibility of escaping the resource curse. Aside from Norway, there are no counter examples in the larger oil-dependent countries.

[3] There is extensive documentation about these poor outcomes. See, for example, see Gelb (1988), Auty (1993, 2001), Sachs and Warner (1995) and Ross (2001b) on economic outcomes, Karl (1997, 1999, 2000, 2004, 2005), Wantchekan (2000), and Ross (2001a) on political economy outcomes, including the relationship to democracy and rule of law, and Le Billon (2001), Collier and Hoeffler (2004,2005) and Kaldor, Karl and Said (2007) on the relationship between oil and war.

[4] Birdsall and Subramanian 2004.

[5] The criteria used to estimate proven reserves are ambiguous and often controversial. Both countries and companies have incentives, at different times, to understate or overstate these reserves. For example, companies that are negotiating production agreements with a host country might understate the reserves, but the same companies could overstate them in discussions with fund managers or equity analysts. OPEC countries are also likely to have overstated their reserves, especially in the 1980s. Kuwait still claims exactly the same reserves level it had in 1985, despite pumping millions of barrels every day since then.

[6] OPEC stopped its annual and sometimes semi-annual practice of publishing field-by-field data in 1982. Thus oil market data is generally a black art like using a set of chicken bones," says Paul Horsnell of Barclays Capital. "If Columbus had thought he'd hit India when in fact he was in the Caribbean, that's about the level of oil market data." Cited in Adam Porter, "How much oil do we actually have?" BBC News, July 15, 2005.

[7] Robert Mabro, "Transparency in the Oil Market and Other Myths," Oxford Institute for Energy Studies, Oxford Energy Comment, February 2001. See also Ali Naimi, Saudi Oil Minister, *Middle East Economic Survey,* Vol. XLVIII, no. 22, May 2005.

[8] The extent to which this is true is difficult to convey. Matthew Simmons notes that this "data vacuum" has led to the proliferation of a whole new class of energy consultants, the so-called "tanker traffic counters," whose job is to estimate production based on observations of tanker traffic at the world's leading loading docks. He recounts the story of Petrologistics, which claims to have spies in all the major ports, though apparently has only one employee who conducts his business above a small grocery store in Geneva. Although this employee feeds information to a number of prestigious places, including the all-important IEA Monthly Report, there is no way to verify the existence of his independent tanker counters, or whether the numbers reported have any basis at all.

[9] At the time of this writing, oil prices have surpassed US$90 on speculative buying of oil futures based on fears that Turkey will invade the Kurdish region of Iraq, record appreciation of currencies vis a vis the U.S. dollar, and an increase in speculation in oil futures. This is not about market fundamentals because global demand, if anything, is weakening, particularly in the developed world, and the potential for disruption from a new conflict in northern Iraq is less than one percent of global supplies.

[10] Extreme volatility began with the price hikes of 1973, was heightened by the collapse of OPEC's system of administered prices in 1985, and has accelerated due to the increasing impact of non-fundamentals on pricing.

[11] Aizeman, J and N. Marion (1999). "Volatility and Investment: Interpreting Evidence from Developing Countries." *Economia* 66: 157-79.

[12] When this description was made by an international banker to an OPEC oil minister (in the presence of this author), the oil minister retorted: "Yes, but you bankers were like drunken bartenders!" But borrow they did – more

rapidly and over a longer period than other developing countries (Karl 1997). This permitted leaders of petro-states to avoid badly needed structural changes for longer than other developing countries.

[13] Named from the perverse effects of natural gas on other forms of productivity in the Netherlands, this occurs when resource booms bring about the rise of real exchange rates, and in response labor and capital migrate to the booming sector, thereby reducing the competitiveness of domestically produced goods and services. When this occurs, the reduced competitiveness in agricultural and manufacturing exports "crowds out' other productive sectors and makes the diversification of the economy particularly difficult. This in turn reinforces the dependence on extractive industries and, over time, it can result in a permanent loss of competitiveness.

[14] Rent is unearned income or profits "reaped by those who did not sow." According to economists, rents are earnings in excess of all relevant costs, including the market rate of return on invested assets. They are the equivalent of what most non-economists consider to be monopoly or oligopoly profits. Rent-seeking refers to efforts, both legal and illegal, to acquire access to or control over opportunities for earning rents. In oil dependent countries, rent-seeking refers to widespread behavior, in both the public and private sector, aimed at capturing oil money through unproductive means.

[15] The only top exporters that are not moderately to highly corrupt are Norway, Canada and the United Arab Emirates. The others include (in order of export strength in 2007 according to International Petroleum Monthly): Saudi Arabia, Russia, Iran, Venezuela, Kuwait, Nigeria, Algeria, Mexico, Libya, Iraq, Angola and Kazakhstan.

[16] Transparency International ranked Angola 147 in its 2007 Corruption Perceptions Index survey of 163 countries and the International Budget Project, an independent nongovernmental organization that measures government budget transparency, reported that Angola was one of the most opaque countries for budget transparency in its 2006 survey of 59 countries.

[17] Seymour M. Hirsch, "The Price of Oil, *the New Yorker*, July 9, 2001.

[18] Adam Smoltczyk, "Rich in Oil, Poor in Human Rights," Spiegel online, August 28, 2006.

[19] Transparency International, "Foreign Bribery Cases in Africa," http://www.transparency.org/news.

[20] Numerous studies have persistently linked corruption to poor economic outcomes. See, for example, Leite, C. and J. Weidmann (1999). Does Mother Nature Corrupt? Natural Resources, Corruption, and Economic Growth" IMF Working Paper WP/99/85.

[21] State authority, as the Magna Carta illustrates, is historically constructed and maintained through a series of exchanges of 'resources for institutions,' and, in the best cases, this produces a virtuous cycle between political institutions and economic patterns In the European experience, for example, state building arose primarily from the long and violent struggle to define national borders – a struggle that required taxation. The development of the modern state paralleled the growth of permanent standing armies because any state that wished to survive had to increase its extractive capacity to pay for its protection; war generated an increased need for revenues that could only be met through taxation or borrowing. Because taxation often provoked costly and violent resistance, and borrowing depended on the ability to demonstrate a secure revenue base, regimes had to invest real political and organizational effort into developing linkages with their subjects in order to raise the revenues they needed. In this respect, states became motors of change. Rulers learned that using consensual mechanisms for extracting taxes was in their interest in the end, even if this meant increasing revenue transparency, submitting to oversight in the revenue-raising and public spending processes, and giving taxpayers a say in how their monies were spent. The net result was the construction of an administrative apparatus that could penetrate the national territory, the creation of merit-based civil services, the evolution of the rule of law to ensure compliance on all sides, and the facilitation of some type of representative institutions that could provide for some citizen input. See Charles,Tilly,. (ed.). *The Formation of National States in Western Europe*. (Princeton: Princeton University Press, 1975) and *Coercion, Capital and European States, AD 990-1992* (Cambridge MA and Oxford UK: Blackwell, 1992). Also see James Mahon, *Liberal States and Fiscal Contracts: Aspects of the Political Economy of Public Finance*, (Paper presented at the Annual Meeting of the American Political Science Association, Washington DC: 2005).

[22] Note, however, that this is not the case where significant state-building occurred prior to the exploitation of oil, gas and mining for export as in Canada or Norway.

[23] This appears to be precisely what occurred until the late 1990s in the OPEC countries when approximately 65-75 percent of the post 1974 gross domestic product was for public and private consumption, largely through subsidies to friends, family and political supporters of the government. The remaining portion (20 to 35 percent of national output) was either invested or used to build sophisticated militaries for national defense or for the suppression of opposition movements.

[24] One Venezuelan president was able to secretly buy weapons to channel to Central America; the president of Azerbaijan could tap into the fund to support the conflict with Armenia, and most observers do not know where Kazakhstan's president is spending these revenues.

[25] Note that the Extractive Industry Review of the World Bank Group, which issued its recommendations in January 2004, reached a similar conclusion.

[26] The World Bank, for example, launched an exhaustive Extractive Industry Review, which resulted, to the leadership's astonishment, in a recommendation to withdraw gradually from all oil and mining activities – something it is not prepared to do.

[27] In addition to all U.S. companies, companies listed on the New York Stock Exchange and registered with the Securities Exchange Commission include many non-US companies. In oil, for example, China Petroleum and Chemical Corporation, China National Petroleum Corporation, PetroChina, Lukoil, Petrobras and many others are listed.

Testimony of Father Patrick Lafon, Catholic Bishops Conference of Cameroon[1]

**"Transparency of Extractive Industries:
High Stakes for Resource-Rich Countries, Citizens and International Business"**

House of Representatives Committee on Financial Services

October 25, 2007

Chairman Frank, Ranking Member Bachus and Members of the Committee: I would like to begin by thanking you for the opportunity to address you on a subject that is quite literally a life and death issue for hundreds of millions of Africans and others in the developing world. This issue is transparency in the extractive industries.

The Catholic Church in Cameroon and in the West and Central African regions has been involved in issues of oil and poverty for more than a decade. We decided to adopt a hands-on approach in the 1990s when the Chad Cameroon oil and pipeline project was being planned. Before this, oil was a taboo subject in Cameroon. But when we realized that after 25 years of the exploitation of oil, there wasn't much to show for it except the fat bank accounts of a few individuals, we as the Catholic Church decided to get involved, not only in Cameroon but across the region. The first result was a policy document by the Catholic Bishop's Conference of Cameroon and another by all the Catholic bishops of Central Africa issued in 2002. In that statement the bishops of Central Africa spoke with one voice to call on oil companies to "contribute to transparency and the fight against corruption by publishing the oil revenues they pay to our national governments."[2]

Beyond policy statements, we have taken practical measures to try to improve the outcomes of oil projects in favor of the poor. We decided to set up a monitoring program for the Chad Cameroon oil project to see whether the governments and oil companies were doing what they said they would do. This particular oil project has not resulted in much improvement in the situation of the common man in Cameroon. For example, the question of compensation was badly managed. Also, in the case of Cameroon, the World Bank did not use the leverage it had to require a revenue management law for the use of all oil revenues in Cameroon, as it had done in Chad.

The Church is answering the cries of the people of Central Africa for more justice in the use of oil revenues. Lack of transparency can breed corruption and has done so. Angola, Cameroon, Congo Brazzaville, the Democratic Republic of the Congo, Equatorial Guinea, Gabon, Nigeria, Sao Tome e Principe and Chad are among some of the most promising oil, gas and mining exploration areas. But they are also some of the world's most corrupt

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[1] Fr. Patrick Lafon was, until August 2007, the General Secretary of the Catholic Bishop's Conference of Cameroon, and was a former member of the International Advisory Group of the Extractive Industries Transparency Initiative.

[2] *The Church and Poverty in Central Africa: The Case of Oil*, Association of Episcopal Conferences of the Central Africa Regiona, July, 2002.

countries. One has only to consult the Transparency International Corruption Perceptions Index to verify that this is so. Since the mid 1990s, several countries in sub-Saharan Africa have experienced strong revenue growth from the petroleum industry. In most cases, however, this new wealth has not contributed to economic development but has been used for the enrichment of the leaders of these countries and the associated elites.

Cameroon is a case in point. Not all oil revenue gets into the state budget and, according to the IMF, the state oil company, the SNH, finances extra budgetary spending. EITI audit data and analysis by the IMF highlights a difference of about $286 million in reported oil revenues from 2001-2004. The IMF and the World Bank have confirmed that such discrepancies never pass through the treasury and into the budget. The SNH is thus another treasury but a very opaque one at that. Money is distributed directly from here without any legislative control, to serve unclear priorities. In Cameroon and throughout the region, transparency is being hindered on account of contract opacity. Confidentiality clauses are seriously hampering the ability of the Church and civil society in their desire to hold governments to account.

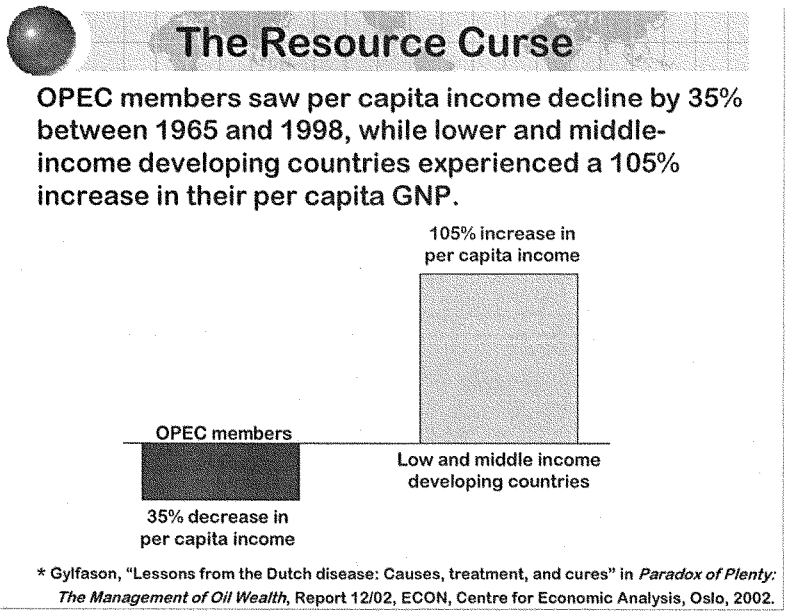
Rampant corruption and poverty is leading increasingly to conflicts in the region which threaten the oil supplies that everyone needs. This means that a proper management of public affairs is in everyone's interest.

Clearly revenue disclosure and accountability in resource rich West and Central Africa still has some road to travel. The Catholic Church and its allies in the region stand ready to use information that is disclosed to foster government accountability. We have already been able to make some progress as the Church in the region. In Congo-Brazzaville, members of the Catholic Church's Justice and Peace Commission are leading the charge on revenue and contract transparency and some information and contracts have been disclosed. At the same time, Brice Mackosso, a lay member of the Commission, and a human rights activist, Christian Mounzeo, were detained for months last year for his activism on the issue.

In order complete the transparency agenda, we recommend that governments, oil and mining companies and international financial institutions:

- Opt for a mandatory rather voluntary approach to EITI
- Implement disaggregated – company by company – reporting of revenues paid to governments
- Ensure that all extractive industry revenues are part of national budgets
- Abolish confidentiality clauses in contracts
- Publish information on the extractive industries regularly
- Investigate questionable bank accounts belonging to third world dictators.

Thank you for your kind attention and I am happy to answer any questions you may have.


The Resource Curse
OPEC members saw per capita income decline by 35% between 1965 and 1998, while lower and middle-income developing countries experienced a 105% increase in their per capita GNP.
105% increase in per capita income
OPEC members
Low and middle income developing countries
35% decrease in per capita income
* Gylfason, "Lessons from the Dutch disease: Causes, treatment, and cures" in *Paradox of Plenty: The Management of Oil Wealth*, Report 12/02, ECON, Centre for Economic Analysis, Oslo, 2002.

the

Figure 1

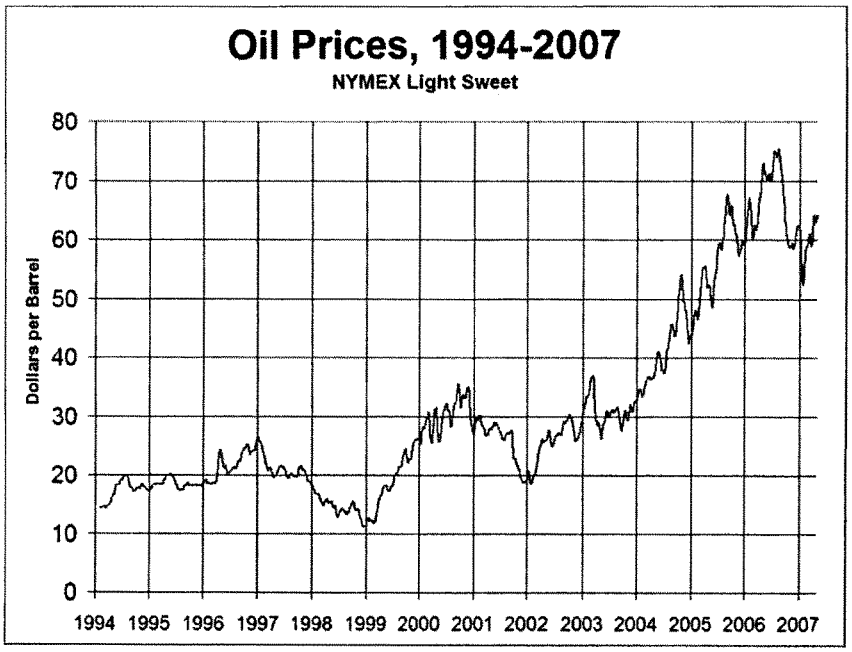

Oil Prices, 1994-2007
NYMEX Light Sweet
Dollars per Barrel
80
70
60
50
40
30
20
10
0
1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007

Figure 2

Transparency of Extractive Industries: High Stakes for Resource-Rich Countries, Citizens, and International Business

TESTIMONY

Paul Mitchell
President
International Council on Mining and Metals

Introduction

The International Council on Mining Metals (ICMM) presents the following testimony on the transparency of extractive industries. ICMM is the industry's peak CEO-led organization dedicated to sustainable development. It comprises 16 of the leading international mining and metal companies as well as regional, national and commodity associations (see Annex A). A number of major US-based mining companies (Alcoa, Freeport-McMoRan and Newmont) and the National Mining Association are members. ICMM's mission is two-fold – to distinguish its members as industry leaders and to make a contribution to raising standards across the industry as a whole.

This testimony covers three topics: an overview of the socio-economic performance of mining dependant economies; what are the key factors influencing different outcomes including the role of revenue transparency; and how can positive outcomes be achieved in more countries.

The performance of mining economies

In 2004 ICMM, in partnership with the World Bank and UNCTAD, commenced a research project to better understand the socio-economic performance of mining dependent countries[1]. The primary purpose was to identify more successful countries and the reasons for their success, thus enabling policy improvements to be adopted more broadly.

The study had two main components. Firstly, we identified 33 mineral dependent economies globally based on ores and metals making up 20% or more of a country's merchandise exports on average over the 38 years between 1965 and 2003. We then assessed national economic performance by looking at six variables and comparing the results for individual countries with

[1] That is excluding those dependent on oil and gas.

their global income group and region [so for instance, Chile was compared with all "upper middle" income countries and with the Latin America region]. The variables used were:

- Economic growth- GDP per capita for 32 years [1970-2002];
- Economic diversification- non-mineral GDP growth [1980-2002];
- Poverty alleviation as measured by infant mortality rate, Human Development Index, and two Millennium Development Goals, namely, proportions of national populations below the goals for minimum dietary requirements and access to drinking water.

The results are summarized in Table 1 and details are given in Annex B. The most striking finding is that performance is very mixed: about 45% of countries have done relatively well but the remainder, a slight majority, performed relatively weakly. Better performers include Chile, Botswana and Malaysia, while the poorer performers include Bolivia, Liberia and PNG. The key messages are: there is plenty of room for improvement and that the quality of national governance is fundamentally important - this, not resource dependency, has the greatest influence on socio-economic outcomes.

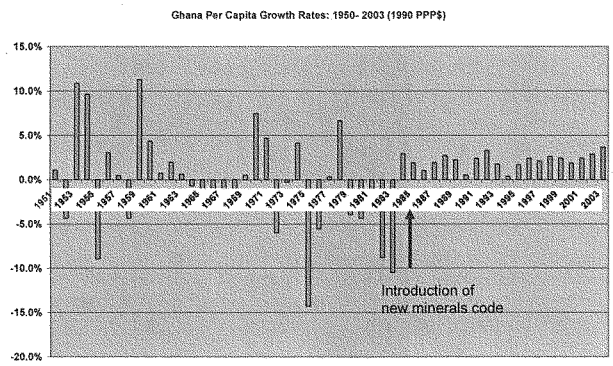
Table 1: Summary of Country Performance

Better Performers		**Weaker Performers**	
Better Performers	**Generally Better Performers**	**Weaker Performers with relatively better performance in a few economic (E) and social indicators (S)**	**Clearly Poor Performers**
Chile **Botswana** **Malaysia** **Tunisia** **Ghana** **Mexico**	**Colombia** **Guinea** **Jamaica** **Mali** **Morocco** **Mozambique** **Namibia** **Senegal**	**South Africa (E)** **Tanzania (E)** **Guyana (E)** **Mauretania (E)** **Gabon (E + S)** **Peru (S)** **Suriname (S)** **Togo (S)** **Jordan (S)** **Zimbabwe**	**Bolivia** **Central African Republic** **Congo** **Liberia** **Niger** **PNG** **Philippines** **Sierra Leone** **Zambia**

The second part of the study was detailed examination of four developing countries (Ghana, Tanzania, Chile and Peru) which provide more specific guidance on positive use of resource endowments. These studies examined the countries' economic records over the past fifty years. All four have been characterized by volatility, fluctuating economies, high poverty and radical shifts in governance from autocratic to democratic. However, following implementation of economic and policy reforms all experienced significant economic growth in which mining played an important role.

In Ghana, since the Economic Recovery Program was introduced in 1983, there has been an unbroken 20 year period of economic growth (see Figure 1). Investments in mining have exceeded USD 5 billion, minerals are the country's leading export commodity, mining is the main source of tax revenue [up to 12% of the total] and mining accounts for 5.2% of GDP.

Figure 1: GDP Growth in Ghana



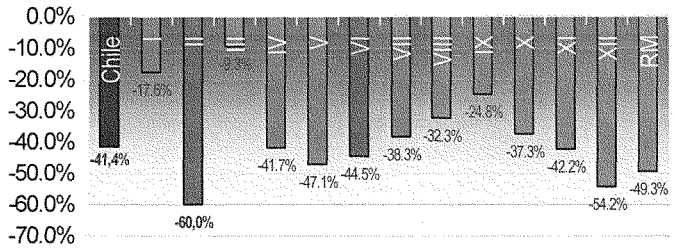
In Peru, since 1992, USD 8.9 billion has been invested in mining, the industry now pays 29% of income tax to the national government, it employs some 350,000 people directly and indirectly, and mining accounts for 6% of GDP. Similar stories were found in Chile and Tanzania.

In terms of social and poverty alleviation outcomes, the results were more mixed. In Ghana the national poverty head count has been reduced by 12% [from 52 to 40%] over the eight years to 1999, while at the same time poverty rates in sub-Saharan Africa generally remained stagnant (at about 46%). In Chile, an even greater fall occurred with an impressive 41% reduction in the fourteen year period up to 2003. Importantly, poverty reduction has been greatest in mining

districts with the fall in Chile's Antofagasta region, for instance, being 60% between 1990 and 2003 (see Figure 2).

However, poverty alleviation has not occurred in all countries with both Peru and Tanzania showing no significant changes over the period of growth in mining activity [although limited local reduction has occurred in major mining districts].

Figure 2: Changes in Income Poverty in Chile by Region - 1990-2003



Source: Groningen Growth Centre

The overall conclusion is clear: mining investment can be one of the first sectors to produce economic growth when basic policy and institutional reforms occur, and, this can lead to significant poverty alleviation. Proponents of the resource curse would suggest that the reverse will occur with a variety of problems emerging: economic stagnation, corruption, Dutch disease and declines in governance standards. The studies show that these risks can be avoided when sound policies are adopted. Summaries of the case studies are given in Annex C.

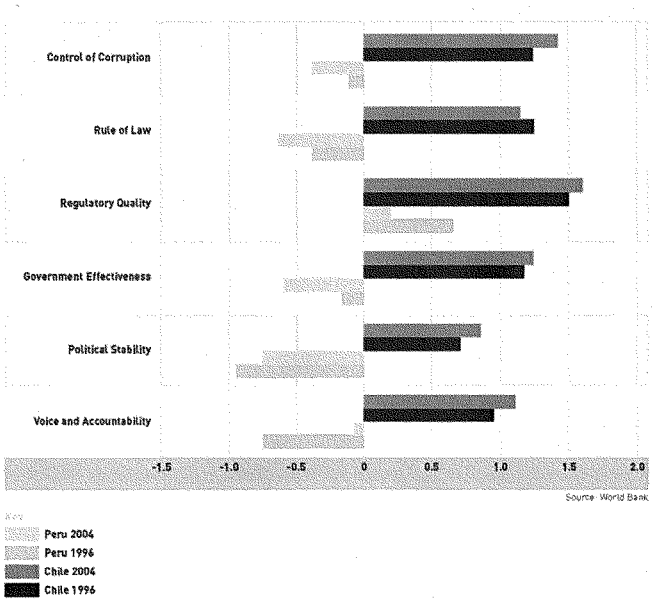
The role of transparency

ICMM's research also covered changes in national governance in mining dependent economies. The World Bank measures governance quality using six indicators (voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and corruption control). In the country case studies we found that governance generally improved along with mining related economic growth as shown in Table 2 and Figure 3.

Table 2: Governance Indicators Compared – 1996 and 2004

Indicator	Peru (96)	Peru (04)	Chile (96)	Chile (04)	Tanzania (96)	Tanzania (04)	Ghana (96)	Ghana (04)
Voice and Accountability	-0.73	-0.04	0.93	1.09	-0.77	-0.35	-0.35	0.39
Political Stability	-0.90	-0.68	0.75	0.89	0.02	-0.38	-0.10	-0.06
Government Effectiveness	-0.18	-0.58	1.20	1.27	-1.18	-0.37	-0.07	0.17
Regulatory Quality	0.65	0.17	1.52	1.62	-0.52	-0.55	-0.14	-0.28
Rule of Law	-0.35	-0.63	1.26	1.16	-0.70	-0.49	-0.12	-0.16
Control of Corruption	-0.10	-0.35	1.28	1.44	-1.03	-0.57	-0.47	-0.17

Figure 3: Governance of Peru and Chile



Unfortunately, the bank's indicators do not provide a direct measure of transparency but its 'control of corruption' indicator gives a guide. Reference to the four country case studies shows

that performance against this indicator was reasonably weak (-1:03 to - 0:10) in three countries (Tanzania, Peru and Ghana) and good (1.28) in only one – Chile. This suggests that high levels of transparency are not a pre- requisite for the initiation of socially beneficial mining investment, being overshadowed by the aforementioned macro economic and legal factors.

Notwithstanding, an important recent publication (Escaping the Resource Curse - Humphreys, Sachs and Stiglitz, 2007) suggests a strong link between transparency and a range of governance improvements both nationally and for corporations. These include:

- Greater competition between firms seeking exploration and development rights;
- Enhanced efficiency in negotiation processes between governments and mining companies;
- Enhanced credibility about governments' contract decisions and increased ability to guarantee the security of deals;
- Improved political stability, leading to better access to capital markets for governments and greater incentives for responsible government spending;
- More positive attitudes by populations about their governments; and
- Improved accountability generally that is for governments, corporations and NGOs.

We conclude that in creating prosperous communities the key initial factor is a strong commitment to economic and legal reform. Transparency is a part of this, particularly in removing the layers of secrecy that can characterize the resources sector and in improving accountability and effectiveness more generally. The main message is that transparency is an essential component of reform programs but the agenda is much broader than transparency alone.

What are the key success factors?

The single most important variable is host countries' commitment to economic and institutional reform; the successful countries have progressively built an adequate institutional and policy framework normally over a period of some decades, coinciding with increasing mineral investment. An appropriate framework has three components, as follows:

- Policies to encourage resource investment:

  - sound macro-economic management and effective property, mineral and contract laws;
- Policies to encourage social cohesion and investment security:
  - transparency in resource allocation decisions and revenue flows, (here the Extractive Industries Transparency Initiative, EITI, is an important positive step)
  - effective and equitable use of increased economic activity, including public revenues;
- Policies to foster effective use of resource revenues:
  - realistic forecasting of increased revenues;
  - clear understanding of priority development needs [e.g. physical infrastructure, human capital or long-term social spending;
  - effective, coordinated and accountable responsibilities for planning and implementation [i.e. intra-government coordination and government-company coordination; and
  - focus on investment for priority needs, not consumption.

What is the way forward?

The mining world has changed dramatically in recent years and three changes are particularly relevant to the prospects for reform. Today:

- Developing countries are much more important, both as sources of minerals and as producers of metals [both more than 50% of global production];
- Sources of investment have diversified substantially. Major international mining companies are now domiciled in China, India, Russia, Chile and Kazakhstan as well as in traditional centres; and
- Demand has grown rapidly in a context of constrained supply, thus there is a scramble for resources and host countries are now able to choose their investment partner rather than fighting to attract any investors at all.

This is a challenging environment in which to foster governance improvements as research shows that reform is most likely under conditions of economic need rather than buoyancy. Nevertheless, leverage exits because the public good is served by positive economic outcomes and there is much room for improved outcomes. Communities expect benefits from exploitation of their non-renewable natural capital; investments are secure when communities perceive

equitable benefits and reputations [both corporate and governmental] are protected through good governance.

The challenge is how to bring about reform? Here the key leverage point is national governments in host countries - they decide who get access to resources and under what conditions. Governments need support from two important groups - international agencies to develop capacity and civil society to ensure accountability. In relation to the former, the World Bank has a crucial role, it is the development agency with the greatest experience in building countries' minerals' governance capacity; it must be encouraged to pursue capacity building because the resources sector is the only significant source of private investment in poor countries and the bank's participation is essential for it to fulfill its poverty alleviation mandate. Thus, it is of great concern that many of the bank's country offices are shying away from involvement in the resources sector because of political and other challenges. Companies also have an important role - to make the case for good practice by demonstrating superior outcomes on the ground. In this regard ICMM's Sustainable Development Framework which commits member companies to public disclosure in accordance with the Global Reporting Initiative with independent assurance of reporting, is a significant step in improving accountability and public trust.

ICMM
International Council on Mining & Metals

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Mining Industries Associations of Southern Africa
National Mining Association
Nickel Institute
Prospectors and Developers Association of Canada
Sociedad Nacional de Mineria de Chile
Sociedad Nacional de Mineria Petroleo y Energia
The Cobalt Development Institute
World Coal Institute
World Gold Council

16 Corporate Members
28 Association Members

October 2007

Annex B: Ranking Mining Countries by Performance in terms of Growth and Poverty Alleviation

All 12 indicators given equal weight		All 8 growth indicators given equal weight		All regional comparisons (growth and poverty) given equal weight		All income-group comparisions (growth and poverty) given equal weight		All social indicators given equal weight	
Country Score	12	Country Score	8	Country Score	6	Country Score	6	Country Score	4
Chile	12	Botswana	8	Chile	6	Chile	6	Chile	4
Botswana	9	Chile	8	Ghana	6	Malaysia	6	Ghana	4
Tunisia	9	Mozambique	8	Mexico	6	Botswana	4	Malaysia	4
Ghana	8	Tunisia	6	Namibia	6	Mozambique	4	Mexico	4
Malaysia	8	Colombia	4	Tunisia	6	Tunisia	3	Colombia	3
Mexico	8	Ghana	4	Botswana	5	Colombia	2	Tunisia	3
Mozambique	8	Guinea	4	Colombia	5	Ghana	2	Guinea	2
Colombia	7	Guyana	4	Guinea	5	Jamaica	2	Jamaica	2
Guinea	6	Jamaica	4	Mali	5	Mexico	2	Jordan	2
Jamaica	6	Malaysia	4	Morocco	5	Guinea	1	Mali	2
Mali	6	Mali	4	Senegal	5	Jordan	1	Morocco	2
Morocco	6	Mauritania	4	South Africa	5	Mali	1	Namibia	2
Namibia	6	Mexico	4	Guyana	4	Morocco	1	Peru	2
Senegal	6	Morocco	4	Jamaica	4	Peru	1	Senegal	2
South Africa	5	Namibia	4	Mauritania	4	Senegal	1	Suriname	2
Guyana	4	Senegal	4	Mozambique	4	Suriname	1	Togo	2
Mauritania	4	South Africa	4	Tanzania	4	Bolivia	0	Botswana	1
Tanzania	4	Tanzania	4	Gabon	3	Central African Rep	0	Gabon	1
Gabon	3	Gabon	2	Malaysia	2	Congo DR	0	South Africa	1
Jordan	2	Zimbabwe	1	Togo	2	Gabon	0	Zimbabwe	1
Peru	2	Bolivia	0	Zimbabwe	2	Guyana	0	Bolivia	0
Suriname	2	Central African Rep	0	Jordan	1	Liberia	0	Central African Rep	0
Togo	2	Congo DR	0	Peru	1	Mauritania	0	Congo DR	0
Zimbabwe	2	Jordan	0	Suriname	1	Namibia	0	Guyana	0
Bolivia	0	Liberia	0	Bolivia	0	Niger	0	Liberia	0
Central African Rep	0	Niger	0	Central African Rep	0	Papua New Guinea	0	Mauritania	0
Congo DR	0	Papua New Guinea	0	Congo DR	0	Philippines	0	Mozambique	0
Liberia	0	Peru	0	Liberia	0	Sierra Leone	0	Niger	0
Niger	0	Philippines	0	Niger	0	South Africa	0	Papua New Guinea	0
Papua New Guinea	0	Sierra Leone	0	Papua New Guinea	0	Tanzania	0	Philippines	0
Philippines	0	Suriname	0	Philippines	0	Togo	0	Sierra Leone	0
Sierra Leone	0	Togo	0	Sierra Leone	0	Zambia	0	Tanzania	0
Zambia	0	Zambia	0	Zambia	0	Zimbabwe	0	Zambia	0

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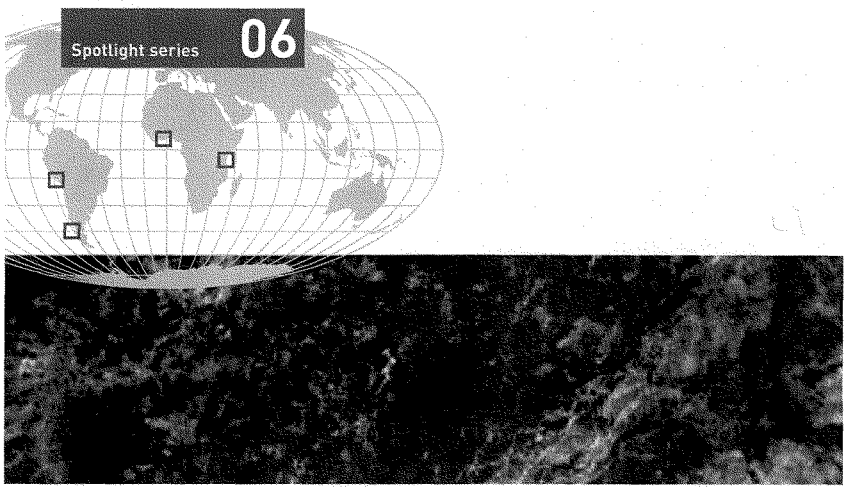
Chile

Executive summary

The Challenge of Mineral Wealth:
using resource endowments to foster sustainable development

October 2006



Chile

Chile provides striking evidence of the contribution that mining can make to economic growth and poverty reduction. Chile's government has used taxes and royalties from the industry to effectively deliver social development (while also keeping taxes on mining competitive so as to attract investment). Mining has also led to significant job creation, both directly and indirectly. Prudent macroeconomic policies and good governance have underpinned the local and national benefits

In contrast to its modern-day successes, Chile's history provides a warning of the economic challenges sometimes associated with mineral dependence. In the early twentieth century among Chile's main exports were nitrates, dug from the Atacama Desert, and used worldwide in fertilizers and explosives. But during World War I, new synthetic industrial processes were developed to manufacture nitrates, leading to a collapse in the global market which depressed Chile's economy for more than ten years.

In recent decades, however, Chile has not only avoided such economic problems, but has used its mining industry (dominated now by copper production) to help fuel significant increases in national wealth as well as falls in poverty. Chile is now among Latin America's wealthiest countries. The region of Antogafasta (Chile's 'Region II') in which mining is the dominant industry, moreover, has more than twice the per capita GDP of the country as a whole[1], and has witnessed particularly rapid declines in poverty.

Chile is one of the four country case studies of ICMM's Challenge of Mineral Wealth initiative, which was conducted in collaboration with UNCTAD and the World Bank. This Spotlight describes the main findings of the Chile case study, outlining mining's impacts both at the national level, and around the Escondida copper mine (Chile's largest mine) in particular, and also exploring some of the factors behind Chile's success. The aim of the overall Challenge of Mineral Wealth initiative is to identify ways to improve mining's socio-economic impacts – and Chile may hold some lessons for other, so far less successful mineral-rich states in this respect[2].

It should be emphasized that all the elements of the Challenge of Mineral Wealth initiative were overseen by an independent advisory group, so as to help ensure the objectivity of the research, and stakeholders were widely consulted on its findings (please see Spotlight series 04 'Process and Feedback'). The government of Chile was also invited to review the Chile case study. "The ICMM project underlines the importance of the positive experience of our country's mining resources", commented Cochilco, the Chilean Copper Commission, in its response.

[1] Based on 2003 figures.
[2] The full case study (as well as the other three country case studies) will

Copper-bottomed benefits

Disentangling the effects of mining from other drivers of economic performance is difficult. Nonetheless mining has clearly had important impacts in Chile in recent decades. Accounting for 8% of GDP in 2003, mining also dominates the country's exports (42% of the country's exports were minerals and metals in the same year) and two state-owned companies alone accounted for nearly 6% of government revenue between 1994–2004. With an increase in foreign investment since the early 1990s, the sector has grown rapidly with major increases in copper production (during the period 1991-2003, total foreign mining investment was some US$15.5 billion).

Though production has expanded over time, the importance of mining has actually declined in a relative terms as Chile's economy overall has grown significantly too (over the period from 1990 to 2003 average annual GDP growth was 5.4%). Chile has also succeeded in broadening its exports, and has become an important exporter of such products as fruits and some manufactured goods.

In this respect, Chile has successfully avoided a problem sometimes associated with resource extraction: this is that the economy becomes narrowly focused on minerals, with other tradable activities becoming uncompetitive as mining exports cause an appreciation of the real exchange rate or bid up prices for scarce production factors (part of an overall phenomenon sometimes described as the 'resource curse'). In Chile this has largely been avoided in recent years. In previous decades it had been a problem; also the recent large increases in the price of copper and the consequent rapidly rising export income could potentially pose a renewed macro-economic challenge. Even so, with the exception of a currency appreciation and subsequent economic crisis in the early 1980s, there appear to have been no signs of a 'resource curse' since the economic reform process extending from the early 1970s and continuing to the mid 1980s. A major mining industry in Chile, in short, has co-existed with – and also appears to have helped drive – impressive economic growth (thus by 2003, for example, Chilean GDP per head was the highest in South America).

Similarly Chile's overall performance on social and governance indicators has been broadly, and in many respects strikingly, positive. Chile currently holds one of the highest rankings on the Human Development Index in Latin America and the Caribbean. Poverty has also fallen dramatically (in 1990, some 39% of the population was considered to live below the poverty line as defined by the World Bank; by 2000 the proportion had fallen to 21%). While these outcomes are impressive, some challenges still remain: for example, Chile's income distribution remains among the most unequal in Latin America.

In terms of governance, Chile's performance is also strong. The World Bank uses six composite indicators of the quality of governance. Chile performs well above Latin American averages across all of these, with a strong lead, for example, on the indicators dealing with 'rule of law', 'control of corruption' and 'regulatory quality' (please see Figure 1). Clearly aspects of governance – such as what would now fall

seriously flawed during the period of military government of General Pinochet from 1973 to 1990. Now, however, well after the return of democracy, Chile performs relatively well in this area too. Between 1996 and 2004, the only period for which data on the World Bank indicators is available, there were some shifts in each of the measures, but trends were again broadly positive. On the issue of governance, in short, as with Chile's economic performance, it would be hard to argue that mining has held back, or somehow 'cursed', the development and progress of Chile's society and institutions.

Focusing on the effects of mining in Chile's Region II, where the Escondida mine is based, provides encouraging evidence too. Driven by rapid mining expansion, Region II's economic growth has been faster than across Chile as a whole (which explains how GDP per head reached US$11,996 in 2003, double the national average). Statistics for 2000 also show Region II had the lowest poverty rate in the country, having as mentioned experienced particularly rapid declines in poverty. Literacy and education levels in the region are also the highest in the nation.

The Escondida mine itself is located in the Atacama desert, 170 km to the southeast of Antofagasta, the nearest major town. But the mine's remoteness belies its economic significance. Total investment in the mine, which began construction in the 1980s, had reached some $4.2 billion by 2004. The mine is jointly owned by BHP Billiton (the majority shareholder and operator), Rio Tinto, a Mitsubishi Corporation-led consortium, and the International Finance Corporation. BHP Billiton, Rio Tinto and Mitsubishi Materials Corporation are all ICMM members.

In addition to directly employing 2,810 people in 2004, induced employment from the mine in the same year is estimated in the case study to be over 9,000. Escondida accounted for 1.7% of Chilean GDP in 2003 and over 3.5% in 2004. Significant economic benefits are also clearly retained nationally and locally. 99% of direct employees are Chilean nationals, for example, while 80% of the mine's procurement requirements are met from within Chile, and almost half from Region II (albeit a portion of the domestic procurement is likely to consist of imported goods bought from local agents). Escondida also has a policy of investing 1% of pre-interest and pre-tax profits annually in support of local community initiatives.

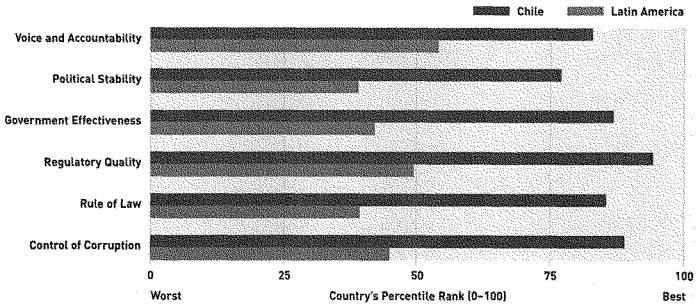
Causes of success

What then are the explanations for these broadly positive outcomes from mining in Chile? And can these be replicated by other mineral-rich countries? While the case study did not provide definite answers to these questions, various points are worth noting here (please also see Spotlight series 03 'Ways Forward').

The fundamental, albeit broad, explanation highlighted by the case study is the commitment of successive Chilean governments to economic, policy and institutional reform. Without doubt, Chile's favorable geology, its infrastructure (such as port capacity), and tax regime, have all helped attract mining investment. At the same time, mining's overall economic potential has only been realized through a set of broader policies, institutions and governance processes.

In terms of macro-economic policies, for example, in recent decades governments have generally placed strong emphasis on fiscal prudence, and also used sound monetary policy to control inflation and to avoid real exchange rate appreciation. Over time, Chile's integration in the global economy has been accelerated with encouragement of exports and trade liberalization, while state intervention in the economy was reduced as part of the neo-liberal reforms beginning in the 1970s. Taken together these policies helped Chile avoid potential macroeconomic 'resource curse' effects from mining, while creating a strong enabling environment for the

Figure 1: Six Governance Indicators for Chile compared to Latin America averages, 2004



ICMM under its Resource Endowment initiative, which aims to better understand how large scale mining activity in low and middle income countries impacts the socio-economic development of host countries. This action-research project is being done together with UNCTAD and the World Bank Group, with broad stakeholder engagement. For the latest information on the initiative, including details of publications, activities and partners visit www.icmm.com

CEO-led organization comprising many of the world's leading mining and metals companies as well as regional, national and commodity associations, all of which are committed to improving their sustainable development performance and to the responsible production of the mineral and metal resources society needs.

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growth of the private sector, leading to significant job creation.

In addition, mineral tax revenues – mainly from state owned companies, but increasingly from privately owned firms – were over time effectively channeled into social development. Escondida is the largest private tax payer in Chile: paying US$1.1 billion for the period January-June 2006. This phenomenon is currently a challenge to the Government in terms of managing these additional –transitory in nature– funds on one hand and the expectations of the people on the other. A range of macroeconomic tools are being put in place for addressing the first challenge. A Copper Stabilization Fund has played a crucial role in this respect in smoothing fluctuations in government expenditure, thus helping both to maintain macroeconomic stability and to provide the steady levels of funding necessary for sustainable social programs (The Fund is replenished by saving all copper revenues from the state-owned mining company Codelco above a long-term reference price for copper). Together, these macro level policies and processes helped drive down poverty nationwide.

On a local level, the impressive development trends noted in Region II have been driven by economic growth processes, in which the mining sector – supported by government policies – has stimulated a range of other economic activities. Redistribution of mining tax revenues has played less of an important role here (state revenues from mineral production are not earmarked for redistribution to mining regions, unlike in some other mining countries). On the other hand, Chile has developed stronger linkages between the mining industry and other sectors of the local economy than have many other mining countries. Suppliers to the industry have flourished, partly as a result of deliberate fostering on the part of the mining firms, particularly Escondida. Also, mining companies and the government have in recent years jointly supported the establishment of a 'mining cluster', a key part of which has been to provide finance for suppliers seeking to obtain ISO 9000 and 14000 certification.

In general, successive Chilean governments have pursued all these positive macro- and micro-level policies with some persistence. The democratic governments which followed the end of military rule in 1989, for example, broadly maintained the market friendly economic reforms of the previous regime and also reversed its neglect of basic freedoms and human rights. Without doubt, various economic policy errors were made by Chilean governments since the 1970s – though lessons were learned and mistakes not repeated.

It is now important of course that the economic reform process be kept on track. The Chilean copper industry, for example, needs to remain internationally competitive (one current issue here is escalating wage demands: Escondida, for example, faced a tough collective labor negotiation including a 25 days strike in August). In terms of taxes and royalties levied on mining, it should be remembered that positive economic outcomes have been achieved so far in Chile under a fiscal regime relatively favorable to mining firms (although modified in 2005 with the introduction of a to be less the level of taxes, and more how they are used by the government.

But if the fundamental factor behind the success of mining in Chile so far has been the policies and reforms pursued by its successive governments, what is the underlying explanation for such long-lasting commitment to reform on their part? Clearly the overall quality of Chile's governance (as noted previously) is an important driver. So too, is the high quality of the civil service and the leadership (for example, in terms of commitment to fiscal prudence) shown by individual politicians. Of course, the precise reasons why Chile made sound policy choices will depend on the particular issue and time period in question. It may be, however, that one other underling factor is Chile's consensual style of policy development, underpinned by the country relative social cohesion.

Certainly Chile's institutions enjoy sufficient public legitimacy to effectively manage potential issues arising from mining which in other less well-governed countries have led to deeper societal tensions. The case study notes in general the atmosphere of cooperation and compromise in Chile both across the political spectrum and between different actors in society. This is most important and visible between government and industry, but also exists with other parts of civil society, including universities and associations in crucial supporting roles.

The United Nations University 'World Governance Survey' also suggests that Chile has established a specific pattern of policy consultations and that this type of collaboration between public institutions and the private sector has been an important factor contributing to the country's economic success. At a national level, Chile has certainly enjoyed an unusual degree of policy stability and political consensus by Latin American standards. This is partly a function of the constitution and electoral system which encourages coalitions and consensus-based policies. Since the end of military rule, for example, Chile has been governed by four successive governments of the centre-left Concertación coalition. At a local level, meanwhile, the joint work between the government and companies in support of Region II's 'mining cluster' – or put another way, in maximizing the positive economic linkages from mining – is a further illustration of such a collaborative approach.

While such factors may not be easy to replicate in other mining countries, the importance of collaboration is certainly a theme of the recommendations from the overall Challenge of Mineral Wealth initiative (again please see Spotlight series 03). At a minimum, Chile indicates to other countries that partnerships between governments, companies and other actors may be needed to unlock mining's full benefits.

ICMM would like to thank all the individuals, governments and organizations that contributed to the study, full details of which are included in the main report. In particular, ICMM appreciates the cooperation and support of: the Government of Chile, including authorities in Santiago and Antofogasta as well as representatives of local government in Antofogasta; Escondida management in Santiago and Antofogasta (Mauro Valdes and Jorge Zeballos); BHP Billiton (Holly Lindsay); management of the Escondida foundation; representatives of the Escondida labor unions; local NGOs and community groups; national universities in Santiago and Antofogasta, business associations and representatives of the small scale miners

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Ghana

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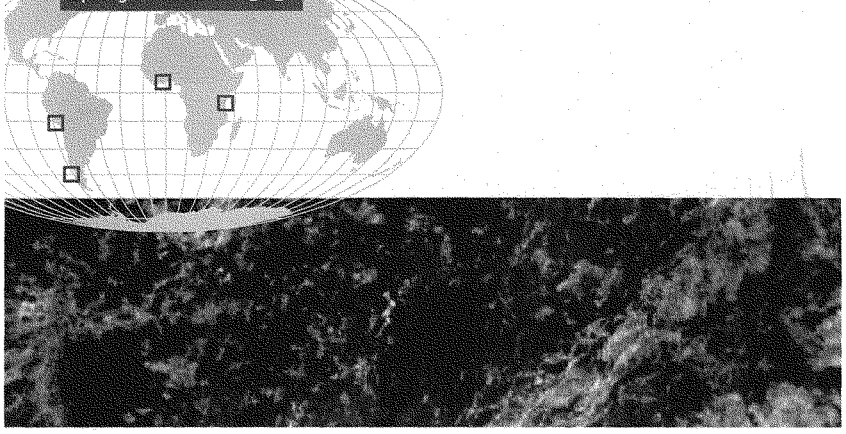
Spotlight series **07**



Ghana

The example of Ghana suggests mining can provide an important kickstart to previously-struggling economies as well as help to drive down poverty. It also, however, illustrates the challenges for both companies and governments in ensuring the potential benefits from mining are fully realized

Mining has long been important to Ghana's development. From the 8th century onwards, the area of present day central Ghana derived most of its power and wealth from gold mining (and from related trading along trans-Saharan routes with Arab merchants from North Africa). As a British colony known as the 'Gold Coast', Ghana also had a significant mining sector: the gold mine of Obuasi, which is still one of the world's richest goldfields, for example, dates from the 1890s.

But, more importantly, what does Ghana's post-independence period indicate about the contribution – or otherwise – of mining to the nation's development? This is a key question tackled in the Ghana case study – one of four country case studies – of ICMM's' Challenge of Mineral Wealth initiative, which aims to identify ways to improve mining's socio-economic impacts. This executive summary describes the main findings of the case study[1].

The short answer to the question is that a resurgence of mining investment in Ghana from the mid 1980s appears to have made an important contribution to turning around the national economy, and to reducing poverty. At the same time challenges persist around mining in Ghana: for example, the case study reported perceptions among local communities that they receive insufficient economic benefits from mines. The case study indicates that there is room for improvement in how companies manage their broader impacts in this respect – and also that governance and the effectiveness of public institutions may need to be further improved, particularly at the regional and local level.

To help ensure its objectivity, the overall research for the Challenge of Mineral Wealth initiative was overseen by an independent advisory group, and key findings were reviewed at two multi-stakeholder workshops. Ghana's Mineral Commission, a government agency, also reviewed and provided comments specifically on the Ghana case study.

Material recovery

Starting with the impacts of mining at the national level, these were not easy to isolate given that mining – despite its long and influential history – has typically been a small part of Ghana's economy (although comprising a much bigger portion of exports). The national economy remains dominated instead by agriculture, with cocoa a particularly important crop.

The approach taken by the case study was to contrast the way in which the economy performed in the period from just after independence in 1957 until 1983 (the point at which the country's 'Economic Recovery Programme' was launched), with the period after 1986, during which mining enjoyed a resurgence. In the earlier period both the Ghanaian economy and the mining sector were essentially stagnant. In the latter period both have performed much more strongly.

The poor performance of Ghana's economy in the early post-independence years is striking. For example, at the time of independence Ghana had a real per capita GDP of over US$450 (in 1995 prices). This was, for example, more than 40 percent higher than in Botswana. By 1985 Ghana's per capita GDP had declined to only US$313 and Botswana was substantially richer. During the years of economic collapse, mining suffered along with other industrial sectors (for example not a single new gold mine was opened).

Since the mid 1980s, by contrast, economic growth has been both higher and more stable. Ghana is now considered one of the more successful African economies – and mining appears to have been an important element of the recovery (see Figure 1). The economic reforms of the 1980s and 1990s included a new, investor-friendly minerals code. Between 1986 and 2001 over $5 billion was invested in new mining projects and mining has overtaken cocoa as the leading export earner (although reforms in the cocoa sector are now leading to increased exports there). Minerals still accounted for only around 5% of GDP in 2004. Even so, mining has also been the biggest source of foreign direct investment, and is now a significant contributor to the government's budget.

Can it be said that mining was actually a catalyst of the post-1983 economic growth? A direct cause and effect is difficult to prove. Clearly, though, the fortunes of mining have been closely linked with those of the economy at large, with the policies and improved governance that stimulated the overall economy also helping to unlock mining's revival.

Importantly, the Ghana case also suggests that mining, and gold mining in particular, may be one of the first sectors that can sustain growth in a previously failing economy once some minimum package of economic and institutional reforms have taken place. In some ways this is logical – unlike many other productive sectors gold mining needs quite a limited institutional and infrastructural base to be able to prosper. Key requirements include sound property rights, a realistic real exchange rate and taxation that is not punitive. Conversely, gold mining does not need, for example, a robust domestic market (given that the gold is exported). Nor does it need a sophisticated transport and communications infrastructure (typically gold ore goes through an initial refining process at the mine site, before being flown overseas for final refining).

In terms of poverty reduction, too, the evidence suggests mining has made an important contribution. Ghana, it should be emphasized, remains a very poor country: its recent economic spurt began from a low base. Nonetheless, since 1991 household poverty has declined substantially, suggesting that growth has been benefiting a wide cross-

[1] The project was also conducted in collaboration with UNCTAD and the World Bank.
[2] The full case study (as well as the other three country case studies) will

high level of mining activity have both lower absolute levels of poverty, and have experienced faster declines in poverty levels than other regions.

Focusing on the effects of specific mining projects in Ghana also indicates some broadly positive outcomes. The mine chosen for in-depth analysis as part of the case study was actually the historic Obuasi mine mentioned previously. This is now owned by AngloGold Ashanti, an ICMM corporate member, and is both the largest mine in Ghana, and the nation's largest private sector employer.

Obuasi was a greenfield site when the mine was established in the nineteenth century, but today a town of 150,000 to 200,000 has grown up around the mine. The mine itself employs about 6,750 employees and contractors, almost all of whom earn well over national average wages. Many other jobs have also been created indirectly by the mine. Though the numbers here are difficult to estimate, total employment generated by the mine in the area is between 28,000 and 72,000, according to the case study calculations.

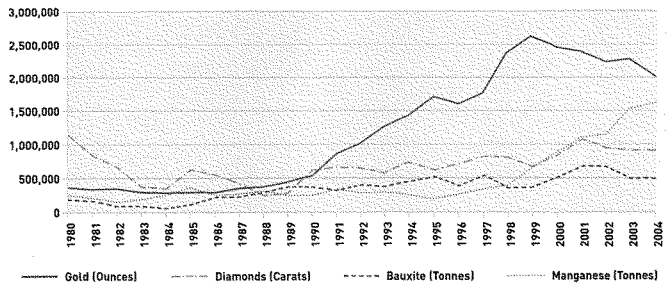
The mine also provides housing for a large proportion of its employees, and runs schools and a hospital for its employees and their families. One area where impacts are relatively modest is in procurement, with only a small proportion of procurement spending being sourced in the Obuasi area. Value added to the Ghanaian economy (i.e. contribution to GDP), however, is estimated to be in the order of $70 million a year, which is equivalent to just under a half of total turnover. AngloGold Ashanti also has a long track record as a supporter of community projects (for example, it built the municipal hospital and gave it to the government). Other contributions include providing free power to relocated communities and supporting the provision of water infrastructure and electrification. At the national level, AngloGold Ashanti has also been involved in a number of economic diversification initiatives, including support for establishing Ecobank, a merchant bank which is now a major player in the West African financial sector.

Critical context

In spite of these benefits, however, the case study also highlighted challenges, and ongoing political and public debates, around the impacts of mining in Ghana. This dovetailed with a point made at one of the stakeholder workshops held by ICMM on the overall Challenge of Mineral Wealth initiative: that popular perceptions of mining often require closer investigation[3]. In Obuasi, for example, there is some dissatisfaction among communities, in spite of the impacts mentioned above. Some local people have criticized the mine for not doing enough, complaining about the condition of the roads, for example, or inadequate water supplies.

Another local issue is the active artisanal mining population in Obuasi. Artisanal miners or *galamsey*, as they are known in Ghana, are common across Ghana's goldfields. In Obuasi *galamsey* cause relative minor disruption to AngloGold Ashanti operations (although several staff have been violently assaulted by *galamsey*). However, their environmental impact is considerable, not least because of their inadequately controlled use of mercury. Some other problems have also been attributed to *galamsey*, including the use of child labour and the sort of social order issues often associated with large groups of itinerant male workers. Conversely, the *galamsey*, supported by some local NGOs, have made allegations of unjustifiably heavy-handed behavior by government and mine security personnel. These allegations have been refuted by the company, all parties – including AngloGold Ashanti, the government, and NGOs – recognize the need to tackle the broad issues raised by artisanal mining.

Figure 1: Mining Output in Ghana



[3] For more information about the 24 October 2005 workshop proceedings

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On a national level, an open question is whether the economic benefits captured from mining, while already significant, might have been even greater. The World Bank has noted that these are not as large as might be expected. This is because of the high import content of the mining sector and, as new mine projects come on stream, the repatriation of profits. Raising the tax take on mining is not necessarily the answer here, however, given that this could deter further investment in the sector.

A related concern is whether mining regions are benefiting as they should from taxes raised from mineral production. A common complaint reported in the case study is that little of the tax from mining appears to find its way back to mining communities, in spite of a formal system – the Mineral Development Fund – set up to address this matter. Certainly, the impacts of mining are viewed broadly positively by many stakeholders, the case study notes. But other specific concerns have also often been raised: for example, over environmental impacts and accidents, the treatment of resettled communities, and also the way in which mine closures are managed.

Without doubt, mining companies share responsibilities for many of these issues. For example, the procurement budgets of mining firms do not appear to be benefiting local and national suppliers as much as they might. There is also evidence that some corporate social investment could be targeted more effectively on poverty alleviation; and that in Ghana more generally, some resettlement projects have been poorly handled. At the national level, corporate involvement in poverty reduction strategy processes could be stepped up.

The case study also indicates, however, that governance and institutional weaknesses may lie at the root of number of the concerns. The case study analyzed such issues using a taxonomy developed in an earlier phase of ICMM's initiative to understand the links between different aspects of governance and key drivers of development. A basic point of context here is that Ghana is still a centralized country – in part a legacy of its history of colonial rule. There are several regions, but no strong regional government, and at the local level there are districts and municipalities, plus traditional 'Stools', presided over by traditional chiefs. Neither the municipalities nor districts have adequate capacity, resources or revenue raising powers to effectively address local development issues.

Partly for this reason, the capacity of regional institutions to translate mining revenue redistributed via central government into development at the local level is at best work in progress. Recent general improvements in budget management have not filtered down adequately to resolve these problems, and nor have the donor sponsored programs such as the Heavily Indebted Poor Countries Initiative.

This helps explain at least some of the dissatisfaction around mines such as Obuasi. With local public bodies sometimes failing to deliver basic services such as water, sewerage and good roads, communities turn instead to mining firms to provide these essentials. Certainly the case for community development projects, and a lack of local capacity to relieve the company of some of these expectations.

> Ghana's experience indicates the importance both of encouraging investment in the mining sector, and then also of following this through with further governance improvements.

This in turn indicates the need for an explicit and careful development of local administrative and planning capacity, supported by somewhat larger and also more reliable fiscal revenue streams. This could gradually result in greater local empowerment as well as coherent local and regional frameworks in which education and health could be provided more effectively, and also the long term economic future of the region could be charted (factoring in possible mine closures, among other changes). Capacity building efforts could be supported by the mining companies, and co-financing of particular projects could involve local governments, the national government and international donors, as well as the companies themselves.

To emphasize, none of this is to detract from the benefits brought by mining in Ghana, and its arguably critical contribution to the national economic revival. What it indicates rather is that the macro-level governance and policy reforms that jump-started this revival in the 1980s, have been insufficient as yet to fully capture mining's potential benefits and help resolve all the dilemmas and controversies around its impacts. Put another way, Ghana's experience indicates the importance both of encouraging investment in the mining sector, and then also of following this through with further governance improvements.

More detail on the recommendations from all four cases studies of the Challenge of Mineral Wealth initiative can be found in the Spotlight series 03, 'Ways Forward'.

ICMM would like to thank all the individuals, governments and organizations that contributed to the study, full details of which are included in the main report. In particular, ICMM appreciates the cooperation and support of: the Government of Ghana, including the Ghana Minerals Commission (the government agency responsible for regulating and promoting investment in the mining sector), Ghanaian Environmental Protection Agency (EPA), Ministry of Finance, representatives of the Select Committee on Energy and Mining of the Ghanaian Parliament, Member of Parliament for Obuasi, the Ghanaian Central Bank; and AngloGold Ashanti management in Accra, Obuasi and Johannesburg (and in particular Alan Fine, Paul Hollesen,

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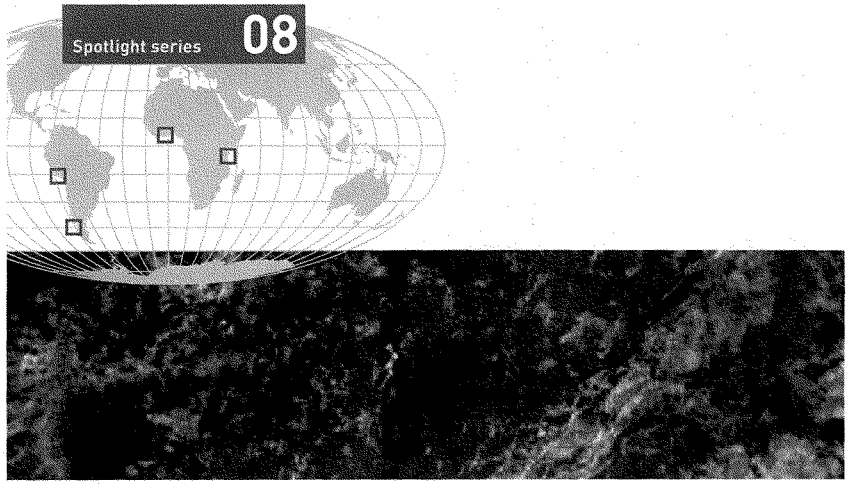


Peru

A surge of mining investment in Peru since the early 1990s has brought benefits to the national economy. Yet poverty and inequality have remained high, with trickle-down benefits held back partly by incomplete governance reforms. This has in turn intensified social tensions around mining

Government policies towards mining became a hotly-debated political issue in the run-up to Peru's presidential elections in 2006. But at the root of many of the social tensions surrounding the industry are local, rather than national, political dynamics. In particular, it has often proved difficult at the local level around mines in Peru to strike long-lasting compromises between company and community interests.

An example of this is the experience of the Tintaya copper mine, owned by BHP Billiton, an ICMM corporate member[1]. Following local criticisms over the environmental and social impacts of the mine, an innovative dialogue process was established between the company, the local communities and a number of NGOs, which led to an agreement by the company to return land to communities and to increase spending on local development, as well as to implement other community-friendly measures. The dialogue had been generally perceived to be a success. Even so, tensions later re-erupted: in 2005, a crowd of over 2,000 protestors broke into the mine, demanding an increase in local development funding from the $1.5 million originally agreed to $20 million.

This executive summary provides an overview of the Peru case study – one of four country case studies – of ICMM's[2] Challenge of Mineral Wealth initiative. An underlying cause of tensions between companies and communities such as at the Tintaya mine, the case study has found, is governance and institutional weaknesses, particularly at the local level. Without public agencies able to act as a trusted mediating and enforcing authority, compromises struck between the various parties are more likely to prove short lived, and conflicts may quickly re-emerge.

According to the case study, institutional and governance problems also help explain why – in spite of the considerable economic benefits brought by mining investment in Peru – poverty and other social problems often remain acute. If these problems could be overcome, the case study argues, larger socio-economic benefits could be delivered from mining, social tensions mitigated, and operational risks reduced. Importantly, the research of the Challenge of Mineral Wealth initiative was not just overseen by an independent advisory group: the Peru case study was itself reviewed by the government of Peru. "The study is particularly helpful in pinpointing key issues and aspects that deserve special attention", Peru's Minister of Mines and Energy, Glodomiro Sánchez Mejía, wrote in a letter to ICMM in March 2006.

Wealth and poverty of the nation

Focusing first on the national-level impacts of mining, there is little doubt that these have been positive in economic terms. Between 1992 and 2004 domestic and international mining companies in Peru made total investments of about US$9.8 billion. This investment surge was triggered by significant policy changes towards the sector. With the start of the Fujimori Presidency in the early 1990s the underlying philosophy for governing the economy took a complete U-turn. Following a previous period of state dominance of the mining sector, private sector involvement, especially foreign direct investment, was actively encouraged and state-owned mining assets were privatized. Regulatory changes provided legal and fiscal stability for companies.

Some basic figures can be used to illustrate mining's recent economic contribution to Peru. Mining and metals exports now comprise roughly half the country's merchandised exports, according to government figures. In 2004 mining contributed about 6.9 % of GDP (the figure for 2003 was 6.8%). While direct and indirect employment from mining relative to the economically active population is small (in total about 3.5%), this is due to the capital intensive nature of the industry. Broader indirect effects, however, are believed to be large. Of the $1.5 billion of inputs delivered to the industry, an estimated two-thirds are supplied from within Peru (this includes imported goods delivered by Peruvian suppliers). In 2003 the mining sector paid for about 4% of government's actual spending and contributed slightly more than 5% to government's total tax intake (making the sector one of the largest overall taxpayers in the country).

Contrary to the theory of the 'resource curse', there is no evidence that mining has detracted from broader economic development in Peru. In fact, its resurgence has coincided with a period of greater economic stability. Liberal economic policies have led to a relatively stable exchange rate, decreased inflation and official reserves at comfortable levels. Over the past 15 years, the macro-economy has been well understood and competently managed. Within this improved policy framework, mining has clearly played a kick-starting role in boosting a previously ailing economy.

Unfortunately, however, this positive macroeconomic picture has not been mirrored by improvements in many social indicators. An exception to this is that over the period from the 1960s to 2002 three key social indicators - infant mortality, life expectancy and literacy rates - have generally improved. Nonetheless the 2004 Report on Human Development for Peru from the United Nations Development Programme finds that the country has been unable to reduce social inequality and very significant disparities in income and regional development. More than half of Peru's population continues to live in poverty and nearly a quarter lives in extreme poverty, with the problem often particularly acute for rural, indigenous communities. In this respect, Peru differs from the other case studies: in Chile and Ghana, for example, poverty levels have fallen as mining investment has increased. Peru also retains one of the most unequal

[1] The International Council on Mining and Metals. Also please note that in 2006 BHP Billiton agreed the sale of Tintaya to Xstrata, another ICMM member.

[2] The project was also conducted in collaboration with UNCTAD and the

Within mining areas in Peru, moreover, it is difficult to pinpoint any particular regional effects of the industry's activities on poverty reduction. Available data shows no clear patterns. One important development whose effects are only beginning to play out, however, is that since 2002, 50% of corporate income tax collected from mining companies is redistributed to regions, municipalities and districts where mines are located (the figure was previously 20%). This mechanism – the *Canon Minero* – allows these sub-national state bodies more independent expenditure decisions. Although the *Canon Minero* transfers in 2003 constituted only a small proportion of total actual government spending, they can be highly significant at the local and regional level, and have recently risen dramatically (see Figure 1). The rules for redistribution of the transfers have been changed three times in the past four years, reflecting the highly controversial nature of the criteria. While increased transfers to mining areas should in theory improve local poverty reduction (an issue discussed again later in this executive summary), many of the changes are simply too recent to show up in the data.

A less ambiguous message, on the other hand, comes from analyzing the direct and immediate economic impacts of individual mines in Peru: the case study involved a detailed examination, for example, of the country's largest operational copper and zinc mine, the Antamina mine in the Andean region of Ancash, which has clearly made some significant economic contributions. Owned by a consortium of BHP Billiton, Mitsubishi, Teck Cominco and Falconbridge, and with operations begun in 2001, the mine has an expected lifespan of around 20 years.

The company operating Antamina – La Compañia Minera Antamina – has set out a number of explicit sustainable development goals including, for example, the provision of 100% access to basic services such as water and electricity for communities in the area of impact, and 100% increase in per capita income also in the area of impact. The mine's social investment budget for 2005 was around $7.5m, with the local population involved in the design and implementation of projects. More significantly the mine contributed some $662m to the Peruvian economy in 2005, the case study calculated, including taxes paid, goods procured, either locally or nationally, and jobs created (a total of around 9,000 – 12,000 jobs are estimated to have been created by or depend, directly or indirectly, on Antamina).

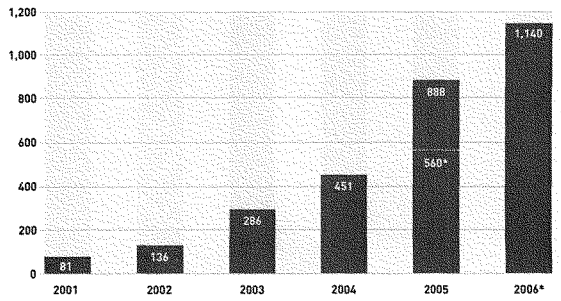
Digging for the cause

So what explains this overall situation in which mining has brought national economic benefits, in which mining companies are contributing economically as a result of their individual operations, yet in which poverty and other social outcomes remain in need of urgent attention?

Without doubt there is room for improvement in the way companies manage their broader socio-economic impacts. With regard to Antamina, for example, the case study indicated that that the company could have improved the way in which it consulted with communities – in particular, early indications of employment for local people raised expectations which have yet to be fully met (in spite of the company's local employment initiatives.) There is also a need to integrate the company's efforts into coherent local or regional government development plans.

However, this is arguably only an aspect of the problem, with governance issues playing a deeper role. Certainly, Peru's performance on those governance indicators conventionally measured by the World Bank has been weak. Recent changes have led to more participation and trust of society in the political process and have improved political rights. However, real improvements in the workings of the public service and administration and the legal system have remained outstanding.

Figure 1: **Canon Minero Transfers 2001–2006 (Million Nuevo Soles)**



*** Budget as approved at the beginning of the fiscal year Source: MEF; Elaboración: CAD Ciudadanos al Dia**

ICMM under its Resource Endowment initiative, which aims to better understand how large scale mining activity in low and middle income countries impacts the socio-economic development of host countries. This action-research project is being done together with UNCTAD and the World Bank Group, with broad stakeholder engagement. For the latest information on the initiative, including details of publications, activities and partners visit www.icmm.com

CEO-led organization comprising many of the world's leading mining and metals companies as well as regional, national and commodity associations, all of which are committed to improving their sustainable development performance and to the responsible production of the mineral and metal resources society needs.

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More specifically, the main factor that has constrained mining from making much greater contributions, the case study argues, is that national-level macroeconomic and structural reforms (which set the stage for the surge in mining investment from the 1990s) have not always been matched by equal improvements in institutional capacity and in political-administrative processes at the regional and local level. This is particularly important given the higher levels of funding now flowing to sub-national state bodies under the *Canon Minero*.

Evidence from the case study pointed, for example, to a lack of organizational capacity on the part of local governments to manage the impacts of mining. Proactive arrangements are needed where local and regional governments have very weak political-administrative capacities. Public agencies would be better able to serve the development needs of communities and deliver basic social services if there were strengthened approaches to strategic planning, more effective public expenditure programs and better monitoring of results.

Such improvements are needed to ensure the *Canon Minero* funds actually deliver commensurate advances in living conditions. The transfers certainly represent a significant opportunity for development (for example, they often far exceed companies' own social investment budgets), but unless spent effectively, they may turn out to be a mixed blessing. A related danger is that because *Canon Minero* funds must be spent on capital projects (described eloquently in the case study by one interviewee as "anything that involves cement"), as opposed to say capacity-building programs, spending plans will not sufficiently take account of cost implications for future years.

Similar problems beset efforts to build local supply chains and to foster economic diversification in mining regions: the case study found that, whatever the particular company approaches in this area, institutional and governance arrangements supporting this remain weak. If the policy objective is to encourage new poles of private sector development (which are naturally localized in the case of mining) this again will depend on building competent local and regional authorities which have reasonable endowments of financial resources (either through their own tax revenue base or predictable and reliable central government transfers) and also of human resources and general administrative capacity.

Finally, governance weaknesses also appear to underlie many of the social tensions surrounding mining in Peru. With local and regional government bodies often struggling to provide basic public services, such as healthcare, water or electricity, communities often turn instead to companies for such goods (which reinforces what might be described as a paternalistic, rather than sustainable development, model for mining). In many instances the firms have responded positively and provided additional resources. But communities still often perceive such corporate social investments as insufficient. Though often understandable given the pressing nature of local needs, such expectations may persist irrespective of amounts spent, and the fact the companies have neither the capacity nor the mandate for

The Peru case study highlights, in short, the critical importance of improved governance and institutional arrangements for translating the financial resources brought by mining into more effective development – as well as for reducing the social tensions it may trigger.

With public agencies lacking the capacity to mediate and enforce agreements between companies and communities, meanwhile, companies have often chosen to negotiate directly with communities over their additional local contributions. These arrangements have in turn sometimes led to a bidding process in which agreements reached in the short run have proved unstable in the long run. It is precisely this dynamic that appears to be at the heart of the recent tensions at the Tintaya mine mentioned at the start of this note, as well as at other mining projects in Peru.

The Peru case study[3] highlights, in short, the critical importance of improved governance and institutional arrangements for translating the financial resources brought by mining into more effective development – as well as for reducing the social tensions it may trigger. This is easier said than done of course, and is likely to require increased partnerships between companies, governments, communities and other key stakeholders. Please see Spotlight series 03, 'Ways Forward', for a summary of the practical recommendations derived from all four of the case studies in this respect. This note also describes how ICMM plans to take forward its own work in this area.

[3] The full case study (as well as the other three country case studies) will be published by UNCTAD following Government review.

ICMM would like to thank all the individuals, governments and organizations that contributed to the study, full details of which are included in the main report. In particular, ICMM appreciates the cooperation and support of: the Government of Peru, including various ministries and semi-autonomous agencies; and Compañia Minera Antamina S.A management in Lima, Huarmey and at the mine (and in

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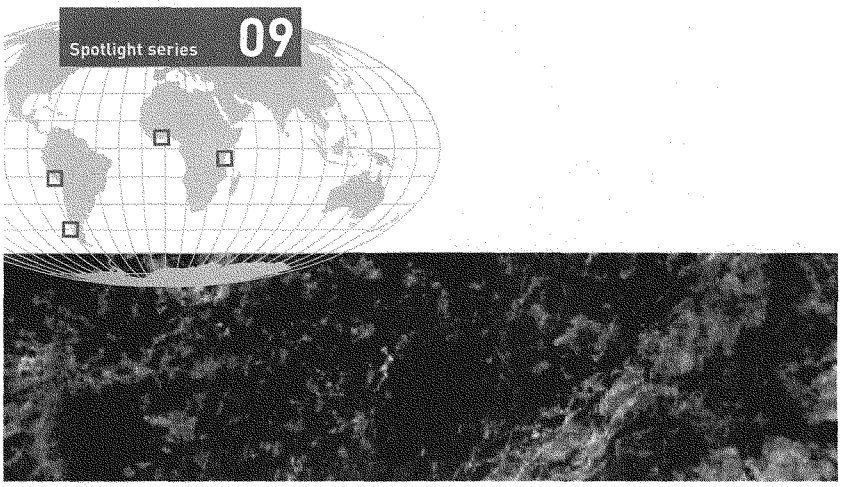
Tanzania

Executive summary

The Challenge of Mineral Wealth:
using resource endowments to foster sustainable development

October 2006



Tanzania

Rapid expansion of mining in Tanzania has brought economic and development benefits but also some social tensions including, for example, conflicts between small-scale and major commercial miners. A deepening of governance reforms at the regional level could help overcome such problems as well as further enhancing mining's economic impacts

Two sorts of private-sector mining activity have boomed in Tanzania in recent decades. First, the ending of Tanzania's state monopoly over mining at the end of the 1980s presaged a rapid growth in artisanal and small-scale mining. By 1995, an estimated 550,000 Tanzanians were earning some of their income from such mining (albeit this boom proved relatively short lived: the small mines often soon dug as deep as they could using their basic technology). Second, the opening of the economy to foreign firms and new and more attractive mining legislation has more recently led to a major expansion of investment in large-scale mining. This has attracted an estimated $1.3 billion in investment since 2000: easily the largest source of FDI to the country.

On both counts, the economic impacts have been broadly positive. The mining sector as a whole now accounts for over 40% of the country's exports as well as around 3% of its GDP. The rapid growth in artisanal mining in the late 1980s meanwhile appears to have had a 'startling' impact in relieving rural poverty, in the words of a USAID study in 2001. At the same time, however, both booms have led to some tensions. For example, there have been conflicts directly between large-scale and artisanal miners over land use (with the latter sometimes operating in areas legally claimed by the former, and alleged violence sometimes erupting as a result). Recently, there has also been a national political debate over the taxes and royalties levied on the commercial mining firms, with calls for the companies to make bigger payments.

This Spotlight provides an overview of the findings of the Tanzania case study – one of four country case studies – of ICMM's[1] Challenge of Mineral Wealth initiative. As well as examining commercial mining's impacts in Tanzania at the national level, the case also analyzed the impacts of a particular large operation – Placer Dome's[2] North Mara mine in the Tarime district in North Western Tanzania. While the case study indicated that mining's impacts have been positive on balance, it also sought to understand the deeper drivers of both the benefits, and tensions which mining has brought[3]. A key issue in this respect, it was found, was the quality of governance. Improvements in economic policies and governance have helped create a sound national policy environment for mining; but remaining governance weaknesses, particularly at the regional and local level, underlie at least some of the tensions – and may also have prevented the full potential benefits of mining from being realized.

In this way, the case study contributes to the overall aim of ICMM's initiative: to identify ways to improve mining's socio-economic impacts. To strengthen its rigor and credibility, all research for the initiative, including the Tanzania case study, was undertaken by independent consultants and overseen by an independent advisory panel. The main findings from the initiative were also reviewed by different stakeholder groups, including civil society organizations, academics, and international donors. Please see Spotlight series 01 – 04 for a overview of the initiative. The rest of this Spotlight sets out the main points of the Tanzania case study.

Mining for data

On a national level in Tanzania, there is little doubt that mining has contributed to an economic turnaround in recent years. As mentioned the commercial mining industry has recently revived (with most of the new investment going into five major mines, including North Mara). Supported by Tanzania's long-delayed macroeconomic and structural reforms in the mid-1990s, and radical new mining legislation in 1998, gold production has soared. The mining sector now accounts not just for a large proportion of the country's exports, but also for around 75% of its foreign direct investment, and a rising, albeit smaller, share of government tax revenues (currently 3.6%).

Significantly, the performance of Tanzania's economy has also improved during this period of mining resurgence. During 1996-2003, average annual GDP growth was 4.8%: generally higher (and certainly much more stable) than anything seen in the previous decades since the country's independence in the early 1960s.

How exactly has mining contributed to this overall economic revival? The sector is estimated to have contributed about 0.3% of this average annual GDP growth of 4.8% during the period 1996-2003 (or some 6% of the total). On the one hand, because commercial mining is such a capital intensive activity, it has contributed less to Tanzania's employment and value-added (and so to GDP) than might be expected given the scale of the recent investments.

On the other hand, mining has been able to deliver its contribution at a critical, early stage in the process of national reform, when other private sector activity has proved more difficult to stimulate. Tanzania has had a long history of poor macroeconomic management; and clearly a fragile country run for years on strict socialist lines does not easily make the transition to a market-based economy. Commercial mining, however, has shown itself to be unusual in this respect, capable of operating successfully in an environment that is still only partly reformed and in which the support structures usually necessary for private sector growth – such as physical infrastructure and an overall business culture – are still weak. The case study did not conclude that mining per se *caused* Tanzania's improved growth performance. But it did find that mining was one of the few and main sources of early investment in response to a broader package of improved policy and other developments that together explained the positive

[1] The project was also conducted in collaboration with UNCTAD and the World Bank.
[2] Placer Dome was acquired by another Canadian company, Barrick Gold, in 2006, after the case research was completed.
[3] The full case study (as well as the other three country case studies) will

In terms of mining's social impacts, the case study also examined the sector's contribution to Tanzania's overall progress towards the UN Millennium Development Goals (MDGs)*. On the one hand, household survey data in Tanzania (based on the latest available figures from 2001) suggests that the country's recent economic revival has not as yet led to significant falls in its – very high – rates of poverty since the early 1990s. However, the case study did find some basis for cautious optimism about mining's social contribution.

In particular, the extra growth that has been associated with the boom – even if small on the national canvas – is large for those communities actually living in mining areas. In terms of the main MDG, the eradication of extreme poverty, for example, the economic activity generated by mining has had positive local effects. As well as employing and providing work through contractors to almost 8,000 workers in total (see Figure 1), commercial mining firms in Tanzania have also helped create good quality jobs through their procurement activities (some 45,000 additional jobs, according to an estimate in the case study). Much of this work has gone to people in the mining areas themselves.

The major mining firms have also often committed to sustainable development agendas that are advanced compared with national industry norms, adopting relatively progressive approaches to issues such as gender empowerment, environmental management and community development. At the North Mara Mine, for example, the case study found that Placer Dome had adopted active measures to enhance levels of local employment and business development. It had also funded various health, education and infrastructure projects, including clinics and schools (and in this way had contributed to other MDGs, such as those relating to education and health).

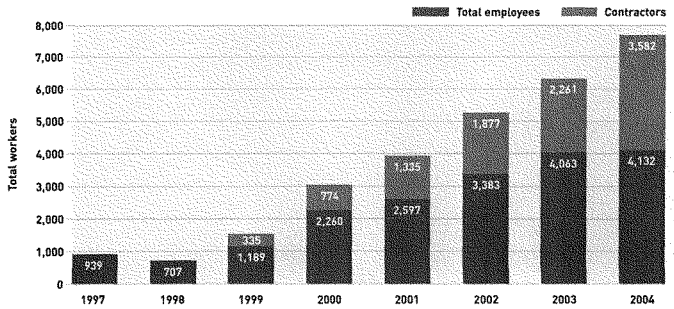
At the same time, however, it is clear that mining's local impacts are not without problems – nor as positive as they might be. As noted previously, the activity of artisanal and small-scale mining (ASM) workers has sometimes been restricted by the granting of leases to large operations (albeit many ASM jobs might not have survived longer term in Tanzania in any case given the inherent limitations of this type of mining). In terms of relationships between the mines and local communities, these clearly need to be stronger if all the potential positive impacts of mining are to be realized. Yet the companies generally recognize that this goal has not been fully achieved – in spite of their efforts, for example, on community development. Related to this, the economic trickle-down effects from mining in terms of stimulating other productive activities are recognized to be still limited and certainly much less than those seen in more mature mining economies such as South Africa.

Lessons of gold

So there is potential to improve further the impacts of mining in Tanzania. But what are the underlying explanations for the success that has been achieved so far? And what reforms are needed to create more positive outcomes?

The study suggests that Tanzania's overall success in reviving its commercial mining sector – and the national-level economic benefits this has brought – can be attributed to three broad factors. The first is Tanzania's reform of its mineral legislation, which helped attract a new wave of large commercial investors from 1999 onwards. While critics argue that the 1998 mineral legislation has been slanted too much in favor of the mining companies (hence the recent calls for them to pay more tax and royalties), the firms point out that the country's tax regime still represents a significant deterrent to investment compared with countries that compete for the same investments. This is borne out by

Figure 1: Employment in the large scale mining industry in Tanzania, 1997–2004



* See www.undp.org/mdg/ for explanations of the Millennium

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independent comparative reviews of mining regimes across the world[3].

The second factor is Tanzania's recent policies of macroeconomic stabilization and structural adjustment. The country has achieved lower and more stable inflation and also a fiscal balance that is more easily financed without inflation than in the past. Even more important, for a decade now, Tanzania has sustained a reasonably reliable commercial regime that has reduced the earlier substantial risks to investors of undertaking payments and receipts in foreign currency – a key factor in the viability of commercial mining. Serious real exchange rate misalignments have also been avoided, in contrast with previous decades when such misalignments were chronic.

The third component is what appears to have been an improvement in key aspects of Tanzania's governance since 1996. A critical element here has been the establishment of a stronger, and more effective, central executive power – arguably necessary to achieve the improvements in national economic policy. The reforms of the past few years also now ensure a reasonable degree of delivery of publicly-stated objectives – including poverty-reduction programs – through the budgetary process. Similarly, the government is also now reasonably well equipped to make good use of those revenues that it raises from mining (and future participation in the Extractive Industries Transparency Initiative would be a confirmation of the standards of transparency already achieved in this regard).

At the same time, however, Tanzania's governance does remain weak in many of the areas measured by the World Bank's governance indicators (even though the country's scores against these indicators have improved over the last decade). Public management systems and their implementation remain problematic in some respects and significant financial leakages are still occurring. The control of corruption, although much improved, remains a part of this. This point does cast doubt on the argument sometimes made in policy debates that a comprehensive improvement in governance should be a pre-condition for mining investments[4]. In Tanzania, mining has contributed to a macro-economic revival in spite of some major ongoing flaws in a broadly improving system of governance.

However, the study also argues that the incomplete nature of governance reforms holds the key to enhancing further the positive impacts of mining, as well as tackling some of the local tensions that have arisen. In particular, the case study points to the need for an extension of the governance improvements already achieved at the national level to local government. Conflicts between artisanal and large-scale mining would be easier to resolve, for example, if local authorities had more substantial administrative and financial capacities – and were also better placed to adjudicate fairly between conflicting claims (and in a way which also upheld national legal agreements).

Also, in terms maximizing the local impact of the significant corporate social investments of the five major new investors, a key problem is how to embed these contributions into mainstream public provision. Most of the companies have realized that they need to combine forces with government and social service providers and are seeking guidance over how such arrangements might be structured.

The chances of achieving such goals would be raised if local authorities had stronger management and other capabilities to work as equals alongside the mining companies. The alternative is for the companies to rely too much on the central government which will likely have less detailed knowledge of local problems and priorities. While the present system of local authority financing is improving, it does not yet provide a satisfactory basis for bottom-up planning and financing of economic and social development. Nor does it provide sufficiently equipped interlocutors for the mining companies in local and regional administrations. Skilled public-sector intervention is important to help maximize the local benefits from mining (including stimulating a local economy which is not overly dependent on the industry).

None of this is to detract from the critical role of the national government – for example, in ensuring mineral taxes are spent effectively on a national basis, and in fostering skills and broader employment generation from mining. Nonetheless strengthening local state capacity is an important factor too. Relevant to this is that the Tanzanian government has so far explicitly refrained from providing any preferential treatment to mining areas in redistributing the large mining revenues it receives. So local areas that generate these revenues have less scope to address the many and varied problems and opportunities resulting from the presence of large scale mining. A change in this policy could provide the funds for improving local governance (although other countries, such as Chile, have stimulated development in mining areas without such as a fiscal arrangement).

Certainly, the mining companies in Tanzania can only do so much on their own to ensure their potential economic contributions are maximized. Adequately resourced and effective local and regional (as well as national) authorities are an important prerequisite in this respect. Interestingly, a number of the other country case studies examined as part of the Challenge of Mineral Wealth initiative came to a similar conclusion. Please see Spotlight series 03 'Ways Forward' for the overall recommendations flowing from this finding.

[3] In particular the reviews regularly conducted by the Fraser Institute in Canada. See, for example, The Fraser Institute (2005). *Annual Survey of Mining Companies, 2004/05*, Vancouver, Canada.
[4] See, for example, the *Extractive Industries Review* commissioned by the

ICMM would like to thank all the individuals, governments and organizations that contributed to the study, full details of which are included in the main report. In particular, ICMM appreciates the cooperation and support of: the Government of Tanzania, including representatives of Tarime District Government, Geita District Executive Director; the Tanzania Chamber of Mines and Energy (Emmanuel Jengo), Barrick Gold, who acquired Placer Dome in 2005 (Peter Sinclair); Placer Dome (Jim Cooney, Jonas Kipokola, Ila Temu, Greg McNee and Reward Tenga); North Mara Mine; and local interviewees for the Social Impact Assessment (SIA) including 753 households in the project area, 394 individuals who participated in 20 focus groups, focus group participants in 5 other communities in Geita