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U.S. Energy Security Demands Action on Extractive Revenue Transparency

America's energy security is central to its national security and economic interests. Current proposals to enhance U.S. energy security focus primarily on developing alternative energy sources and diversifying America's suppliers, while overlooking efforts to improve stability in the energy-producing countries that currently supply us. The U.S. can take immediate action to reduce risk in its current suppliers by adopting new regulations and initiatives that promote better governance in producing countries.

Many of America's existing energy suppliers face severe governance and security challenges. In countries like Nigeria, Venezuela and Iraq, corruption and mismanagement of energy wealth—their primary source of income—leads to pervasive poverty, social unrest and political disenfranchisement. Such environments are often accompanied by various levels of conflict that lead to supply disruptions and global price hikes. In the long term, poor governance of energy wealth undermines producing countries' growth and development, which increases political risks for energy investors.

Poor governance is enabled by a culture of opacity around how much countries earn from their 'extractive' industries, and where this money is going. Revenue transparency by extractive companies can better enable citizens to hold their governments accountable, and also promote a more informed investor climate for developing secure energy resources internationally.

Specifically, the new administration should promote greater stability in energy supplying countries by 1) passing the Extractive Industries Transparency Disclosure (EITD) Act currently in Congress, 2) publicly backing a new International Financial Reporting Standard for the Extractive Industries and 3) investing greater financial and political capital in the *Extractive Industries Transparency Initiative* (EITI).

The Problem:
America requires reliable access to a steady stream of energy resources at a reasonable price in order to meet domestic energy demands, drive economic growth and release U.S. foreign policy from undue constraints in dealing with security threats from energy producing countries. It will be some time before new technologies begin to meaningfully improve energy efficiency and reduce America's dependency on fossil fuels.

Likewise, America's ability to further diversify its energy suppliers is geo-politically limited; the majority of known reserves are concentrated in discrete group of countries marked by severe economic, political and/or security challenges such as Nigeria, Kazakhstan, Angola, Iraq and Algeria. The U.S. currently relies on oil imports to meet around 60% of its demand, and more than 20% of its energy supply comes from Africa alone.[1] Political risk ratings for America's primary African suppliers—Nigeria, Angola and Equatorial Guinea—are consistently among the worst in the world. In Nigeria, a major U.S. energy supplier, oil exports fell by 25% in 2007 due to instability in the country's Niger Delta region. America will continue to be forced to rely on its current energy suppliers for some time. No energy security policy can be complete without measures to reduce the special risks that they pose.

For energy-producing countries, a lack of revenue transparency often goes hand and hand with government corruption, political instability and underdevelopment. More than two-thirds of the world's poorest people live in oil, gas and mineral producing countries that are not effectively using their resource wealth to promote sustainable development. From the Niger Delta to Bolivia, the disparity between severe poverty and great resource wealth has led citizens to take up arms against their governments and extractive companies, and led governments to nationalize U.S. and other energy assets abroad.

Corruption and public frustrations over revenue management are encouraged by the culture of secrecy that surrounds extractive revenues. The taxes, royalties, bonuses and other payments that companies make and governments receive are too often shrouded in secrecy, preventing citizens from being able to hold these leaders to account for how revenues are being managed. For example, the IMF estimates that more than $4 billion in oil revenues 'went missing' from the Angolan government's treasury from 1997-2002, a country with the lowest human development indicators in the world.[2] By promoting extractive revenue transparency as a global norm, America can reduce political risk among its present energy suppliers, encourage local development and achieve greater long-term energy security.

The Solution:

More information on how and from where much money is coming into energy producing countries can help citizens more effectively fight corruption and demand improved performance by governance structures. Revenue transparency can help American companies pro-actively reduce political risk by being open about the benefit streams that they are paying to countries that accuse them of exploitation. It can also help extractive investors make more informed decisions about the measures companies are taking to reduce corruption and related political risks in the countries where they operate.

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[1] See the U.S. Energy Information Agency, *Energy in Brief: How Dependent Are we on Foreign Oil?*,.

[2] International Monetary Fund, "Angola: Staff Report for the 2002 Article IV Consultation," March 18, 2002, Angola ranked 162 out of 177 countries on the 2007/20008 Human Development Index by the United Nations Development Program.

Skeptics of revenue transparency cite concerns over the commercial competitiveness of OECD energy companies forced to disclose information that emerging market companies are not. OECD companies are fearful that corrupt leaders will prefer to deal with Chinese and Russian companies that do not bring transparency standards and governance concerns along with them. Yet this is exactly the reason OECD companies should embrace regulatory efforts to mainstream revenue transparency. Voluntary efforts like EITI—of which most major OECD companies are members—are undermined by the absence of major emerging market players. Virtually all major emerging market companies would be covered by mandatory revenue transparency measures such as accounting standards and listing requirements. Regulatory measures are the only means to ensure that all major energy companies disclose the same information, operate on a level the playing field internationally and do not become embroiled in a governance 'race to the bottom' that further undermines everyone's energy security. Revenue transparency is not a silver bullet solution to eliminating corruption and instability in energy producing countries, but it is one of few powerful tools America has at its disposal.

This U.S. is in a unique position to lead revenue transparency efforts that can dramatically reduce political risk and improve stability in the energy-producing countries that supply us. <u>The new administration should take the following steps to promote revenue transparency and strengthen US energy and national security interests:</u>

1. Push Congress to Pass the Extractive Industries Transparency Disclosure Act (EITD): In May 2008 the Chairman of the U.S. House of Representatives Financial Services Committee introduced H.R. 6066, the Extractive Industries Transparency Disclosure Act (EITD) Act, and a Senate companion bill was introduced in July 2008.[3] The EITD Act would create a new stock exchange listing requirement for extractive companies obligating them to report payments to all governments.[4] The new Administration should place the EITD at the top of its legislative agenda during the first term and work closely with Congress to ensure its passage in early 2009.

2. Publicly Declare U.S. Support for an International Accounting Standard for the Extractive Industries

The International Accounting Standards Board (IASB) is currently considering a new financial reporting standard for the extractive industries. At present there is no uniform or universal standard for what payment-related information extractive companies must disclose. Once adopted, this accounting standard would become law in more than 50 countries. The U.S. has a seat on the IASB and should use its influence to push for the finalization and adoption of an International Financial Reporting Standard (IFRS) for the extractive industries in 2009.

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[3] Senator Charles Schumer introduced the EITD act (S.3389) in the U.S. Senate Committee on Banking, Housing and Urban Affairs on July 31, 2008.

[4] This requirement would apply to American and international extractive companies listed with the SEC and cover the bulk of major producers worldwide, including Chinese, Russian, Brazilian and Indian national and international energy companies. See www.openthebooks.org for more detail.

3. Provide Increased Financial and Political Backing for the Extractive Industries Transparency Initiative

The U.S. has recently begun to provide greater high-level support for one of the most important global policy initiatives on revenue transparency, the *Extractive Industries Transparency Initiative* (EITI).[5] The EITI voluntary international initiative has become an important driver of increased transparency and accountability around extractive revenues in key oil and mining countries. The multi-stakeholder requirement of the initiative has also created a bit of protected space for public discourse in countries where there has been precious little up to now. The new administration should declare EITI a major policy priority for its energy security and development agendas. It should increase its contribution to the EITI global trust from $1 to $2 million to support country implementation. It should also designate a high-level U.S. Government representative to participate consistently as a member of the global EITI board, on which it currently sits, represented most recently by both the Director of Policy and Planning and now the Director for International Energy and Commodity Policy at the Department of State.

4. Apply EITI to Payments and Revenues generated from oil, gas and mining activities on US federal lands.

Having the US commit to implementing EITI at home, as Norway has done, would have an enormous impact on the transparency movement, building momentum to develop a truly global standard of transparency in these vital sectors. Norway's recent participation has already encouraged some Gulf producers like Kuwait and Qatar to give serious consideration to implement. US implementation would pressure other hard cases – Russia, Turkmenistan – to follow suit.

Senator Lugar, ranking member of the Senate Foreign Relations Committee, issued a report on EITI late last year which included the recommendation that the US implement EITI. Other Senators have expressed an interest in this idea. EITI implementation would have the added important benefit of increasing the transparency of the Interior Department's much criticized management of federal minerals. Secretary of the Interior Salazar has expressed a strong commitment to increasing transparency and accountability specifically around minerals management. Adopting EITI would put an internationally recognized transparency stamp on US minerals revenue disclosure policies and demonstrate that the Administration unequivocally means what it says in this regard. It would be the strongest possible leadership by example.

5. Support the Inclusion of Pipeline Revenues in the EITI disclosure process.

Opaque arrangements around oil and gas transit, such as those between Russia and Ukraine, increase the risks of massive corruption and disruption of vital supplies, with widespread economic and political implications. Ensuring that these arrangements are transparent and the money flows visible to the public will reduce these risks and enhance energy security. Adding transit revenues to the menu will also bring additional countries

[5] For more information on EITI, see www.eitransparency.org.

to the transparency game, which would not otherwise participate in EITI. Sudan, Egypt, Georgia, China even, could be brought on board.

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