TRANSPARENT GOVERNANCE
IN AN AGE OF ABUNDANCE

Experiences from the Extractive Industries in Latin America and the Caribbean

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Editors
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While several Latin American and Caribbean (LAC) scholars and practitioners have highlighted the importance of transparency in the extractive industries, only a few have attempted, in a single volume, to introduce relevant theoretical knowledge by analyzing the roles of governments and presenting concrete and current examples. This book aims to address precisely this gap in knowledge.

The editors have made an effort to select experiences that are relevant to a wide spectrum of stakeholders, drawing important lessons from the management of extractive industries in LAC countries over the past decade. While there are promising developments and innovations, the countries also face significant challenges in their efforts to strengthen transparency in extractive industries. Transparency in governance in this sector is a critical priority and LAC countries have embraced it and are actively pursuing it.

The book highlights the importance and the benefits of transparency in the governance of extractive industries in the LAC region. A central message is that high-quality and well-managed information is critical to ensure the transparent and effective governance and regulation of extractive industries. This is especially true in the management of revenues derived from the extractive industries in a time of fluctuating commodity prices. While it is not the solution to all problems, transparency is a first step and key component in the resolution of the fiscal, institutional, and social challenges surrounding the sector. People in the region are demanding greater openness and accountability in this critical sector, which drives growth in many countries.

This publication covers a wide spectrum of challenges and opportunities along the extractive industries value chain, from licensing to revenue management. It does so in a systematic fashion, first presenting the theories that have arisen to explain the challenges in the sector; then exploring transparency-imbued regulatory solutions; and finally, highlighting the
importance of better public management as a solution to the governance gap in the extractive industries. The book is structured in three main parts. Part I, Understanding the Governance Gap, provides an overview of theories that explain the governance challenges inherent to the extractive sector, as well as key initiatives developed to address them. Part II, Legislation, Licensing, and Contracts, addresses challenges in the region, delving into how governments can increase revenue, improve their negotiating power, and ultimately provide better services to their citizens through improved legislation and increased transparency in licensing and contracts. Part III, Public Management and Fiscal Regimes, focuses on how fiscal regimes and institutions can be improved by greater transparency.
The LAC region has experienced an unprecedented age of abundance during the past decade. The region is the world’s leading source of metals and its second most important source of oil. In the first quarter of 2014, it produced over 10 million barrels of oil and more than 800 million cubic meters of natural gas per day (IEA, 2014). The region holds approximately one-third of the world’s mineral investment portfolio and is the principal target for global investors in this sector (Larsson and Ericsson, 2014). The prices of many of the commodities exported by countries in the region have risen dramatically over most of the last 10 years.

The wealth of minerals and hydrocarbons in the LAC region has translated into substantial revenues and macroeconomic growth but, as extensively portrayed in the media, operations in the extractive sector have also led to significant challenges, such as corruption and negative social and environmental impacts. Local communities have expressed their concern for the lack of tangible development benefits stemming from the exploitation of natural resources, prompting heated debates on if and how extractive industries can promote sustainable and inclusive economic growth.

An underlying concern of this book is to highlight the need to move beyond the resource curse debate. The inverse relationship between natural resource abundance and economic development is known in the specialized literature as the “resource curse” or the “paradox of plenty.” For decades, this conundrum has captured much of the attention of the research dedicated to the extractive industries and—since the 1950s—numerous theories have been put forward to explain the apparent negative effects of natural resources. It has been suggested, for example, that natural resource abundance leads to dependency and increased vulnerability to the volatility of commodities, as well as to the encroachment of perverse rent-seeking incentives in the institutions of the sector.

However, relatively recent empirical studies suggest that meeting development targets through the expansion of the extractive sector is possible. Drawing from the experiences of countries such as Australia, Botswana, Canada, Chile, and Norway, some scholars have argued that sustained
economic growth, supported by natural capital, is possible under certain circumstances. These experiences show that the extractive sector, when properly governed, can contribute to the development of infrastructure and basic services; promote technological innovation and the enhancement of the skills and knowledge of the workforce; and support the development of local businesses through the integration of supply chains.

These country experiences point to the importance of checks and balances—that is, having effective mechanisms in place to prevent corruption and enhance transparency and accountability—to reduce the negative externalities of natural resources exploitation. Policy measures and institutional mechanisms that improve efficiency and foster participation also emerge as important elements.

How then does the LAC region fare in comparison to other regions? The data is encouraging. As discussed in Chapter 2, according to the 2013 Resource Governance Index (RGI), published by the Natural Resource Governance Institute (formerly the Revenue Watch Institute), more than half of the 11 countries that score highest in terms of quality of governance in the extractive sector are located in the LAC region (i.e., Brazil, Chile, Colombia, Mexico, Peru, and Trinidad and Tobago). This data, however, should be interpreted cautiously. Despite encouraging results in some countries, the region as a whole is still lagging well behind OECD countries in some critical areas, such as in the Rule of Law and Control of Corruption components of the RGI. This suggests that countries in the region still have a long way to go in complying with legal principles and institutional arrangements. This is especially problematic in a region where the negative impacts of natural resources exploitation are felt disproportionately among indigenous communities.

The book also explores some of the key challenges hindering governance in the extractive sector in the region. The most important of these challenges is social conflict. In late 2013, the Latin American Observatory of Mining Conflicts (OCMAL), a network of civil society organizations that records large-scale metal mining conflicts, reported that there were at least 198 active conflicts affecting 297 communities throughout the region. A study published in the Proceedings of the National Academy of Sciences found that delays caused by these conflicts can result in costs of around US$20 million per week for mining projects valued at between US$3 and US$5 billion. Perhaps more importantly, these conflicts signal the profound and negative impacts that the extractive sector can have on the environment, cultural practices, and established local economic activities. They demonstrate that the failure to live up to citizen’s expectations is proving increasingly costly both in economic and political terms for investors and governments.
At the heart of effective governance of the extractive sector is the fundamental question of how to address the capacity constraints of governments. Governing the sector requires navigating complex policy design and implementation across multiple sectors, such as water and sanitation, infrastructure, environment, and social protection. Countries have to address accountability and oversight challenges in the face of limited experience and expertise. Shortfalls and gaps in financial, human, and technical resources can hinder a government’s ability to adequately enforce and implement necessary regulations. A key task for multilateral development organizations, such as the IDB, is to tailor the technical assistance to the needs of individual member countries and continue to explore new approaches to improve the quality of governance in the region.

Social protection and governance are both intertwined with the challenge of “reach.” How can governments ensure that economic and social benefits from extractives industries are fairly distributed to local communities? Even after a decade of record-level commodity prices, the debate about the best way to effectively and sustainably capture value from the sector for all citizens remains unresolved. The discussion continues on both the conceptual and policy implementation fronts, focusing on taxes and royalties, infrastructure corridors, mineral clusters, mandatory local content, and technology transfer requirements. While these challenges are present at all governance levels, subnational governments are especially vulnerable, because of their low capacity and lack of resources to manage revenue windfall.

In the last decade, governments, industry, and civil society organizations have developed diverse instruments for increasing transparency under the assumption that the public sector’s capacity to manage and control the activities in the extractive sector has a direct effect on risks and conflict prevention. In addition to political will, the effective implementation of these tools requires a wide range of skills and expertise. It is therefore important to support capacity building of LAC government officials and to help them keep abreast of the latest innovations in both the private and public sectors. Over the last decade, the knowledge gap between the private and public sectors has increased along every step of the value chain, from the negotiation of contracts, regulation of impacts, consultation with the myriad stakeholders, and to the saving and spending of revenues and royalties.

A first step toward finding solutions to these challenges is to leverage the transformative power of transparency as a way of not only preventing corruption but also redefining the relationship between governments and citizens. Fortunately, LAC countries have been enhancing their extractives transparency frameworks. Most countries in the region have adopted and
started implementing access to information and transparency laws at the national level, while introducing new transparency mechanisms in the extractive sector. Moreover, the interest in the EITI has also grown over the last few years. In 2012, Peru became the first country in the region to become compliant with the EITI standard. Since then, Guatemala and Trinidad and Tobago have made great strides towards compliance with the standard, paving the way for other countries, such as Colombia, Guyana, Honduras, Mexico, and Suriname to explore the initiative.

The cases presented in this book demonstrate that transparency policies can help redress inefficient procedures, impose deadlines and conditions for information disclosure to the public, set quality standards for the information, and help create a culture of open government in public administration. Transparency policies can also encourage more active engagement of different stakeholders in the governance of the extractive sector, and reflect the beginning of a more profound transformation of the relationship between government and citizens.

Despite positive developments, three main challenges emerge from the cases analyzed. The first is related to the availability of data: governments need to make reliable, high-quality information available in a timely fashion and in a digital, user-friendly format. Second, governments must be aware of the issue of access: platforms for disseminating extractives data and information need to be easy to navigate by a wide range of stakeholders. Third, merely disseminating data is not sufficient; governments must also find creative ways to solicit feedback from citizens and encourage the use of available data.

While the level of transparency in a particular governance system helps determine its quality, initiatives to promote transparency can help improve it. Transparency can enable investment in the extractive sector, support the emergence and consolidation of better institutions, and build trust among stakeholders—all of which contribute to a thriving extractive sector.

REFERENCES


Chapter 1: Transparency Laws, Standards, and Benchmarks in the Extractive Industries

JUAN CRUZ VIEYRA, MALAIKA MASSON, AND MARTIN WALTER

This chapter provides an overview of initiatives to promote transparency, with a special focus on their influence in Latin American and Caribbean (LAC) countries. It stresses that stakeholders operating and engaging with each other in a context of both structural constraints and enabling factors drive these initiatives. It provides a simple heuristic to distinguish among myriad instruments developed and implemented to turn the curse of resource wealth (the “resource curse”) into a blessing. Exploring the differences between alternative approaches helps highlight the overall consensus on framing transparency as a necessary step toward the resolution of governance issues in the extractive industries. In light of the relative success of LAC countries in implementing transparency policies and reforms, it also stresses that improved transparency alone is not sufficient to ensure that resource endowment effectively translates into social and economic welfare.

Chapter 2: Measuring up to Transparency and Accountability Standards: Challenges and Opportunities for Effective Governance

JUAN CARLOS QUIROZ

How governments manage their oil, gas, and mineral resources has a direct impact on their efforts to develop their economies and provide opportunities to their people. But, how far have countries come in adopting and implementing best practices in resource governance? The Resource Governance Index (RGI) provides the first measure of transparency and
accountability mechanisms in the extractive sector in 58 hydrocarbon- and mineral-producing countries around the world. The index provides a timely assessment of how countries in the Latin American and Caribbean region compare to other regions. The RGI aims to provide comparative data, foster an informed debate about governance in the extractive industries, and contribute to empirical research on how governance affects the management of mineral resources. Elected officials, policymakers, civil society, and the media can use the information gathered in this index to identify governance challenges and promote best practices. The index intends to raise awareness about governance issues in the development community and beyond.

Chapter 3: From Dependency Theory to Local Governance: Evolution of the Research on Extractive Industries and Development

Osmel Manzano

Throughout the extensive literature on the subject, the role of natural resources in development has been presented as either a curse or a cornerstone of development. This chapter attempts to clarify this paradox by reviewing the literature from a different perspective. General hypotheses that were not sustained by microeconomic fundamentals can no longer be used to guide policymaking in resource-rich countries. The policy debate on resource-rich countries needs to move beyond this simple dichotomy and take into account the ways in which the extractive sector interacts with the rest of the economy, particularly at the institutional and the local levels.

Chapter 4: Conflict and Natural Resources: Is the Latin American and Caribbean Region Different from the Rest of the World?

Michael Ross

Oil-rich countries have civil wars at significantly higher rates than oil-poor countries. While other studies have demonstrated this pattern at a global level, this chapter demonstrates that it is equally valid in the Latin American and Caribbean (LAC) region. It also describes one important anomaly. In the LAC region, oil is only linked to government conflicts, while in the rest
of the world, oil heightens the danger of both government conflicts (in which rebels fight for control of the central government) and secessionist conflicts (in which they fight for a sovereign state). This is not because the region produces petroleum with unusual properties, but because it is uniquely “secession-proof.” Lessons about conflict prevention in oil-producing states developed at a global level are also valid for the LAC region.

Chapter 5: Implications of the Dodd-Frank Act and European Union Rules on Transparency for Extractive Industries

HEATHER A. LOWE

This chapter reviews recent legal and regulatory initiatives toward transparency in government revenues from natural resource concessions and extraction, and analyzes the impact such initiatives could have in resource-rich Latin American and Caribbean (LAC) countries. Under the United States’ Dodd-Frank Act Section 1504 and the European Union’s Accounting and Transparency Directives, oil, gas, mining, and (in the EU) logging companies, must publicly disclose royalties, taxes, and other payments made to the governments of countries in which they operate. Once fully implemented, these initiatives will produce a wealth of data for governments and civil society that can be used to hold these companies accountable and ensure that their countries’ natural resource wealth is effectively utilized. In analyzing the applicability of these requirements in several LAC countries, many, but not all, of the companies’ active in extracting resources file reports under one or both of these regimes. While most well-known global extractive companies fall under these laws’ disclosure requirements, some local companies and state-owned enterprises in the LAC region do not. This lacuna suggests that to ensure that a complete and robust data set for extractive projects taking place within their boundaries will be generated, LAC countries that have not already done so should consider joining the Extractive Industries Transparency Initiative (EITI) and implement similar reporting requirements of their own. The chapter concludes by discussing the multifaceted utility of information disclosed under these regimes to the governments of resource-rich LAC countries, ultimately finding that these regimes are not sufficient to surmount the resource curse facing many of these countries but that resource transparency is a crucial and necessary step along the path to effective resource deployment for poverty alleviation.
Chapter 6: The Role of Information in the Allocation of Petroleum Exploration and Production Rights

Rhea Brathwaite and María José Jarquín

When allocating petroleum exploration and production rights, policymakers must make balanced decisions that maximize returns while taking the political, economic, and legal/institutional landscape into account. Despite the inherent challenges involved, certain practices, such as the dissemination of information, are universally beneficial. Examining the discretionary and the auction methods based on a set of eight practices which improve access and dissemination of information gleaned from a literature review, and drawing from experiences in Brazil, Colombia, Norway, and the United States, this chapter explores the role of information in leveling the playing field in the allocation of petroleum exploration and production rights.

Chapter 7: What Can We Learn from Oil Contracts? Clarifying the Links between Transparency and Accountability

Jordan Kyle

Releasing historically confidential oil contracts into the public sphere is becoming a key part of the global transparency movement, but there has been little explanation of how contract transparency can improve resource governance. To fill this gap, this chapter addresses how accountability can develop over both fiscal and non-fiscal contractual clauses. Using data from over 100 real oil contracts signed in eight Latin American countries between 1955 and 2002, this chapter shows that citizens need supplementary contextual information to evaluate and interpret fiscal clauses such as the government’s share of profits. Social and environmental clauses are more easily interpreted, but they are often too vague to immediately enhance accountability through transparency. Moreover, for both fiscal and non-fiscal clauses, optimal design is not always obvious, and citizens need to weigh complex tradeoffs. The link between transparency and accountability, therefore, will likely only develop over time, as information about the resource sector and resource governance increases, and as countries develop robust mechanisms for incorporating citizens’ feedback into contractual negotiations. Whereas much of the existing literature posits that
contract transparency will promote accountability, this chapter builds on that concept by illustrating how to use specific clauses to promote different aspects of accountability and information from real contracts to support the claims.

Chapter 8: Finding the Balance: Transparency and Accountability versus Confidentiality in the Extractive Industries in Trinidad and Tobago

TIRA GREENE AND MARK REGIS

Trinidad and Tobago, a mature hydrocarbon-producing country, encounters difficulty in meeting the confidentiality obligations in legislation and extractive industries contracts required by the Extractive Industries Transparency Initiative (EITI). This chapter examines the challenges it faces in surmounting confidentiality and secrecy obligations in tax legislation and extractive industries contracts. It recommends creating guidance notes for use in discussions with tax authorities and company officials as they try to strike a balance between confidentiality obligations and the public’s right to know about information in contracts and legislation.

Chapter 9: Transparency in the Management of Revenues from the Extractive Industries: The Case of Colombia

DIEGO ARISI AND ANA CAROLINA GONZÁLEZ ESPINOSA

The receipt of substantial amounts of oil and mining royalties by oil and mineral-producing departments and municipalities has not translated into the expected results in terms of poverty alleviation and human development at the local level. It has even generated some distortions to political and economic life in these territories. Corruption and inefficiency in resource management tend to be the explanation in understanding this paradox. Therefore, the proposed policy solutions have focused on strengthening external controls over local authorities’ management at the national level. Given the inadequacy and ineffectiveness of such controls, new transparency, accountability and institutional strengthening initiatives as well as reforms of the resource allocation system have emerged.
This chapter explores the challenges faced by local governments in the management of revenues derived from nonrenewable natural resource exploitation, as well as the results of transparency initiatives aimed at improving local revenue administration.

**Chapter 10: Fiscal windfalls, transparency, and the efficiency of public good provision: evidence from Brazilian local governments**

**Martín Ardanaz**

This chapter explores the impact of fiscal windfalls (e.g., oil royalties) on the public finances of Brazilian local governments during the recent commodity price cycle. Given that an important share of oil royalty payments are distributed to municipalities based on geographic criteria, it estimates the effects of receiving additional revenue windfalls on three outcomes of interest: levels of fiscal transparency, budgetary allocations, and the efficiency of local public good provision in the urban infrastructure and housing sector. Based on a dataset comprising more than 5000 municipalities between 2000 and 2011, this chapter finds that the probability of declaring public finance data (a proxy for fiscal transparency) is reduced when a municipality receives royalty payments and, while fiscal windfalls are accompanied by expenditure increases across all types of sectors (education, health, and especially, infrastructure), the efficiency of public spending at the local level decreases with the size of the windfall shock.

**Chapter 11: Transforming Oil Abundance into Sector Performance: Which Institutions Really Matter?**

**Lenin H. Balza, Ramón Espinasa, and Raul Jimenez Mori**

What determines if natural resource abundance is a blessing or a curse? This chapter explores the interaction between an economy’s oil sector, economic growth, and its overall institutional framework. It shows that oil abundance has had a positive influence on economic growth, conditioned on the country’s institutional quality. Regardless of a country’s institutional environment, oil abundance positively influences its national income. This chapter challenges the usefulness of broad institutional quality indicators
in assessing their effects on oil sector performance, suggesting the need for a comprehensive assessment of governance specific to the oil industry. It argues that sector performance depends primarily on sector-specific institutions, and, to a lesser extent, national institutions. Furthermore, it suggests that transparency is an important feature that shapes the relative quality of these sector-specific institutions.

Chapter 12: The Council on Ethics and the Extractive Industries

Pablo Valverde Martínez

The Norwegian Government Pension Fund Global’s Council on Ethics assesses companies in the Fund’s portfolio and recommends whether they should be excluded from the Fund or placed under observation. The Council’s work is unique among institutional investors in that it is site-specific and in that it serves one purpose: finding and assessing companies for exclusion. The existence of the Council and its influence on other funds can play an important role in how companies and investors approach controversial extractive projects.
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Pablo Valverde Martínez, Country Manager at the EITI International Secretariat in Oslo, Norway, works primarily with countries in the Middle East and North Africa. Previously, he worked as a senior advisor to the Council on Ethics for the Norwegian Government Pension Fund Global, where he was responsible for the preliminary assessments of companies in the fund. He also conducted evaluations of extractive companies in Latin America and West Africa and participated in projects aimed at strengthening the council’s work on labor rights and corruption. Pablo has a master’s degree in war studies from Kings College London and a postgraduate diploma in international studies from the University of Barcelona. He also has a degree in political science from the University of Trondheim.
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Martin Walter, Consultant for the “Strengthening Governance in the Extractive Industries in Latin America and the Caribbean” project at the Energy Division of the IDB, has researched and published on climate, energy, and international water governance. Previously, Martin worked for the UN Environment Programme, where he researched the impact of corruption on the environment and analyzed operational safety and corporate social responsibility issues as an independent consultant. He has a master’s degree in comparative environmental policy specializing in Latin America from the Institut d’Etudes Politiques (Paris) and a dual PhD in political science from Northwestern University and the Institut d’Etudes Politiques.
This book is a valuable contribution to the debate about the policies and mechanisms that are available to promote transparency in the governance of the extractive industries.

Eleodoro Mayorga Alba
Minister of Energy and Mines
Government of Peru

This book makes an important and timely contribution to our understanding of how natural resource abundance can translate into sustained growth and inclusive development.

Børge Brende
Minister of Foreign Affairs
Government of Norway

In this valuable publication, the IDB brings to the forefront the enormous importance of the transparency with which all actors in the extractive industries should operate.

Amylkar Acosta Medina
Former Minister of Mines and Energy
Government of Colombia

Civil society struggles to ensure good governance, including appropriate checks and balances and citizen participation at all levels. For this, citizens must have access to updated and reliable information. This volume contributes to the debate on this urgent and complex topic.

Carlos Monge
Regional Coordinator for Latin America
Natural Resource Governance Institute

The Government of Trinidad and Tobago congratulates the IDB for providing an avenue to share experiences in enhancing transparency in the extractive sector.

Kevin Ramnarine
Minister of Energy and Energy Affairs
Government of Trinidad and Tobago

The World Bank applauds the IDB for highlighting the importance of improving the quality of extractive governance—an increasingly pressing issue for countries in Latin America and the Caribbean, and a core component of our agenda.

Paulo De Sa
Manager
Oil, Gas, and Mining Unit
Sustainable Energy Department
The World Bank Group

This book conveys a message that strongly resonates with the vision of the EITI Secretariat, which is that systematic information disclosure can contribute to enhancing accountability and efficiency in extractive revenue management for the benefit of all stakeholders.

Clare Short
Chairwoman
Extractive Industries Transparency Initiative (EITI)