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Editor-in-Chief

Thomas W. Wälde
twwalde@aol.com
Professor & Jean-Monnet Chair
CEPMLP/Dundee

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Oil, Gas & Energy Law Intelligence

Extractive Industry Transparency; An ENATRES Discussion by M. Schloss

About OGEL

OGEL (Oil, Gas & Energy Law Intelligence): Focusing on recent developments in the area of oil-gas-energy law, regulation, treaties, judicial and arbitral cases, voluntary guidelines, tax and contracting, including the oil-gas-energy geopolitics.

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Our aim is for OGEL to become the hub of a global professional and academic network. Therefore we invite all those with an interest in oil-gas-energy law and regulation to contribute. We are looking mainly for short comments on recent developments of broad interest. We would like where possible for such comments to be backed-up by provision of in-depth notes and articles (which we will be published in our 'knowledge bank') and primary legal and regulatory materials.

Please contact **Editor-in-Chief** Thomas Wälde at twwalde@aol.com if you would like to participate in this global network: we are ready to publish relevant and quality contributions with name, photo, and brief biographical description - but we will also accept anonymous ones where there is a good reason. We do not expect contributors to produce long academic articles (though we publish a select number of academic studies either as an advance version or an OGEL-focused republication), but rather concise comments from the author's professional 'workshop'.

OGEL is linked to **ENATRES**, the electronic energy law, policy and economics information and discussion forum moderated by Thomas Wälde.

Extractive Industry Transparency; An ENATRES Discussion

Edited by Miguel Schloss - 7 January 2007

The detention of C. Mounzeo, an anti-corruption campaigner in Congo Brazzaville and member of the Extractive Industries Transparency Initiative (EITI) triggered a discussion on the best way to address corruption in such sectors.

M. Schloss stressed that it was naïve to believe that tracking extractive industries taxes, royalties and other payments is somehow going to reduce corruption. Such “controls” can be easily gamed by unscrupulous governments or enterprises, and people who protest can be left hanging on their own without much recourse for corrective action (as shown this case in point).

Schloss said that the greatest problems are not centered on how to stop or even control mischievous behavior and associated corruption, but in the failure to understand the forces at work. In fact, many of the “solutions” being promoted are based on strengthening controls and monitoring vehicles that don't have remotely the agility of today's economic forces, thereby getting everyone to bark at the wrong tree, for lack of proper diagnoses of the problems to be resolved. Accordingly, he advocated for a more empirically grounded assessment of each case, and more tailor-made solutions, such as found in a few countries that have succeeded to address the problems more effectively.

One way or another, in the end, the solutions have to be grounded on institutions that are accountable, are compatible with the institutional capabilities in the countries concerned, and are driven by commitments resulting from incentives, rather than mere bureaucratic compulsion of donors or well meaning advocacy groups.

The majority of comments supported this view.

- **H.W.Wabnitz** referred to a number of cases where he was involved in Africa, where neither the World Bank nor the governments concerned had the necessary incentives beyond rhetoric, some publicity and face saving gestures.
- **R. Prichard** made some contextual comments, stressing that combating corruption necessarily involved a broader set of actions, requiring diverse and adaptable tools: a mixture of carrots and sticks; a mixture of laws, policies, incentives, regulatory penalties and taxes that are applied and administered by good governance systems – all of which has to be underpinned, as Schloss suggested, by a better understanding of the main forces at work is the starting point for developing an appreciation of the many variables that influence outcomes.
- **C. Zimmermann**, drawing distinctions between different forms of corruption, noted that in countries where the government's commitment to democracy is weak, and where people have historically been punished for speaking out

against their rulers, a major step toward improvement in governance is simply freedom of speech and freedom of the press. What is needed under such circumstances is more "sunshine" for residents of countries with governance problems. More generally, he felt that the problem of corruption is more acute wherever people believe that they have a chance to accumulate great wealth and/or great political power without much education and without much work. Also, he stressed that people who are able to speak out against corruption may unintentionally send the wrong message when they declare some sort of campaign against corruption but do not touch the individuals and companies that are most often accused in the press of some form of corruption.

- The same as **S. Boehmer-Christiansen**, concluded that a certain amount of transitional corruption must be considered unavoidable. She also noted that lack of freedom of speech may be essential for political stability even survival, and with it a requirement for investments. She felt, however, that the correlation between economic growth and corruption is very imperfect, and thus the fight against corruption was not necessarily as compelling as one might think.
- **W. Ascher** felt that Schloss' diagnosis of corruption is compelling, and felt that one shouldn't consider governments and elites as monolithic. For every agency that benefits from a lack of transparency, there is likely to be an agency disadvantaged by it. Finance ministries typically resent the leakage of rents that should go into the central treasury; especially corrupt agencies may provoke actions by other agencies to reduce the leakage. The key then, is to take advantage of "bureaucratic politics;" i.e., the conflicts within governments that afford the opportunity to initiate reform from within.
- **L. Berliner** expressed total support from M. Schloss' views.
- **J. Matthews** sent an Op-Ed Article in the NY Times, which concluded that what counts is how systems are structured, and that change that, Africa, like elsewhere, needs a permanent source of political pressure from citizens and business groups — not just general disgust, but advocacy.

On the other hand, two participants took a more positive view of EITI:

- **J-P. Favennec** stressed that, while this initiative may not be perfect, it may be a good way to start talking the issue.
- Similarly, **M. Ross**, while recognizing that one shouldn't expect EITI to eradicate corruption in the extractive sectors, if it can even make a difference at the margins - in countries where huge sums are being ripped off while people languish in poverty - it will have been worth it. He stressed that EITI should be seen as a good start, and that we should not see the "ideal" (as he depicted Schloss' proposal) as the enemy of the "good."

Reflecting on the various comments, M. Schloss stressed that corruption is a systemic problem. If you build control vehicles, with great precision on a narrow set of variables (in this case tax and similar payments between enterprises and governments), you just as easily can hide informal payments through gold plating production costs, transfer pricing to downstream activities (e.g. in the imports/exports process), effecting payments in public expenditures programs. Accordingly, one must address the issue through the incentives structures, checks and balances, oversight vehicles, etc. throughout the supply chain. There are countries that have done so, and have consequently made a good deal of progress (like Chile, Botswana, and a few others), outside the framework of EITI.

By the same token, he stressed that these efforts, and the consequent institutional solutions should always be considered by their very nature as work in progress, given the very dynamic character of corruption and governance issues -- i.e. every solution to identified vulnerable areas is bound to generate new capabilities to circumvent enhanced controls built as a result of new institutional requirements, and traffic of influences inevitably adapt their operations in ways that exploit precisely the obstacles that weigh governments down. Accordingly, whatever solution is designed must be light, flexible, and under constant review to reflect the institutional capacity in the countries concerned, the way transactions evolve in light of the control measure put in place, etc.

More broadly, any solutions passes through: (i) an open, transparent, depoliticized public administration; (ii) an empowered and strong civil society; (iii) an accountable political process; (iv) solid oversight arrangements, proper checks and balances, and effective mediating mechanisms. Whatever the particular institutional arrangements to achieve such objectives, one way or another, there is an urgent need to link action in extractive industries to the broader governance framework for anything to work. Only in this way, can one expect the incentive structures to work for improved controls (and address deep and difficult to overcome vested interests conflicting with such improvements).

In a separate though related discussion, in connection with Angola's case, J. P. Perez Castillo concluded that every OPEC member is suffering from the resource curse, because the absorptive capacity of an economic system is invulnerable to good policies and transparency improvements, when these are intended to jump start the process of expansion of such capacity without the necessary and sufficient ingredients in place, which can come about only through gradual consistent and systematic effort.

*Miguel Schloss, Advisory Board, Dalberg Group
New York, NY - Washington DC - Geneva, CH - Copenhagen DK - Santiago, RCH
www.dalberg.com*

Notes

[1] Most of the original postings referred to above can be found in the **ENATRES** archive <http://enatres.ogel.org/members/enatres/2006/11/threads.asp#00076> (login required)

[2] More information about EITI can be found at their website www.eitransparency.org. Also the OGEL Knowledgebank has numerous related documents to this subject (www.gasandoil.com/ogel)