

Memo for Workshop on Poorly Governed Resource-Dependent States
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REPORT

Last year, at the direction of Senator Lugar, the minority staff of the Senate Committee on Foreign Relations examined extractive industry transparency and issued a report “Petroleum and Poverty Paradox: Assessing U.S. and International Community Efforts to Fight the Resource Curse.”

We travelled to twenty-one natural resource-rich developing countries to assess U.S. and international efforts to address the “resource curse,” the phenomenon whereby large reserves of oil or other resources often negatively affect a country’s economic growth, corruption level and stability. Overcoming the impacts of this curse helps promote U.S. policy goals of poverty alleviation, good governance and energy security. With the volatile price of oil inflicting economic pain on American consumers, creating vast pools of sovereign wealth controlled by often authoritarian regimes, and jeopardizing gains that have been made in poverty alleviation worldwide, the prudent management of energy flows and their revenues has formed a critical nexus of U.S. foreign and domestic policy: failure to secure our interests abroad has threatened prosperity at home.

Our report argues that transparency in revenues, expenditure and wealth management from extractive industries is crucial to defeating the resource curse. Achieving transparency requires a higher profile in U.S. diplomacy and foreign policy. When oil revenue in a producing country can be easily tracked, that nation’s elite are more likely to use revenues for the vital needs of their citizens and less likely to squander newfound wealth for self-aggrandizing projects. When financial markets see stable economic growth and political organization in oil-rich states, supplies are more reliable and risk premiums factored into prices at the gas pump are diminished. And as official corruption tempted by oil wealth abates, our foreign assistance dollars can find more fertile ground to alleviate the suffering of the world’s most needy.

RECOMMENDATIONS

The report, completed before the November election, includes recommendations for the administration, Congress, the international community and extractive companies to help nations fight the “resource curse” and advance the U.S. policy aims of reducing poverty, improving governance and securing our energy interests. Recommendations include:

- 1) The President should put greater emphasis on promoting extractive industry transparency by developing a clear strategy and designating responsibility for implementation of that strategy.
 - a) The President should outline a clear strategy to drive our government’s push for extractive industry transparency from bidding and contracts, through company payments to governments, to budget transparency and accountability of spending. Such a strategy will necessarily draw upon expertise spread across government agencies. The strategy should identify the State Department as the lead coordinating agency and the Bureau of Economic, Energy and Business Affairs as the lead bureau responsible for promoting extractive industry transparency.

- b) The President should lead by example and have the United States become an implementing country of the EITI. This move would pay large benefits by encouraging more developing countries to follow.
- 2) The Secretary of State should exercise more effort on transparency issues, and build on international momentum for extractive industry transparency at the United Nations, at the EITI secretariat and through our embassies.
- a) The Secretary of State should elevate U.S. representation to the EITI Executive Board to the Under Secretary for Economic, Energy and Agricultural Affairs. The U.S. has capable representation but at a rank much lower than the representatives from other countries, which limits the ability of the U.S. to secure change.
 - b) The Secretary of State should clearly inform embassies of the importance of transparency efforts and more vigorously support such efforts in international fora. For instance, instead of simply voting for the recently-passed EITI United Nations regulation, the U.S. should also have been a co-sponsor.
 - c) The Secretary of State should develop a tailored extractive industry transparency advocacy strategy, according to the conditions in the host-country. Where appropriate, U.S. Government representatives need to engage directly with extractive country governments to explain the benefits of increased transparency, identify opportunities to promote change, and, where appropriate, encourage them to sign onto EITI.
 - d) The Secretary of State should review personnel capabilities at embassies in natural resource rich states and fill current gaps in embassy staffing.
 - e) The Under Secretary for Economic, Energy and Agricultural Affairs should regularly lead coordination meetings of U.S. Government agencies involved with extractive industry transparency and should track agency actions and results.
 - f) The United States should bolster its support for EITI by immediately depositing its \$3 million contribution to the Multi-Donor Trust Fund.
- 3) U.S. bilateral assistance in extractive countries should be focused on good governance, transparency and building civil society.
- a) Our Ambassadors and country teams should review their portfolios for critical opportunities to build capacity in governance, especially in revenue management, thus leveraging the most valuable additional asset—technical know-how—the U.S. can bring to bear where financing is not the problem.
 - b) USAID, along with the Treasury Department and other agencies, should emphasize technical assistance for extractive industry transparency in relevant countries, and EITI implementation in countries that have signed up for the initiative.
 - c) Coordination between country teams and technical agencies in Washington should be improved and mechanisms put in place so that U.S. Government agencies are able to respond promptly and effectively to requests for technical assistance.
 - d) As Overseas Private Investment Corporation (OPIC) is already doing, all U.S. foreign assistance agencies (USAID, Millennium Challenge Corporation, ExIm, etc.) should integrate transparency promotion into their oil, gas, minerals and timber programs, projects and policies.
 - e) U.S. agencies should use public-private partnerships to provide information technology and training for platforms, such as geonavigator and mineral mapping software, to

distribute information so that there would be “no excuses” for countries that profess to want to disclose.

f) U.S. bilateral assistance should also expand upon public-private partnerships to engage experts in the private sector for technical assistance.

g) U.S. bilateral assistance should build upon co-funding arrangements for technical expertise where host governments rich in extractive revenues pay the bulk of costs for such arrangements.

4) The Secretaries of State and Treasury should engage China, India and Russia on transparency issues generally and encourage them to become supporting countries of EITI. Indian and Chinese companies are securing extractives contracts around the world, particularly in Africa. If they do not integrate transparency into their operations, they could undermine other international efforts.

5) The Securities and Exchange Commission and the Treasury Department should encourage the International Organization of Securities Commissions (IOSCO) to develop consistent requirements for disclosure of extractive payments by companies to governments so that all the major stock exchanges require the same information. They should also support an International Accounting Standard for disclosure of extractive payments to governments.

6) The international donors who give aid to resource-rich countries should focus their efforts on improving revenue management and fighting corruption. Relatively small amounts of aid money could thus help channel large amounts of countries’ own funds toward poverty reduction.

a) The World Bank and the International Monetary Fund, which make regular assessments of countries’ performance, should be consistent in assessment of countries’ progress on transparency compared to their own professed benchmarks. They also should ensure that their staffing at key posts reflects commitments made to those governments in technical assistance on improved financial governance.

b) The regional development banks should integrate EITI into their operations. Not all of the regional development banks have endorsed EITI and, of those that have, few have fully applied EITI principles in their projects. The regional development banks should condition loans on revenue disclosure and contract transparency.

c) The International Monetary Fund should consistently examine the transparency of extractive industry revenues for all resource rich countries in its Article IV reviews.

d) The International Monetary Fund should actively engage and provide technical assistance to resource rich countries to implement the IMF sovereign wealth fund guidelines.

7) The G-8 should show commitment to transparency in action, not just words.

a) The 2008 G-8 report on its anti-corruption accomplishments was a good start but it needs to be done every year at a higher standard of disclosure and contain commitments to improved activity during the next disclosure period.

b) The U.S., in conjunction with the other G-8 nations, should require that oil and mining companies listed on their stock exchanges publish country-by-country data on their royalty, tax and other relevant payments as part of routine financial reporting, and ask credit rating agencies and commercial banks to take explicit account of a country’s transparency record.

c) G-8 countries with significant extractives industries should sign up for EITI which would enhance the credibility of the initiative and encourage other countries to join.

8) Congress should support mandatory financial reporting requirements on a multilateral basis. This could be done through the G-8, where repeated endorsements of EITI and revenue transparency have not been followed up with concrete action. The SEC could seek to harmonize such reporting requirements among major global stock exchanges through the International Organization of Securities Commissions.

9) Congress should pass legislation requiring that U.S. foreign assistance to extractive industry dependent countries include significant support for transparency.

10) Extractives companies, which have taken the initiative in some countries but not others, should step up their engagement to promote transparency and be more proactive in public disclosure of revenue payments to foreign governments. Oil and mining companies should voluntarily disclose their extractives payments to foreign governments. They should publicly endorse transparency in bidding and contracts.

11) Oil and other extractives companies should develop a reporting template for standardized disclosure of payments to be adopted as a global standard. Such a template could usefully be developed in conjunction with the EITI Secretariat.

12) The EITI Secretariat should ensure clear criteria at each stage of progression to avoid the appearance of political favoritism in the implementation of EITI.

a) The EITI board should have a mechanism to issue reports to the UN Security Council and other appropriate bodies.

b) EITI should improve its efforts to clearly delineate, to countries and companies, the benefits of participation.

c) EITI needs to focus more on technical assistance and make available to countries that sign-up for EITI a package of technical assistance to show good will and international support for the countries' success through EITI.

d) EITI must redouble its focus on implementation. While much effort has been dedicated to expanding the roll of EITI countries, a few successful countries could serve as concrete models for the gains EITI could bring.

13) EITI certification criteria should resolutely include reporting by state-owned extractive industries companies. Credit rating agencies should make more explicit the importance of transparency as part of governance structures for indicating credit worthiness.

SUBSEQUENT DEVELOPMENTS

Thus far, most of the reaction to the "Petroleum and Poverty Paradox" report has been positive.

In order to call the Obama Administration's attention to the importance of extractive industry transparency, Sen. Lugar, the Senate's senior Republican, included the topic in questions for the record for Secretary of State nominee Hillary Clinton's confirmation hearing (appended below). Committee staff has discussed it with the Treasury Department transition team, with new Obama White House staff, and with career civil servants in the relevant agencies.

The Treasury Department's Office of Technical Assistance, when doing work in extractives countries, is paying additional attention to transparency issues.

Though the United States' contribution of \$3 million for the EITI Multi Donor Trust fund was appropriated at the end of 2007 and congressional notice of the payment was given in August 2008, the funds had not reached EITI as of February 2, 2009. Staff has been regularly contacting

USAID (which is responsible for the transfer of funds) to ensure that the funds are deposited as envisioned.

Since the report was released, Norway expressed its interest in becoming an Extractive Industry Transparency Initiative candidate country. This helps bolster the argument for the United States to become a candidate country. Staff talked to relevant technical level personnel at agencies responsible for the disclosure of revenues earned by the Government of the United States from extractive industries including: the Department of Interior, Mineral Management Service, U.S. Geological Survey, and U.S. Forest Service. They reported that compliance with the EITI certification regime would be probably be fairly simple (barring unforeseen formatting difficulties or whatever) since most of the information is already available.

Foreign Relations Committee minority staff continues to consider the Extractive Industries Transparency Disclosure bill which would require that companies listed on U.S. exchanges disclose their extractive industry payments to foreign governments. The bill was introduced in the last Congress, Representative Barney Frank held a hearing on the bill but it was not passed into law. We expect that it will be reintroduced in this Congress. Minority committee staff has had discussions with the SEC about the proposed legislation. The SEC staff (under the Bush administration) said the bill did not appear to place undue burdens on the agency but questioned whether the disclosure requirements were pertinent to the agency's mission of informing and protecting investors. Committee staff is waiting for new Administration to get in place at Treasury, State, SEC, etc., then will re-engage on the disclosure bill.

QUESTIONS FOR THE RECORD

Below are select "Questions for the Record" submitted by Senator Lugar to Secretary of State nominee Senator Hillary Clinton. Answers were received January 12, 2009.

Transparency in Extractive Industries and Related Issues

158. The Senate Foreign Relations Committee staff report entitled "The Petroleum and Poverty Paradox: Assessing U.S. and International Community Efforts to Fight the Resource Curse" recommended that "the Secretary of State should exercise more effort on transparency issues, and build on international momentum for extractive industry transparency at the United Nations, at the EITI (Extractive Industries Transparency Initiative) secretariat and through our embassies".

- a. Do you agree with this statement? If so, what steps do you expect to take to support extractive industry transparency?

I support a lead role for the State Department in advancing resource transparency at the United Nations, and through our leadership role in the EITI process. Our embassies continue to play an active part in promoting resource transparency and good governance in their host countries.

- b. Do you agree with those who say that one of the most effective ways for the U.S. to show its commitment to extractive industries transparency, and to encourage more transparency by developing countries, would be for the United States to sign on as an EITI implementing country and submit its oil and gas revenues to independent audit? If so, would you commit to taking this step early in the administration?

Domestic agencies, including many at the state and local levels of government, would have to examine this issue before the U.S. government could make such a commitment. U.S. markets and systems for reporting revenues from resource extraction are already among the most transparent in the world. Oil and gas and minerals revenues from domestic production are subject to oversight by national, state, and local levels of government as well as the scrutiny of financial markets and our free media.

159. How can the Administration better engage with China, India and other emerging markets on issues around extractive industry transparency?

The U.S. government has been engaging with China, India, and a number of other governments on the benefits of supporting the Extractive Industries Transparency Initiative (EITI). Increased transparency will lead to more reliable suppliers of energy and other raw materials. As the countries with the fastest-growing energy consumption, China and India have an interest in expanding global energy supplies and raw materials access from stable countries. If confirmed I will direct State Department staff to continue to engage with China, India, and other emerging economies on EITI bilaterally and multilaterally, including through the United Nations.

160. The Senate Foreign Relations Committee report, "The Petroleum and Poverty Paradox: Assessing U.S. and International Community Efforts to Fight the Resource Curse", asserts that "U.S. bilateral assistance in extractive countries should be focused on good governance, transparency and building civil society". How do you think U.S. bilateral assistance, through USAID, OPIC, MCC, the U.S. Export Import Bank, and other agencies, should be prioritized in extractive countries?

In economies dominated by extractive industries, good governance, transparency, and building civil society are critical to providing an environment conducive to sustained poverty reduction and democratic development. The United States and other donors should and do support those efforts with a range of assistance programs, including rule of law and governance reforms, public sector capacity building, and strengthening of independent media and civil society checks and balances. For these efforts to be successful, the countries themselves must bear primary responsibility for leading this process.

U.S. assistance programs rarely provide direct support to the development of extractive industries. When they do, it is important that we promote and support transparency and accountability in the public sector oversight, revenue collection, and other critical areas of good governance. I am committed to working with my colleagues at OPIC, MCC, the U.S. Export Import Bank, and other relevant agencies to ensure that the United States provides consistent, constructive policy leadership on this issue.

OP-ED

Reproduced below is the op-ed, based on the "Petroleum and Poverty Paradox" report, that Senator Lugar published in the Christian Science Monitor.

The petroleum and poverty paradox

We must work smarter to reverse the resource curse.

By Dick Lugar

from the December 11, 2008 edition of the Christian Science Monitor

Washington - Logic says that petroleum-rich countries should be rich. The oil-producing, less-developed nations that reaped a bonanza during the past few years of sky-high oil prices ought to be sitting pretty even as crude prices experience free-fall today. However, things aren't that simple.

Venezuela, for instance, thanks to mismanagement of its oil windfall, is suffering high inflation, a drop in petroleum production, and is talking of possible austerity measures, even though it is the Western hemisphere's largest oil exporter.

In fact, history shows that oil and natural gas reserves frequently can be a bane, not a blessing, for poor countries, leading to corruption, wasteful spending, military adventurism, and instability. Too often, oil money intended for a nation's poor lines the pockets of the rich, or is squandered on showcase projects instead of productive investments.

A classic case is Nigeria, the eighth-largest oil exporter. Despite half a trillion dollars in revenues since the 1960s, poverty has increased, corruption is rife, and violence roils the oil-rich Niger Delta.

The term "Dutch Disease" was coined after the Netherlands' economy weakened following the 1960s discovery of natural gas, thanks to a rising exchange rate and a fall-off in manufacturing. Even OPEC countries are not immune. As a group, their per capita gross national product actually dropped from 1965 to 1998, one study found.

This "resource curse," as economists call it, curses America, too. It worsens global poverty, which can be a seedbed for terrorism, it empowers autocrats and dictators such as Saddam Hussein, and it can crimp world petroleum supplies by breeding instability.

What can we do to reverse the resource curse? A new report I commissioned from the Senate Foreign Relations Committee staff, "The Petroleum and Poverty Paradox", offers some answers. There is no simple cure, of course. But where leaders are ready to face the problem, outsiders can offer important incentives and advice.

One key prescription is to promote stronger anticorruption measures and more openness, or transparency.

The World Bank and the International Monetary Fund have launched efforts to improve accounting and transparency of extractive industry revenues, to make it harder for officials to hide corruption – and easier for citizens to demand that the money be spent wisely.

An especially promising development is the Extractive Industries Transparency Initiative (EITI), a voluntary program which certifies that participating countries, and the oil companies operating there, are honestly accounting for funds flowing into their coffers. The G-8 and UN have praised the EITI and its work.

Yet action falls short. In Vietnam, where 30 percent of the budget comes from oil, the World Bank and major bilateral donors have done little to address extractive industry transparency. Peru and Equatorial Guinea have signed up for EITI, but major-country donors are not stepping forward to strengthen those nations' capacity to manage massive oil wealth. Skeptical Indonesians asked why America has not joined EITI. In Angola, which has the world's highest infant mortality rate, the US is terminating a program to help the country administer its oil billions, which are largely unaccounted for.

There is an urgent need for concerted diplomacy and assistance targeted at budget management and expenditure accountability. Donor coordination in these areas is rare. And China, whose state-backed oil companies have a large footprint in many developing countries, has not yet engaged on these issues.

As we are now seeing, oil prices can come down just as far, and just as fast, as they go up. That's why it's so critical that developing countries act urgently to ensure that their funds are managed wisely, so that they are not left in poverty after earning billions. We can do more to help:

- America should lead by example and sign up for EITI, submitting its oil and gas royalties to outside audit. This low-cost move would encourage more developing countries to follow.
- The G-8 countries should back their transparency words with deeds. They could, for instance, require that their oil and mining companies publish country-by-country data on royalty, tax, and other payments as part of routine financial reporting.
- International assistance to resource-rich countries should focus on improving revenue management and fighting corruption. Relatively small amounts of aid money could thus help channel large amounts of countries' own funds toward poverty reduction.
- Oil and mining companies can be part of the solution by voluntarily disclosing their payments to countries where they operate.

Most important, the United States, whose attention to transparency often appears sporadic, should vigorously back these efforts. Reversing the curse is in everyone's interest.

Dick Lugar is a Republican senator from Indiana and the ranking member on the Senate Foreign Relations Committee.