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EXTRACTING THE MAXIMUM FROM THE EITI

By Dilan Ölcer

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PREFACE

Transparency is increasingly viewed as central to curbing corruption and other dysfunctions of resource rich developing countries. The Extractive Industries Transparency Initiative (EITI) is one of the initiatives, through which the international development community pushes for increased transparency. For example, G8 has, since Evian 2003, strongly supported the EITI as a tool for curbing corruption and improving governance in resource rich countries.

Six years have passed since the EITI was launched. Questions start rising about whether the EITI is having an impact or whether there are ways of improving this initiative. This paper contributes to that dialogue.

The paper finds that although the EITI has been very useful in directing the international community's attention towards the extractive sector, it has not been able to significantly lower corruption levels. Several deficiencies with the EITI are identified in this paper. One of the main issues is that the EITI's minimum disclosure standards and its focus on material payments between the government and the extractive companies are not sufficient to provide sound information on revenue streams and enable scrutiny by the general public. Another issue is that the EITI takes for granted that a strong and independent civil society, including a free media, already exists in countries implementing the initiative.

To address these issues, this paper recommends that the EITI be embedded in a broader reform process and linked to credible institutions, particularly judicial ones. Furthermore, EITI needs to become stricter on definitions and information disclosed in the country reports. In addition to current efforts, EITI and other institutions need to make more efforts to strengthen the civil society's position and ensure a free and independent media in implementing countries. This is indispensible for not only EITI's success, but also for other initiatives promoting transparency. Finally, this paper calls resource rich OECD countries to implement this initiative, rather than just supporting it financially.

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RÉSUMÉ

Pour beaucoup de pays riches en pétrole, en gaz ou en minerais, le développement semble hors d'atteinte : les riches s'enrichissent, les pauvres restent pauvres, les inégalités augmentent, l'économie stagne, la corruption s'étend et les conflits s'aggravent. L'initiative pour la transparence dans les industries extractives (ITIE) a contribué à mettre en lumière un secteur longtemps resté dans l'ombre. C'est un des instruments de soft law de la communauté internationale pour lutter contre la corruption et aider les pays riches en matières premières à bénéficier des revenus de leur sol. Néanmoins, les indicateurs de corruption montrent que les pays qui ont adopté l'ITIE n'ont pas vraiment amélioré leur performance en la matière. Faut-il alors attendre moins de l'ITIE ? Peut-elle être plus efficace ? Ce papier souligne certaines limites du fonctionnement de l'ITIE et formule des recommandations pour renforcer son efficacité.

Mots clés: matières premières, corruption, transparance, ITIE.

Classification JEL: M14, Q32, Q38.

ABSTRACT

For many countries rich in oil, gas and minerals, development remains an elusive goal. The rich get richer, the poor stay poor, inequality rises, economies stagnate, corruption flourishes and conflict deepens. The Extractive Industries Transparency Initiative (EITI) has helped to direct attention towards this sector, which has traditionally been shrouded in secrecy. It is one of the international "soft law" tools supported by the international development community to curb corruption and help resource-rich countries benefit from the revenues from their soil. However, corruption indicators show that EITI countries are not really improving their scores. Does this suggest that there should be a scaling down of expectations about what the EITI could deliver or can it be made more effective? This paper highlights deficiencies in the way the EITI works and makes recommendations that seek to increase the effectiveness of this initiative.

Keywords: natural resources, corruption, transparency, EITI.

JEL Classification: M14, Q32, Q38.

I. INTRODUCTION

History has shown that the discovery and exploitation of some highly prized natural resources, such as oil, gas, and minerals, do not automatically translate into sustainable economic growth and prosperity[1]. This phenomenon, often referred to as the "resource curse" or the "paradox of plenty" (Auty, 1993; Karl, 1997), is primarily of a political and not economic nature.

The extractive sector has traditionally been cloaked in secrecy and managed as the exclusive preserve of political elites and large corporations. Because of the exceptionally high potential rents they can generate, combined with the finite life of the resources, extractive industries have turned many resource-abundant countries into honey-pots, raided by all actors, domestic and foreign, regardless of the long-term consequences of this collective rent-seeking. Citizens in resource-rich countries have in general lacked information about the true value of the resources, the revenues generated by them and the spending of the receipts, since the extractive sector has, by tradition, closed its doors to public scrutiny. This opacity in the industry has also resulted in a lack of technical knowledge that limits the ability of outsiders to engage on complex issues.

If a resource curse is ever to be reversed, it is time to shed more light on the politics and businesses of this sector. But this is easier said than done. In the light of the political problems of power, bargaining, and social injustice that have formed long-standing and institutionalised patterns at the heart of the resource curse, this paper analyses how the Extractive Industries Transparency Initiative (EITI) works.

In 2002 at the World Summit for Sustainable Development, Tony Blair, United Kingdom's prime minister at the time, launched EITI as the future global transparency standard. As a coalition of governments, companies, civil society groups, investors and international organisations promoting transparency in payments made by extractive companies and revenues received by governments, the founders expected that governance and accountability would improve in these countries and ultimately lead to a larger share of revenues being spent on economic growth and poverty reduction.

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1. Apart from negatively affecting the growth rate (Sachs and Warner, 1995), large endowments of natural resources have shown to exacerbate the risk for conflict and civil war (Ross, 2003; Collier and Hoeffler, 2005; Humphreys, 2005), weak democratic development (Ross, 2001; Tsui, 2005) and corruption (Sala-i-Martin and Subramanian, 2003).

"…I firmly believe that the initiative can make a significant contribution to ensuring that the proceeds from mining and energy industries are used for development".

Tony Blair, speech at the first EITI plenary conference in 2003, Lancaster House, London.

Almost six years after its launch in 2002, 26 resource-rich countries and 40 extractive corporations had signed up to the initiative[2]. Apart from the Group of 8, the World Bank and the International Monetary Fund, 12 governments, 80 institutional investors and a number of multilateral organisations and civil society groups support the EITI through political, technical or financial means.

This paper finds that although the EITI has managed to draw the attention of the international development community to this sector, it is very much an initiative still in progress. The paper highlights several deficiencies in the way it works and argues that its minimum standards are not sufficient to provide sound information on revenue streams. Several recommendations are made on how to increase the effectiveness of the EITI as a tool for introducing transparency and curbing corruption in the extractive industries worldwide.

The remainder of the paper is organised as follows. Section 2 looks at how the EITI has interacted with corruption levels in EITI countries compared with non-EITI resource-rich countries. Section 3 provides a description of the idea of the EITI and how it works in theory. A practical analysis of how the EITI is being implemented follows and in Section 4 there is discussion, first of some of the main shortcomings in the design of EITI and then of some additional weaknesses arising from external factors. Section 5 highlights the particular complexities in resource-rich countries by pointing up the existence of multiple agency problems. Section 6 elaborates on how the EITI can become more efficient and Section 7 offers conclusions.

2. Several other countries have made public announcements of their possible interest in becoming candidates.

II. THE EITI: HOW EFFECTIVE?

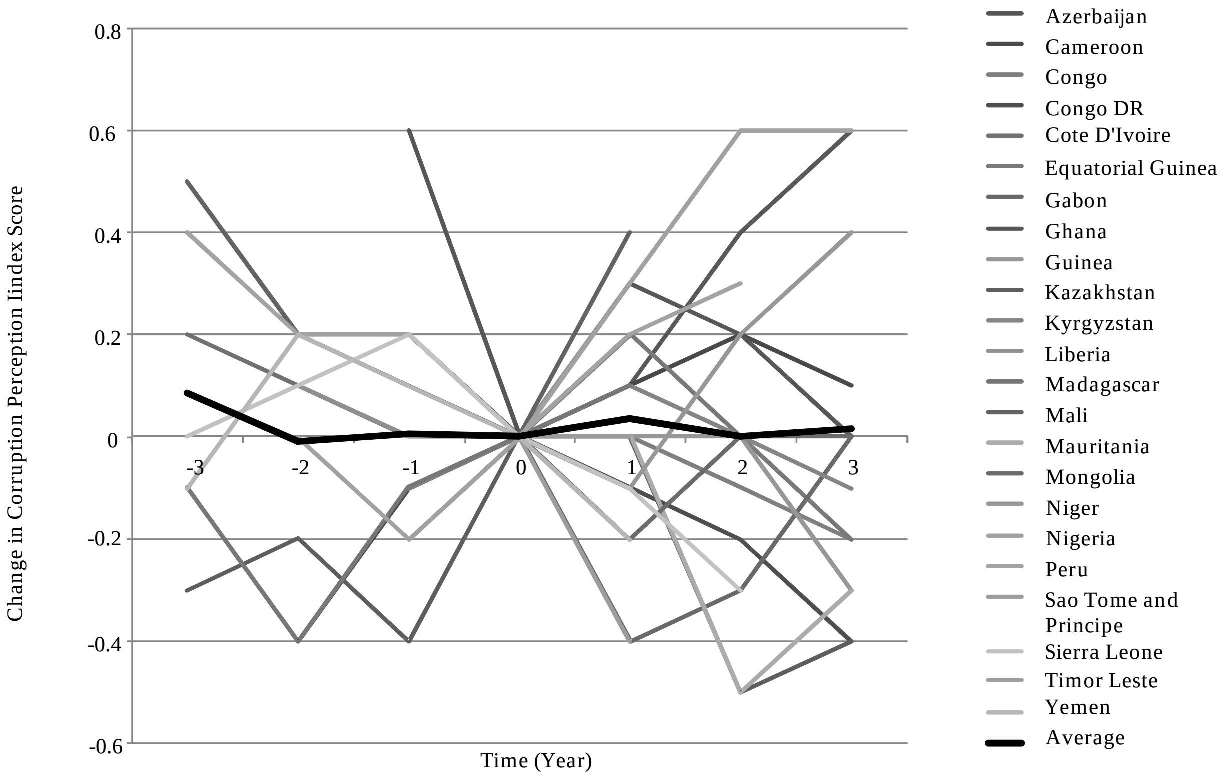
There is a dynamism in the extractive industries that merits special attention. High commodity prices have prompted prospecting, particularly in countries that have previously not experienced substantial resource extraction (Collier, 2008). Several countries, especially in West Africa, have recently discovered new resource fields and therefore caught the attention of energy-importing countries, among them the United States and China. While the surging commodity prices seen during the last few years (setting aside the sharp fall during the 2008 financial crisis) have aroused new hopes about the possibility of using the revenues in an equitable manner and for economic and social development, such price increases potentially reinforce incentives for rent-seeking behaviour (van der Ploeg, 2008). Higher prices can lead to higher rents and thereby intensify unproductive distribution fights over the appropriation of these funds.

The EITI has been strongly promoted in international development dialogues as the instrument that will finally enable resource-rich countries to reap the benefits from their endowments and has thereby created excessive expectations about the impact it could have. Year after year, the G8 has emphasised its support for the EITI, believing that it is an instrument that will improve transparency, accountability, and good governance and thereby lead to sustainable economic growth in the extractive sector.

Yet when perceptions of corruption in the countries that have signed up to the EITI are examined, there has been no visible positive effect so far. Figure 1 illustrates that governments' public endorsement of the EITI principles does not, on average, improve the corruption perception levels in the countries joining the initiative. Moreover, according to the World Bank Worldwide Governance Indicators, control of corruption in EITI countries is actually worse than in non-EITI resource-rich countries, as Figure 2 demonstrates[3]. In fact, EITI countries' scores on this indicator have on average deteriorated between 2002 and 2007. Admittedly, these corruption indices are not limited to the extractive industries but, given the size of these industries in the countries under review, a change would still be expected. Various questions arise: are perceptions of corruption lagging behind actual improvements or are these indices signals of the need to make the EITI more effective? Or else, should expectations be scaled down?

3. Both in 2002 and in 2007, the 75 percentile for EITI countries was lower than the median for non-EITI countries.

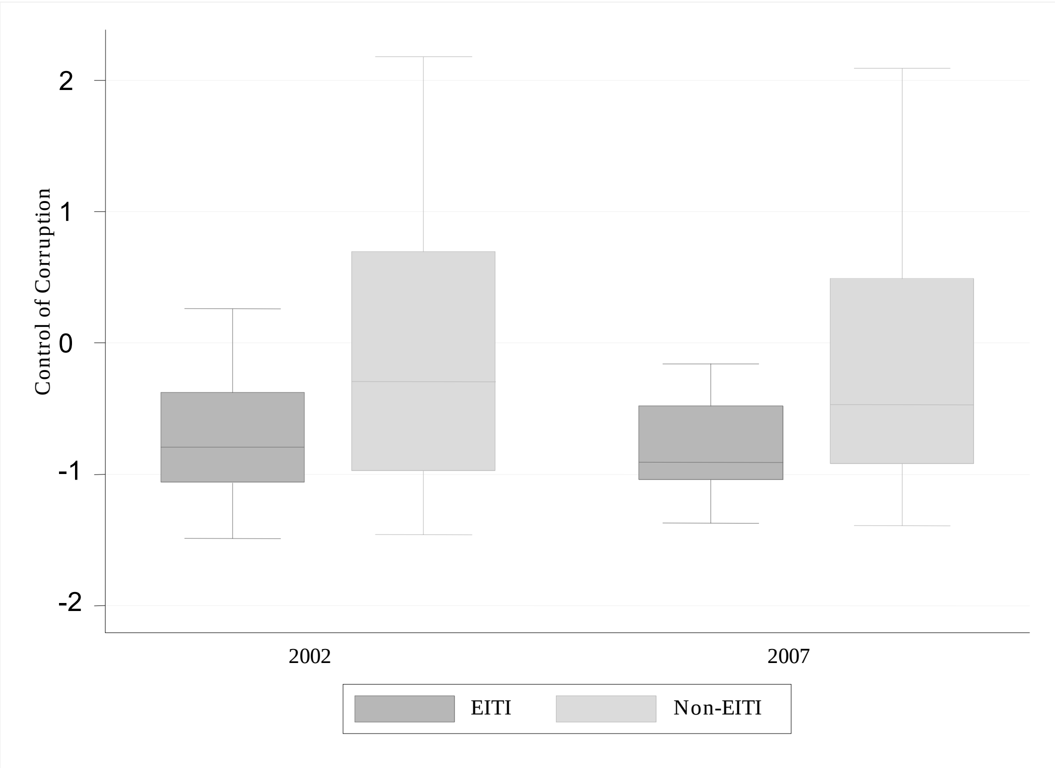
Figure 1. **Corruption perception index before and after the government officially announces the endorsement of the EITI Principles.**



Note: The governments in the respective countries officially announced the endorsement of the EITI principles at time 0. The figure includes EITi candidate countries as of December 2008.

Source: Transparency International (2008) and EITI home page (2008).

Figure 2**. Control of corruption, EITI and non-EITI resource-rich countries, 2002 and 2007.**



Note: The box chart shows the control of corruption index score for EITI and non-EITI resource-rich countries. The edges of each box correspond to the upper and lower quartiles, with the horizontal line inside indicating the median value for each group of country. The "whiskers" outside the box show the upper and lower adjacent values of the data.

Source: Author's calculations based on World Bank Worldwide Governance Indicators (2008a).

III. THE EITI IN THEORY

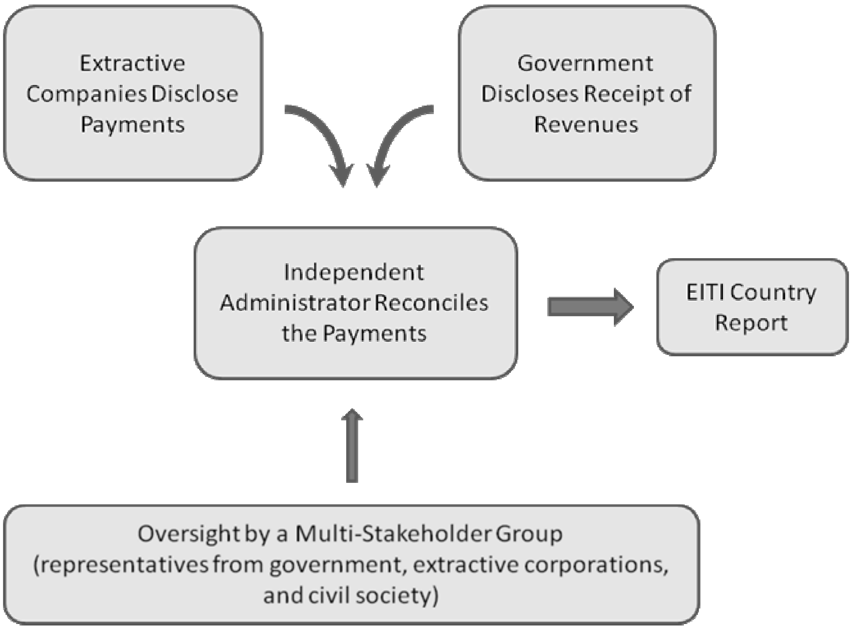
This section presents the EITI: how it is structured in theory, what the different actors are expected to do, what the potential benefits are and who the current members and supporters of this initiative are.

How does it work?

The idea behind the EITI is quite simple. Based on voluntary participation, governments of resource-rich countries are encouraged to publish information about the revenues from their extractive industries (oil, gas and mining) (see Annex 1 for the EITI principles). These revenues are compared to the payments (taxes, duties, royalties, bonuses and other payments) that extractive corporations, regardless of whether they are private, state-owned, domestic or foreign, have made to the government. An independent administrator, who is overseen by a Multi-Stakeholder Group (MSG) consisting of government officials and representatives from the extractive industries and civil society, reconciles and reports the disclosed figures[4]. The EITI report, stating the revenues, payments and the discrepancies found, is then made publicly available and is expected to generate a debate and allow in-country civil society organisations to hold their governments accountable for any discrepancies. Figure 3 illustrates how the EITI is designed to function.

4. The EITI defines civil society as a broad term encompassing all of a country's social and civic organisations – such as development charities, academia, community groups, women's organisations, and faith-based organisations – that do not have commercial or governmental status (EITI Business Guide, 2008).

Figure 3. **How the EITI works.**



The EITI process has four phases (see Annex 2): sign up, preparation, disclosure, and dissemination, which need to be completed within two years for the country to be validated (see Annex 3) as a fully compliant EITI country. This deadline, which was agreed in February 2008, was a response to the slow implementation observed in many candidate countries. Compliant countries must go through a validation process every fifth year. Currently[5] there are 26 candidate countries, of which only one is fully compliant with the EITI[6].

The EITI is implemented at the country level but extractive corporations are encouraged to support the initiative at an international level. To do so, companies need to make a statement in which they endorse the EITI principles and criteria and make it available on their websites, contribute to implementation in candidate countries, and make a voluntary financial contribution to the international management of the EITI. However, being a supporter of the EITI does not require any reporting or disclosure requirements in addition to those for all companies operating in the relevant sectors in countries implementing the EITI.

EITI implementation in a country can be funded through the country's government, a World Bank managed Multi-Donor Trust Fund or by multilateral and bilateral donor agencies. Direct corporate funding, although inappropriate and rare, can sometimes provide technical or administrative support to the multi-stakeholder group.

5. As of February, 2009.

6. Azerbaijan is the only country that has completed the validation process. Rules related to the validation were agreed in 2008, which might partly explain why there is only one compliant country.

Expected benefits

There are several expected benefits from the EITI.

Curbing corruption and rent-seeking. Corruption, in the form of the abuse of private or public power, office or resources for personal gains, is one of the symptoms of the resource curse. Improved transparency in the transactions between governments and extractive corporations means that there should be less room for hidden or opaque behaviour since illicit activity should be detected more easily, which in turn should lead to more revenue being paid into the government budget.

Improving a country's access to capital. EITI-implementing countries benefit from better access to capital since several donor institutions require disclosure of payments. Rating agencies have also started to give countries credit for endorsing the EITI, which helps the country in question to attract more capital. Given the capital intensity and technological sophistication needed in the extractive industries, in combination with long-term stability, to generate return, this aspect is of great importance.

Improving the investment climate. For many investors, both domestic and foreign, corruption has been identified as one of the main barriers to investment. By taking steps towards the implementation of the EITI, especially since it is a voluntary process, countries send signals about their intention to reform and create a sound business environment, which further attracts investors.

Building capacity and empowering civil society. The citizens of many resource-rich countries are poorly informed about their government's revenues from the extractive industries and the actual value of the resources[7]. Since access to this type of data has been very limited in the past, the citizens of these countries have not been able to question or monitor government activities. The EITI could therefore be a first step towards building capacity by encouraging public availability of the revenues from the extractive industries.

Who supports the EITI?

Twenty-six resource-rich countries have signed up to the EITI and a couple of others have made public announcements of their intention to sign up [8]. Moreover, 40 extractive corporations are internationally promoting the EITI, 12 OECD countries are providing political, technical and financial support, and 80 institutional investors, are providing funding and engage supporting companies. Finally, a number of international organisations, as well as the G8 since Evian 2003, are promoting the initiative. Table 1 lists the candidate countries, the internationally supporting extractive corporations, governments and organisations.

7. This is mostly due to the properties of natural resources and the fact that governments are relieved of the burden of having to tax their citizens, which is an essential source of creating informed political debates (Humphreys *et al*., 2007).

8. In February 2008, Bolivia, Trinidad and Tobago, and Chad were removed from this list as they were not showing any signs of commitment.

Table 1. **Supporters of EITI.**

Compliant Country (1)
Azerbaijan
Candidate Countries (25)
Cameroon, Central African Republic, Congo, Democratic Republic of Congo, Cote D'Ivoire, Equatorial Guinea, Gabon, Ghana, Guinea, Kazakhstan, Kyrgyzstan, Liberia, Madagascar, Mali, Mauritania, Mongolia, Niger, Nigeria, Peru, Sao Tome and Principe, Sierra Leone, Timor-Leste, and Yemen.
Supporting Extractive Corporations (37)
Alcoa, Anglo American, AngloGold Ashanti, Arcelor Mittal, Areva, Barrick Gold, BG Group, BHP Billiton, BP, Chevron Corporation, ConocoPhilips, DeBeers, Eni, ExxonMobil, Freeport-McMoRan Copper & Gold, Gold Fields, Hess Corporation, Lihir Gold, Norsk Hydro, Katanga Mining Limited, Lonmin, Marathon, Mitsubishi Materials, Newmont, Nippon Mining & Metals, Oxus Gold, OZ Minerals, Pemex, Petrobras, Repsol YPF, Rio Tinto, Shell, StatoilHydro, Sumitomo Metal Mining, Talisman Energy, Teck Cominco, TOTAL, Vale, Woodside, and Xstrata.
Supporting OECD Countries (12)
Australia, Belgium, Canada, France, Germany, Italy, Netherlands, Norway, Spain, Sweden, United Kingdom, and United States.
Supporting International Organisations and Financial Institutions (12)
United Nations, Group of 8, European Union, African Union, Organisation Internationale de la Francophonie, Organisation for Economic Co-Operation and Development, African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, European Investment Bank, International Monetary Fund and World Bank Group.

Source: EITI homepage (2008 and 2009).

IV. THE EITI IN PRACTICE

While the previous section described how the EITI works in theory, this section looks at the practicalities and highlights problems in the way it is being implemented. The section is divided into two parts, the first focusing mainly on the constraints arising from the design of the EITI, while the second analyses it in a broader external context.

The minimum standards of EITI are not sufficient

Poor quality of information

It is undoubtedly the case that the processes and financial flows in the extractive industries are highly complex. Although it is the central government that signs up to the EITI, there are several government entities that receive payments from the companies. Governments take in revenues as taxes, royalties, payment in kind, bonuses, dividends, and rents through the central bank, the tax authorities, regulatory authorities, a national oil or mining company, regional and state governments, and quasi-governmental organisations.

It is also the case that most people would agree that the availability of information on how much the government is receiving from the extractive industries is imperative if any kind of informed debate or scrutiny of the sector is to take place. However, the information, if it is designed to have an effect, needs to be of a certain quality. The EITI only requires that material payments made by companies in oil, gas, and mining industries and the revenues received by the government are reconciled and that the results are published. Although this reconciliation should be made by an auditor using international standards, it simply details whether the amounts reported agree, not whether they are correct. Considerable problems in the handling of revenues from this sector often lie beneath the surface. Was a royalty paid on the right amount of production? Was the government's share of production sold at a reasonable market price? Did the national company pay a correct amount of taxes and royalties to the central bank? Did it pay in time? Are the figures presentated in the EITI reports consistent with the figures presented in the national accounts? These are some questions illustrating the vulnerability of the figures being reconciled in the EITI reports.

Furthermore the fact that the EITI wants reports based on cash payments, while most company payments are on accruals basis, makes the figures even more liable to manipulation and errors in calculation and therefore also to corruption[9]. Unless a thorough examination underlies the transactions and the figures presented, the EITI report will not be perceived as informative and reliable.

In respect of the actual information provided in the reports, it is surprising that the EITI does not require disaggregated figures. It is up to the MSG to decide whether it wants the reconciliator to publish the report showing the payments from each individual company and payment type (tax, royalty etc.), which would be a disaggregated version, or whether it prefers an aggregated amount meaning that it is impossible for an outsider to judge how much the government received from each company[10]. Interestingly, among the 24 governments that had signed up to the EITI by December 2008, only ten had produced reports. Of these ten, only three present figures on a disaggregated basis. For the other seven countries, it is impossible to match company payments with government revenues, which is supposed to be the core idea of the EITI.

Moreover, although the initiative requires that payments from all companies in the extractive industries should be included in the report, there are instances when this is not the case. The initiative requires that all "material" benefit streams are published but how "material" is defined is up to the MSG. For example, the MSG could decide that all payments of USD 1 million or more are "material". This threshold could also be based on a company's production or a percentage (for example, any stream that represents at least five per cent of the total revenues earned by the country in the previous year). Countries have used this "freedom to define" in different ways. Goldwyn (2008) gives several examples. For instance, in Cameroon the MSG decided which entities were covered but did not reveal the materiality standard it applied in the aggregated report that has been published. In Guinea's 2005 report materiality was defined to include payments from the six largest mining companies. Gabon's report failed to include the government's profit from oil revenues, which is an omission of material streams by any definition. In general, EITI countries that have published reports have not been transparent in their process for defining "materiality" or the analysis of material benefit streams. In practice, this implies that the governments have revenues from the extractive industries that are not included in the EITI reports.

In respect of the discrepancies found between the figures presented by the government and the companies, two comments need to be made. First, most reports so far have displayed discrepancies in one way or another. In Nigeria, the auditors found that companies reported making payments to the Central Bank of Nigeria that the bank had no record of receiving. Likewise, the bank had reported revenues that companies had no record of having paid. Second, it is striking how most of comments, to the extent there are any, blame the anomalies on differences in accounting styles and errors arising from them.

9. Companies prepare their financial statements using accruals accounting, which is required by International Financial Reporting Standards. Governments, on the other hand, have traditionally maintained their financial records on a cash basis.

10. An example from Peru is that family-owned mining companies are not willing to disclose disaggregated figures as they fear for the security of family members.

To sum up, the information in the EITI reports lacks quality and consistency, signalling the non-transparency that still dominates the sector and protects it from rigorous external scrutiny. This point has also been raised in the progress report to the management of the World Bank MDTF (World Bank, 2008b).

Table 2 summarises some of the points related to the transparency and information provided in the EITI reports. It sheds light on the variations among the candidate countries in their government's commitment to the EITI, which is fundamental, and the priority given to it on the domestic political agenda. Nigeria and Ghana emerge as the two countries that have produced most information above the minimum EITI threshold.

Table 2. **Published EITI reports and information provided.**

EITI Reports and Transparency				
Candidate Country	Published report?	Disaggregated by company?	Disaggregated by payment type?	Transparent process for defining "materiality"?
Azerbaijan	Yes	No	Yes	
Cameroon	Yes	No	Yes	
Central African Republic				
Congo				
Congo (DR)				
Cote D'Ivoire				
Equatorial Guinea				
Gabon	Yes	No	Yes	
Ghana	Yes	Yes	Yes	Yes
Guinea	Yes	No	Yes	
Kazakhstan	Yes			
Kyrgyzstan	Yes	No	Yes	
Liberia				
Madagascar				
Mali				
Mauritania	Yes	No	Yes	
Mongolia	Yes	Yes	Yes	
Niger				
Nigeria	Yes	Yes	Yes	Yes
Peru				
Sao Tome and Principe				
Sierra Leone				
Timor-Leste				
Yemen				

Source: EITI Secretariat (2008) and Goldwyn (2008).

The EITI's focus on "material" payments is only a snapshot of the reality

The EITI's focus on transparency in material payments between government and extractive companies is an important first step in shedding more light on this sector. However, it is not enough to provide sound information about revenue streams. If the EITI wants to set a transparency standard and contribute to lowering the level of corruption in the extractive industries, it needs to consider the whole value chain involved in the exploitation and transformation of natural resources. This includes transparency in awarding concessions at one end to the spending of public revenues at the other. Limiting transparency to cash transactions between companies and central government not only denies the general public full access to information, but also fails to address some of the main problems related to the resource curse.

A look at the history reveals that corruption associated with oil and minerals often happens at the beginning of the process – at the moment when contracts are awarded to oil companies or the oil services companies that increasingly construct and run oil infrastructure (Global Witness, 2008)[11]. Similarly, the underlying terms of resource contracts are also considered to be rife with corruption.

Moreover, if the EITI aspires to build societies where citizens can hold their governments accountable for the management of resource revenues, it needs to incorporate transparency into the use of these revenues. According to the estimates of Sala-i-Martin and Subramanian (2003) for Nigeria, the majority of resource rents accruing to the government have not disappeared per se but have been spent on "wasteful" public investments, which have been notorious for rent-seeking, bribery and corruption[12].

Another important feature of the extractive industries that the EITI does not formally consider is transparency at the sub-national level. Large parts of the payments that companies make throughout the value chain take place at sub-national levels (regional and local). Since the negative environmental and socio-economic consequences of the sector are primarily local, the citizens in these regions are the ones most in need of information about their abundant wealth, how much revenue it generates and how it is being transformed into development. Ghana was the first country to go beyond the minimum EITI requirements by undertaking reporting at the sub-national level (from regions, districts or local governments), including District Assembly Representatives in its multi-stakeholder working group, and reporting corporate social payments made by companies at the sub-national level. These steps have helped to move the ownership of the EITI to the grassroots level.

Public availability of information on all resource-related transactions is central to fiscal transparency. Beyond current revenue transactions, it is important that the government reports adequately on the spending of such receipts, on any debt or contingent liabilities contracted

11. One of many examples is that of the former Halliburton executive Albert Jack Stanley who admitted in a guilty plea to the Houston, Texas federal court that Halliburton's engineering subsidiary Kellogg, Brown, and Root paid USD 180 million in bribes to the Nigerian government to win a natural gas plant contract (Global Witness, 2008).

12. Until the 1990s in the OPEC countries, approximately 65 to 75 per cent of post-1974 gross domestic product was for public and private consumption, largely through subsidies to friends, family, and political supporters of the government. The remainder, 25 to 30 per cent of national output, was either invested or used to build sophisticated military forces for national defence or for the suppression of opposition movements (Humphreys *et al.*, 2007).

against resource collateral, on its resource reserves, and on quasi-fiscal activities incurred in association with resource developments (IMF, 2007).

In this respect, the EITI++, which is a World Bank initiative aiming to complement EITI's focus on transparency in revenues, is a worthwhile advance, as it takes a holistic approach to the value chain and aims to provide technical assistance to improve the quality of contracts for countries, and to monitor operations and the collection of taxes and royalties. It further aims to improve resource-rich countries' economic decisions on resource extraction and help manage price volatility and investment of revenues more effectively. However, since EITI++ is in its infancy, it is too soon to tell whether this particular initiative will be able to yield useful information[13].

Voluntary and unenforced

The EITI is a voluntary process, meaning that governments and extractive corporations need to agree to adopt the initiative before data can be published, and it is not enforceable[14]. Although such an approach is positive in the sense that it allows governments to take on the responsibility for implementation, it risks reducing the effectiveness of the initiative.

Corruption, the use of public office for private gain, has typically been analysed from the demand side, blaming kleptocrats in developing countries for accepting bribes. For several decades, western companies were considered to be in a co-ordination problem which game theorists call the Prisoner's Dilemma (see Annex 4 for an illustration of a Prisoner's Dilemma). Bribing public officials to get contracts was part of the way of doing business in many resource-rich countries. Oddly enough, in several OECD countries, payments for bribes were tax-deductible (which in practice meant that OECD taxpayers were subsidising bribery) (Collier, 2007). In contrast, bribing officials in the home country was illegal and a criminal investigation was a natural consequence. Western governments gave priority to ethical business conduct within their national borders while they promoted their multinationals' blind pursuit of profit abroad. However, in 1999, the supply side of corruption gained more attention through the OECD Anti-Bribery Convention, which explicitly prohibits OECD multinationals from bribing foreign officials to obtain advantages in business[15]. Although far from faultless, the convention has been ratified by 37 countries and been transposed into their domestic legislation[16].

The EITI, on the other hand, formally considers both the supply and the demand side of corruption, although the pressure is put on governments to join the initiative on a voluntary

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13. EITI++ was launched by the World Bank Group and Partners in April 2008 (World Bank, 2008c).

14. The Publish What You Pay (PWYP) campaign recommends a mandatory approach to the EITI (PWYP website, www.publishwhatyoupay.org).

15. Whether this convention has managed to overcome the Prisoner's Dilemma in practice is, of course, another question.

16. In addition to all 30 OECD member countries, Argentina, Brazil, Bulgaria, Chile, Estonia, Slovenia, and South Africa have ratified the convention. It might be noted that the United Kingdom, the country initiating the EITI, is one of the states that have been criticised by the OECD for not having made enough effort to introduce and enforce the anti-bribery legislation.

basis and without enforcement. In this respect, the EITI is a typical "soft law", which contains many aspirations that might not be co-ordinated with existing legal commitments, lack the genuine commitment of governments and therefore easily fail.

To consider the likely effectiveness of the EITI, it is necessary to draw a clear distinction between transparency and accountability – two words that are often used, and possibly even misused, in the EITI context. Accountability has three dimensions according to Schedler (1999) – the provision of information regarding actions or decisions, their justification, and recourse to punishment in the case of misconduct. Accordingly it is apparent that transparency is only one part of accountability, and may be of limited value if the other dimensions are neglected. In respect of the first dimension, and as discussed above, most EITI reports published so far are of poor quality and not consistent, as the information provided is often very limited. This casts doubt on the actual transparency provided through the EITI. The second dimension is partly satisfied through the oversight of the MSG. The third dimension - enforcement through punishment – is not formally considered in the EITI. When discrepancies are reported, for example, it is up to the regulatory agencies to resolve differences. Relatively speaking, disclosing information may involve few costs, while changing or enhancing enforcement procedures may be much more difficult to achieve. The EITI therefore risks being an instrument of toothless transparency without full accountability.

The EITI in isolation - just like the OECD Anti-Bribery Convention would have been if not linked to other credible institutions, particularly judicial - is not efficient. Three EITI candidate countries – Nigeria, Sao Tome and Principe, and Timor Leste - have realised this and therefore taken steps to incorporate resource revenue transparency into their domestic legislation. This is a promising step that other countries should follow.

External constraints

Important actors are not members

The EITI aims to set a global transparency standard. For this to be realised, all relevant actors need to support it. While the IMF (2007) has identified 48 countries rich in hydrocarbons and minerals, the EITI has only attracted a total of 26 countries[17].

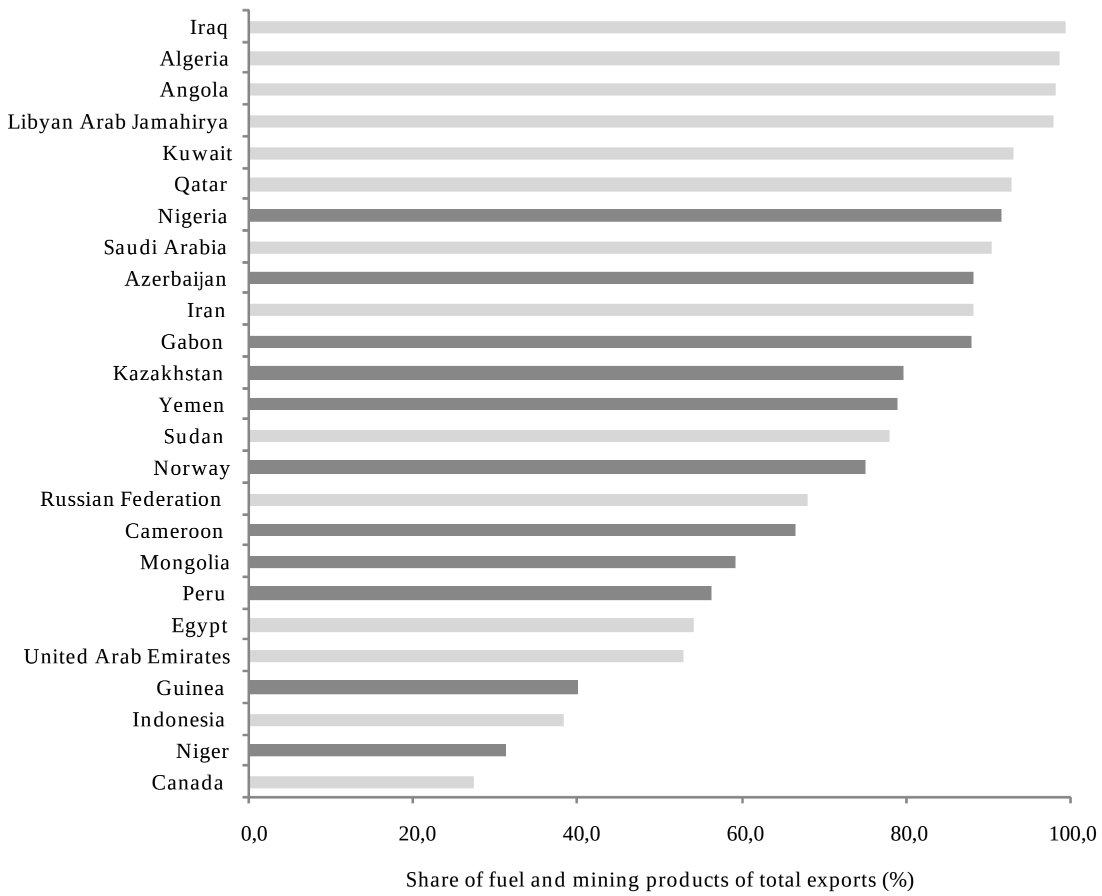
When those countries most dependent on fuel and mining are taken into account, as Figure 4 demonstrates, it becomes obvious that the EITI is not very popular with them. Iraq, Algeria and Angola, for example, are among the world's most fuel and miningdependent countries. Yet, none of them are candidate countries[18]. There are more than ten countries where fuel and mining products account for more than 70 per cent of total exports that have not signed up to the EITI. Among OPEC countries (representing 78 per cent of world crude oil reserves),

17. The IMF has selected these countries based on the following criteria: (i) an average share of hydrocarbon and/or mineral fiscal revenues in total fiscal revenue of at least 25 per cent during the period 2000-2005 or (ii) an average share of hydrocarbon and/or mineral export proceeds in total export proceeds of at least 25 per cent.

18. Iraq has made statements of interest but is not formally a candidate country.

only Nigeria has formally signed up to the initiative. Given that fuel and mining are so important for these countries' export sectors and that the EITI is arguing that transparency according to its procedures would be beneficial for the economic development in the country in question, it is legitimate to wonder why these countries have not welcomed this initiative more warmly.

Figure 4. **Fuel and mining dependent countries.**



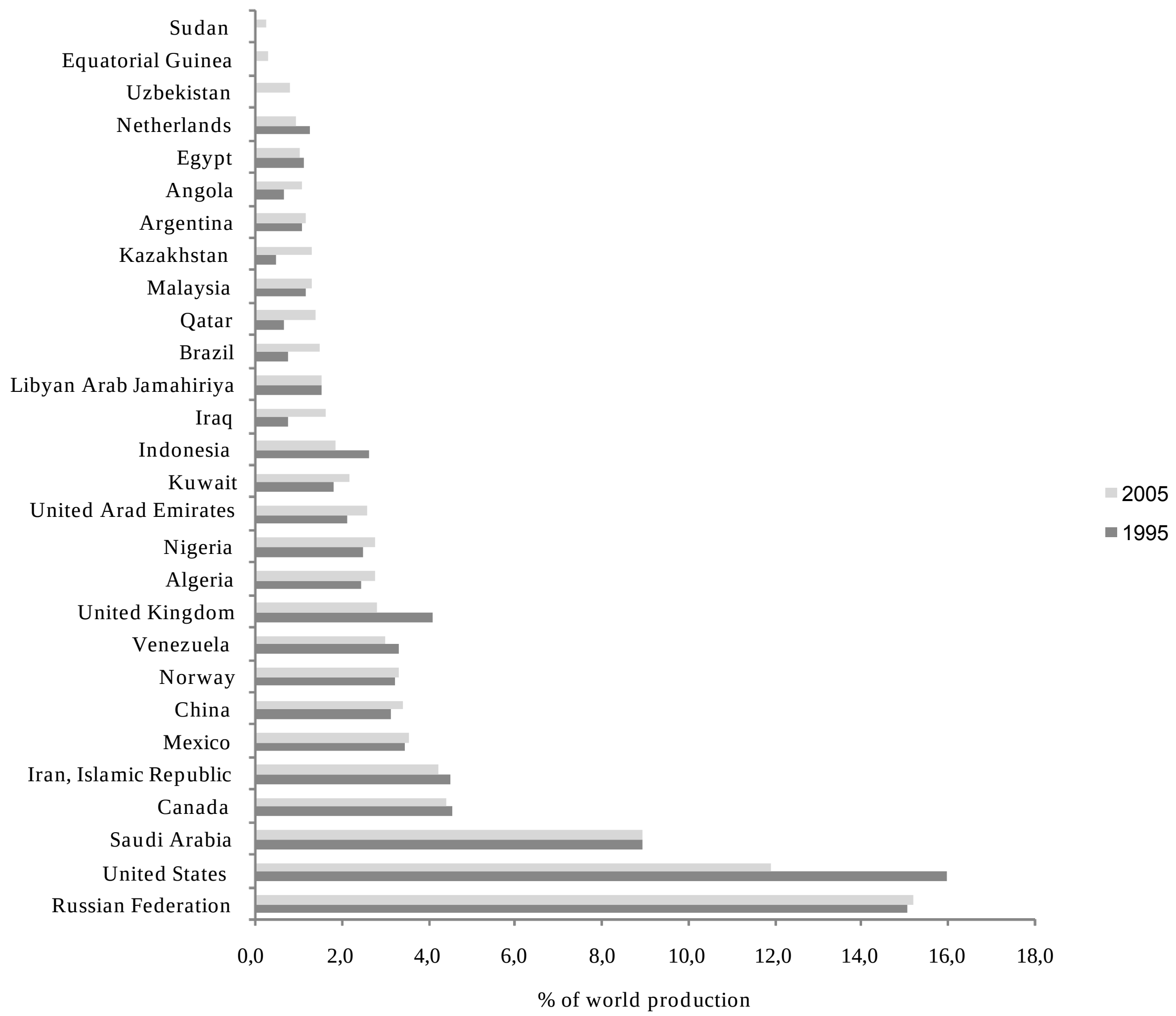
Note: Dark blue bars represent countries that have signed up to the EITI.

Source: WTO (2008).

A look at the world's main oil and gas producer economies (Figure 5) provides a similarly depressing picture. Among the primary 28 producers, only three have signed up to the EITI. The 11 chief producer economies, among them the United States, the Russian Federation and Saudi Arabia, have ignored the initiative. Again, the question arises as to how a world transparency standard can be expected to be set when more than 90 per cent of the production of oil and gas is not subject to the EITI[19].

19. Based on author's calculations.

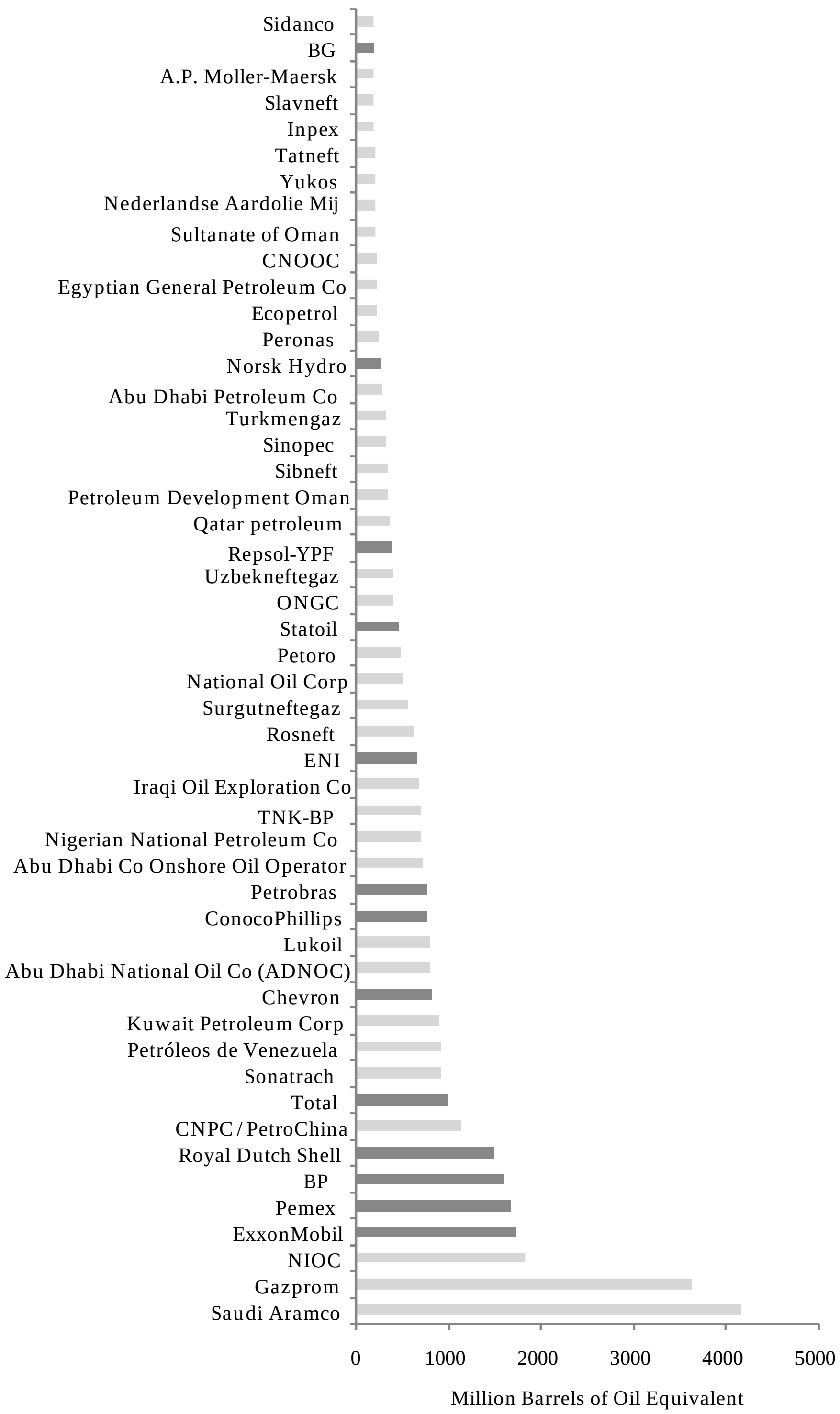
Figure 5**. The world's main oil and gas producing countries, 2000 and 2005.**



Source: UNCTAD World Investment Report (2007).

Even though it is governments that sign up to the EITI, the extractive companies also play a vital role in promoting the initiative. Figure 6 lists the world's 50 largest oil and gas extraction companies and shows that only 13 of them support the EITI. The three largest, Saudi Aramco (Saudi Arabia), Gazprom (Russian Federation), and NIOC (Iran) do not. The remaining 37 companies account for 68 per cent per cent of the production of these 50 companies, as Figure 7 shows, and come from developing as well as developed nations.

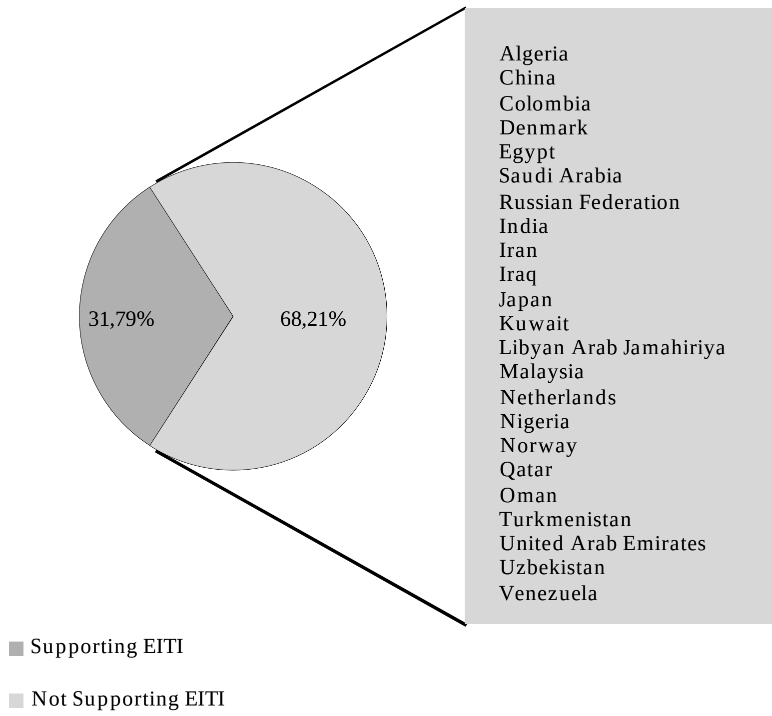
Figure 6**. The world's 50 largest oil and gas extraction companies, 2005.**



Note: Companies are ranked according to total production in 2005. Dark blue bars represent companies that have signed up to the EITI.

Source: UNCTAD World Investment Report (2007).

Figure 7**. Home country of the world's 50 largest oil and gas extraction companies and their support for EITI.**



Source: UNCTAD World Investment Report (2007).

Although the EITI, at first glance, seem to have attracted a great number of governments and extractive corporations, it becomes obvious on closer examination that it has not managed to win the commitment of the most resource-abundant and resource-dependent countries, nor the largest extractive companies.

Another important point – and probably one of the main causes of embarrassment - is that although several developed countries support EITI and encourage developing and emerging economies to join, they are themselves not implementing the transparency initiative. Thus, the supporting developed countries seem not to practise what they preach. For example, even though there are several resource- rich OECD countries, none of them was until very recently a candidate. Today, Norway is the first and only EITI implementing OECD country. The EITI therefore risks being perceived as yet another initiative established by the developed countries for the developing ones.

Civil society is not strong and independent enough to take on the responsibility that EITI implies

Although the formal structure of the EITI suggests that governments are responsible for its implementation and success in a given country, in practice much responsibility is put on civil society. Civil society is expected to put pressure on governments to join the initiative, to have the power to scrutinise the figures presented in the EITI reports (in spite of the fact that most reports reveal very limited information), to know exactly how the financial organisation behind the extractive sector works, what kind of payment types there are, who the relevant government bodies receiving the payments are and so on. The list of the implicit expectations from civil society is long and unreasonable for the countries in need of the EITI. The fact that extractive sectors are technically, legally and financially complex makes the task no easier.

In general, the EITI presupposes a certain environment in which it expects to be implemented. This includes an environment in which civil society is very strong, knowledgeable and independent, where leaders are elected through transparent and democratic elections, and where there exists no conflict of interest between the government and extractive industries on the one hand, and citizens on the other. These characteristics are far from being the reality in most resource-rich countries, including many of those that have joined the EITI. For Africa, Chabal and Daloz (1999) argued that there was that time as yet no evidence of functionally operating civil societies. In their view the existence of some embryonic instances of societal movements opposing central power should not be taken as representing a strong civil society as the organisational capacity of these movements is still very limited. Some voices from civil society organisations confirm their limitations within the EITI framework[20]. Aaronson (2008) notes that for several of these countries the multi-stakeholder approach is a significant departure from the prevailing political and institutional norms. As a result civil society has not always been able effectively and consistently to participate in the EITI process. In some countries, non-governmental organisations (NGOs) were not autonomous since government officials appointed the stakeholder groups rather than letting citizens and NGOs choose the representatives that they wanted. In other countries, civil society representatives were invited to the MSG meetings too late to be able to affect the agenda of those meetings.

Companies supporting the EITI seem to acknowledge the weak position of civil society. In a survey of 14 of the 38 companies supporting the EITI, ten of those responding said that they did business in countries where civil society was arrested or hampered in participating (Aaronson, 2008).

These limitations affect civil society's trust and perception of how seriously the government is committed to introducing transparency[21]. A general survey conducted by World

20. There are several examples where civil society groups have been restricted. One illustration is the government's detention and trial of Christian Mounzeo and Brice Mackosso, two Publish What You Pay coordinators in Congo. In other countries ruled by authoritarian regimes the situation is even worse. In Equatorial Guinea, President Teodoro Obiang Nguema and his government have routinely been criticised by governments and NGOs for systematically restricting basic civil and political rights, such as freedom of expression. The space for any civil society activism on issues of corruption and transparency appears to be non-existent (PWYP, 2006). A government can also restrict supporters of transparency in a more discreet way, for example as in Nigeria, where Nuhu Ribadu, the head of the Economic and Financial Crimes Commission (EFCC) had to resign and was sent on a one year course in policy studies because the EFCC had come too close to top policy layers and had arrested several governors (The Economist, 5 January 2008).

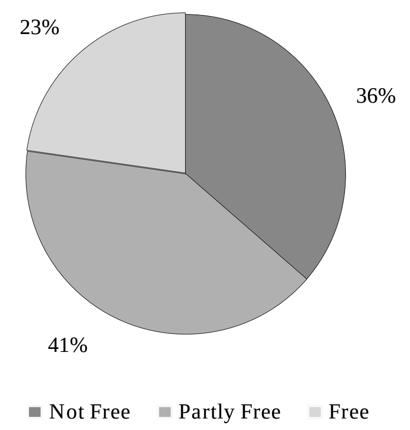
21. According to a member of the Cameroonian PWYP coalition, there is a perception that the government is using the EITI to gain Heavily Indebted Poor Country (HIPC) status, but is not really committed to

Public Opinion shows that in Nigeria for example, 78 per cent of citizens say that their country is run by a few big interests looking out for themselves and only 21 per cent believe that the country is run for the benefit of all the people (Kull et al., 2008a). The corresponding percentages for Azerbaijan were 61 and 25 per cent respectively.

As has been emphasised earlier in this paper, the mere provision of information has no value if there does not exist an environment that can accommodate this information and enable an open dialogue. The freedom of the media is therefore indispensable for a successful EITI implementation. According to a poll by World Public Opinion (Kull et al., 2008b), while 91 per cent of Nigerians and 86 per cent of Azeris say that it is important for the media to be free to publish news and views without government control, 70 per cent of Nigerians and 57 per cent of Azeris would like the media to have more freedom. When assessing the actual freedom of media in their country, 44 per cent of Nigerians and 41 per cent of Azeris think that the media are not very or not at all free.

According to Freedom House, and as shown in Figure 8, 36 per cent of EITI candidate countries are not free in terms of political rights and civil liberties and 41 per cent are only partly free.

Figure 8**. Freedom in EITI candidate countries.**



Note: Chart includes EITI candidate countries as of December 2008, excluding Central African Republic and Timor-Leste.

Source: Freedom House (2008).

These figures clearly show that civil society, which is indispensable for the successful operation of the EITI, needs to be strengthened in EITI-implementing countries. Although a

implementation (although to get HIPC status, EITI implementation is not formally required by the IMF). An NGO representative in Mongolia argued similarly that many people in government see the benefits of the EITI, but when it comes to implementation there is a big problem inasmuch as the government merely looks at the EITI as another public relations opportunity - a politically correct thing to support (PWYP, 2006).

weak civil society is a problem in most EITI countries, it is not confined to them. There are many non-EITI resource-rich countries that score very low on such basic indicators as voice and accountability, separation of power, and freedom of press. Figures 9-12 compare EITI and non-EITI resource-rich countries on several indicators and show that, although variations exist within the two groups, they both score relatively low on these indicators.

Figure 9. **Voice and accountability.**

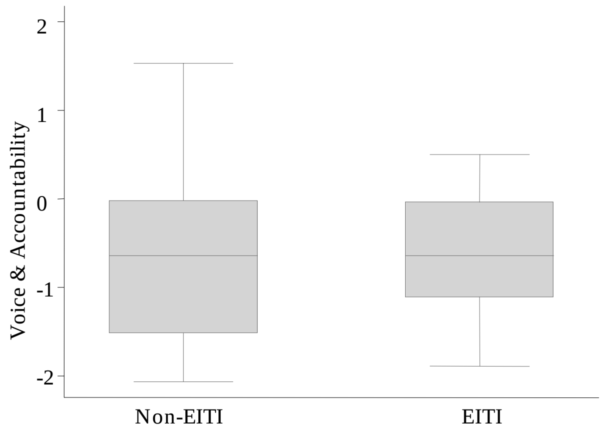


Figure 10. **Separation of power.**

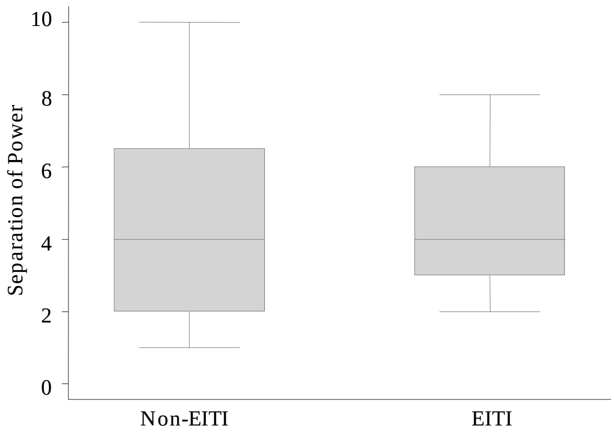


Figure 11. **Freedom of press.**

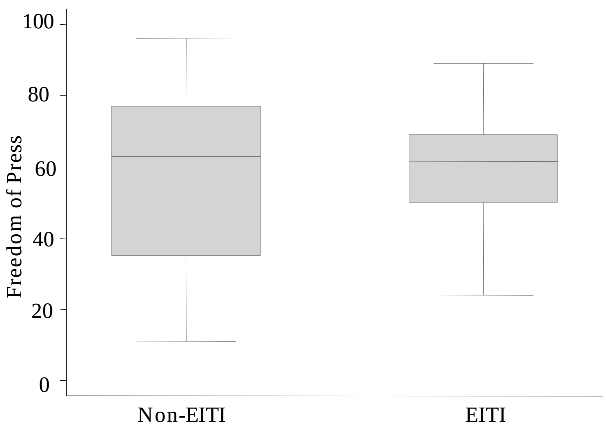
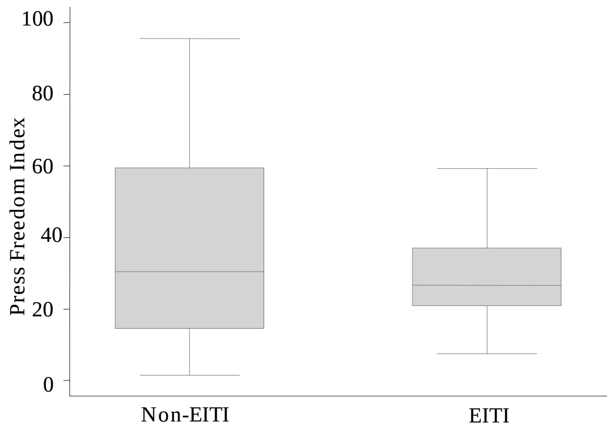


Figure 12. **Press freedom index.**

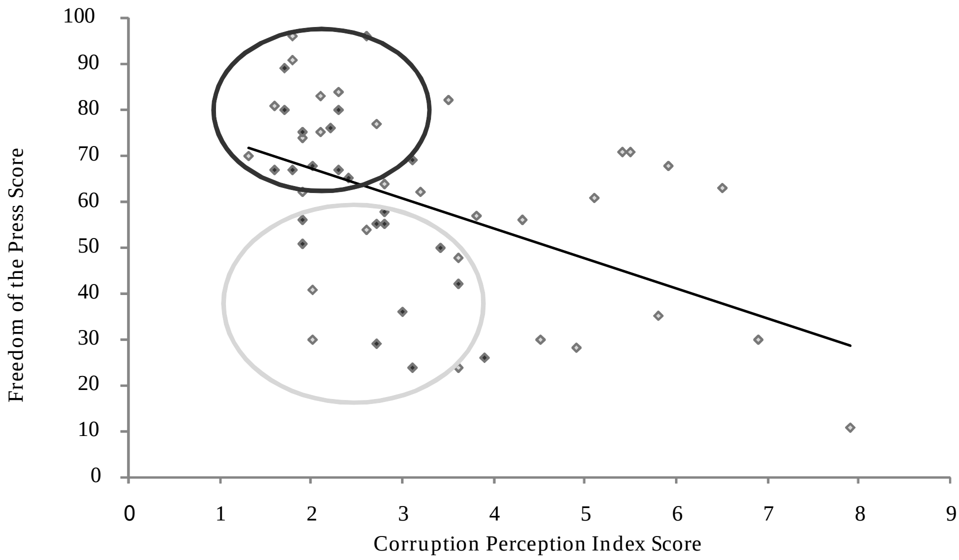


Note: The edges of each box correspond to the upper and lower quartiles, with the horizontal line inside indicating the median value for each group of country. The "whiskers" outside the box show the upper and lower adjacent values of the data.Voice and Accountability measures the extent to which country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and free media. Separation of power refers to the basic configuration and operation of powers (institutional differentiation, division of labour according to functions and, most significantly, checks and balances).

Sources: For Figure 9: World Bank, Worldwide Governance Indicators (2007); Figure 10: Bertelsmann Transformation Index (2008); Figure 11: Freedom House (2008); Figure 12: Reporters without Borders (2008).

A look at the relationship between perceived levels of corruption and press freedom suggests, not very surprisingly, a negative relationship for resource-rich countries. Figure 13 shows that there are several EITI countries (marked with dark blue squares) with high levels of corruption (low CPI scores) and almost no freedom of press (high press freedom scores). These countries are within the dark blue circle, indicating that they will probably not be very successful in generating transparency and including the media in the EITI process. In countries with high levels of corruption but freer media (light blue circle), the EITI has a greater potential to work as an effective instrument for curbing corruption and shedding more light on the sector. Thus the prospects for an open dialogue of extractive industry payments are relatively higher for candidate countries that are within the light blue circle. On the other hand, unless more attention is paid to enabling a freer media and an active engagement of civil society in the EITI process, the countries in the dark blue circle risk failing to extract the benefits of the EITI.

Figure 13**. Freedom of the press and corruption in EITI and non-EITI Countries.**



Note: Dark blue squares represent EITI countries and blue squares represent other hydrocarbon- and mineral rich countries as of December 2008.

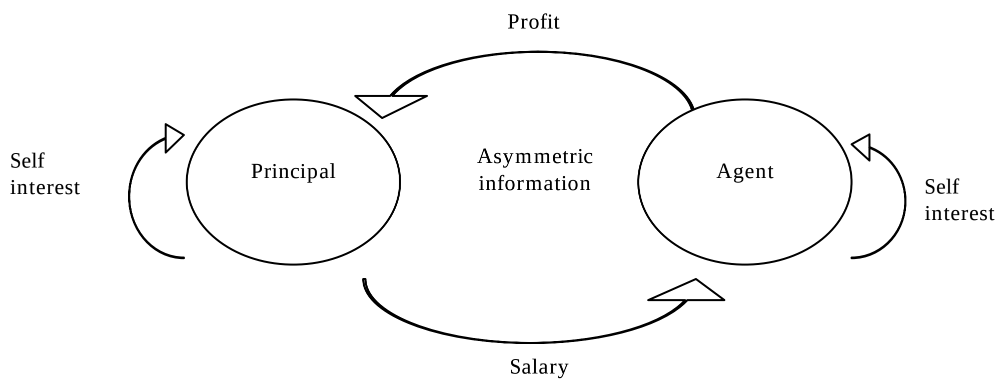
Source: Transparency International (2008) and Freedom House (2008).

V. THE EITI IN A PRINCIPAL-AGENT FRAMEWORK

As Karl (2007) points out, the "resource curse" is primarily a political and institutional problem and less of an economic phenomenon. Most scholars have realised this while policy makers have been slow, and perhaps even unwilling, to grasp the nature of the problem. Political issues of power, bargaining and social injustice have formed long-standing and institutionalised patterns that are at the heart of the resource curse. These institutions, shaped by multinational oil corporations, their host governments, foreign lenders, as well as by states and private actors in exporting countries, need to be considered in their totality. This is not an easy challenge.

In institutional economics, the principal-agent problem is of major concern. It arises when the agent does not faithfully serve the interests of the principal because they have conflicting interests and the actions of the agent are not observable by the principal. Figure 14 shows the basic agency problem.

Figure 14**. A basic principal-agent problem.**



In the extractive sector, there are multiple agency problems. To begin with, the principals and the agents need to be identified. Assuming that the ownership of natural resources is an attribute of sovereignty that belongs to the people, the citizens of the endowed country can be regarded as the principals. Their agents are the rulers of the country, politicians who are supposed to safeguard the well-being of the country and provide public goods to the citizens. Another agency problem exists between the shareholders (principals) of the extractive companies and their managers (agents).

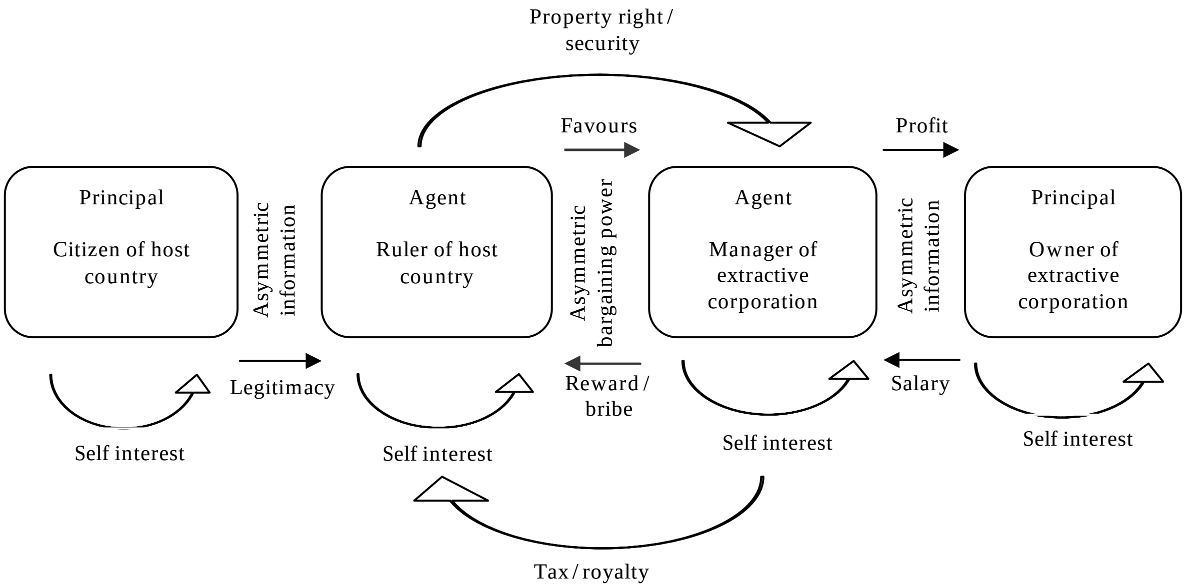
The agency problem in the extractive sector, which Figure 15 illustrates, is particular and severe. While the managers of extractive corporations better represent the interests of the company (and thus its shareholders) and do everything they can in to obtain concessions on the most favourable terms, the rulers of resource-rich countries do not have the same incentive to provide their citizens with public goods. That is because rulers get more rewards (formally through taxes, royalties etc. and informally through bribes) from the managers of extractive companies than from their citizens, who alone can confer legitimacy[22]. Therefore, rulers engage, first and foremost, in negotiations with these managers rather than bargain with their own populations[23]. Since these rulers do not need to tax their own people, they break a critical link between taxation, representation, and state accountability. According to Karl (2007), this is also the reason for why resource-rich countries are less subject to the internal countervailing pressures that helped to produce bureaucratically efficient, authoritative, liberal and ultimately democratic states elsewhere. Moreover, these rulers have greater financial means at their disposal and stronger incentives to remain in power compared with rulers of resource-poor countries.

In the extractive industries, therefore, the agency problem is asymmetric, because the citizens, the principals at one end, are very weak and cannot punish their agents to the same extent as can the principals at the other end, the owners of extractive corporations. The power of the citizens is further limited by the lack of press freedom, which reinforces the asymmetric informational environment that is at the heart of the agency problem.

22. This existence of "wrong" accountability is similar to what sometimes happens in development aid, where rulers become more accountable to their donors than to their citizens.

23. The bargaining power between the extractive corporations and the rulers is also asymmetric. Zambia is a good illustration. At the time of the privatisation of the state-owned Zambian Consolidated Copper Mines (ZCCM) in the late 1990s, the mining sector was suffering from low copper prices and sustained under-investment. As a result, the mining sector was declining and was a burden for the government. Those companies which then bought into the sector were more than often able to negotiate attractive terms from a government that was in a weak position. This has created tensions and lately some of these contracts have been renegotiated (World Bank, 2007).

Figure 15**. Principal-agent problem in resource-rich countries.**



The EITI's focus on material payments between the two agents - extractive corporations and the government - is a good first step, as one would expect that information about these payments would enable citizens to make a more accurate judgment of their rulers' performance. Moreover, the EITI could also be seen as strengthening the position of citizens since it formally requires the engagement of civil society. However, even if civil society representatives are allowed to sit at the same table as their agents, they still remain weak as principals as long as they do not have adequate means to punish misconduct by these agents. Thus the mere provision of information will not help to solve the agency problems, particularly not the weak accountability link that exists between rulers of host countries and their citizens[24]. Unless coupled with checks and balances, the EITI might therefore reinforce the already well-established relationships between rulers and managers, instead of improving the position of the citizens.

24 Besley and Burgess (2002) underline the importance of civil society, the media being a key element, to an effectively functioning democracy. The formal institutions of political competition (such as open elections) are not sufficient to deliver a responsive government unless voters have the real authority to discipline poorly functioning incumbents. This requires effective institutions for information transmission to voters.

VI. WAYS TO EXTRACT THE MAXIMUM FROM THE EITI

The discussion so far produces a certain paradox. While it might be expected that the EITI would be successful in countries with a genuine political will for reform and transparency, and where civil society is strong, independent, and knowledgeable, it might be questioned why EITI was needed in the first place anyway. In countries where these characteristics are absent and the EITI is promoted as a condition for access to finance or other external relations, the prospects for an efficient implementation are not very positive. However, this argument may be more related to the overall impact, rather than the marginal impact, that the initiative can have in a particular country. For some civil society organisations, it is the first time that they have ever had the opportunity to sit at the same table as policy makers and discuss revenues from their extractive industries. This marginal effect is very important.

Countries have used the EITI is various ways so far. For example, while the government in Sierra Leone uses it as part of a larger strategy to document the cost of corruption to governance, Peru uses it as a part of its larger efforts to improve public budgeting (Aaronson, 2008). The EITI can indeed be a good way of discovering where the major bottlenecks are to be found in the revenue flow system. In some countries, there is poor information across government entities that makes it difficult to get comprehensive information. In other countries, information critical to the assessment and checking of tax computations is in the possession of different agencies with no statutory obligation to make it available to the tax authority.

Yet whatever the reason for implementing the EITI, countries will need to go beyond the minimum requirements if they really want to derive the potential benefits of this initiative. That implies providing detailed reports with disaggregated figures that will allow outsiders to match benefit streams with company payments. This includes payments at the sub-national level as well as corporate social payments. Moreover, stricter rules should apply to the definition of material payments in each country. However, implementing countries need to consider transparency beyond revenues and try to incorporate information on how concessions are awarded, contracts negotiated and how the money is spent. This is very much in line with what the World Bank initiative, EITI++, is intending to do and should be considered seriously by resource-rich countries in general. To maximise impact and avoid incompatibilities, EITI and EITI++ could create synergies by increased collaboration.

As far as civil society is concerned, it has been emphasised throughout this paper that more efforts are needed to strengthen these stakeholders, who have historically been in a weak position. There have been several efforts already. The EITI Secretariat has begun to train local facilitators. The World Bank has, for instance, provided funds to NGOs in several EITI-implementing countries and helped governments to involve the NGOs in the EITI process.

Moreover, NGOs active in the developing world on these issues, such as Publish What You Pay, Revenue Watch Institute and Transparency International, have also begun to train activists and develop resources for journalists and citizens to ensure their effective participation in the EITI implementation process. Finally, independent governments, such as those of Australia and the United States, have funded projects to strengthen independent media in candidate countries (Aaronson, 2008). These capacity-building projects are very important, but not sufficient to ensure effective civil society participation. More efforts are needed, both from external actors and from the implementing governments themselves.

Another dimension that needs to be considered more seriously within the EITI framework is the role of the legislature. Linking the EITI to judicial institutions is important since it would give the initiative more credibility and help to enforce transparency in the sector. However, in the case of Africa, it has been pointed out that legislatures often find the extractive industry’s technical complexity beyond their comprehension and therefore lag behind domestic civic groups and international advocacy organisations in their efforts to promote transparency and accountability in the extractive industries (Bryan and Hofman, 2007). Capacity building efforts should therefore also target the strengthening of legislators to improve extractive industry management and oversight.

Finally, to move forward developed countries need to engage. So far 12 OECD countries have supported the EITI financially but only Norway has taken the first steps towards implementing this initiative. Corruption in the extractive industries is not limited to developing countries. Developed countries would also benefit from increased transparency and open dialogue about their extractive sector. Even if some of them are already relatively transparent, there might be an added value in promoting those mechanisms already in place. Besides, the symbolic value in these countries’ participation in EITI needs to be acknowledged. So far, these countries have not been practising what they preach and therefore do not provide any incentives for other resource-rich countries to join this initiative.

In this context it is worth mentioning that US Senator Richard Lugar commissioned a study on transparency in the extractive industries and as a result called on the United States to join the EITI (Lugar, 2008). The United States Congress has also introduced the Extractive Industries Transparency Disclosure Act, which requires all companies, American and foreign, registered with the United States Securities and Exchange Commission to publish how much they pay to governments for oil, gas, and minerals (Open the Books, 2009).

VII. CONCLUSION

The EITI has helped to direct the attention of the international development community towards a sector that has traditionally been cloaked in secrecy. However, it is not a cure-all for the resource curse and will not, in isolation, have much of an impact on the level of transparency in resource-rich countries. Yet, when the EITI is taken beyond its minimum standards and is embedded in a broader reform process, it may well be an effective tool for increasing transparency in the extractive industries.

So far, the EITI has not managed to improve the overall corruption perceptions of the countries implementing it. This paper has highlighted several deficiencies in the current structure of the EITI that hamper it in yielding its true potential. The most essential problems with the EITI can be summarised in the following three points:

The minimum standards of the EITI do not ensure the level of transparency that is necessary to enable scrutiny by outsiders.

The EITI, through its focus on transparency in material payments between governments and corporations, is too restricted and therefore misses addressing some of the problems at the heart of the extractive industries.

The EITI takes for granted that an EITI-friendly environment, including a strong and free civil society and media, already exists in the countries that have joined the initiative.

Although this paper has highlighted the problems related to the EITI, the arguments put forth should not be taken as a wholesale rejection of the initiative. Instead, this study should be regarded as a reminder of the efforts still to be made that are needed to extract the maximum from the EITI and improve the true level of transparency in resource-rich countries. In this respect, the paper offers some recommendations.

The EITI in isolation is not efficient enough. It needs to be embedded in a broader reform process and linked to credible institutions, particularly judicial ones.

In respect of EITI country reports, the initiative should be stricter on the quality and consistency of information. That includes requiring disaggregated data and clear definitions of materiality, but also more information about the underlying contracts and prices. The EITI reports should aim at giving a holistic picture of the extractive industries and cover the whole value chain.

A clear focus should be put on strengthening civil society, including providing detailed education on the way the extractive industries are organised, financially, politically, and legally.

The special targets of these capacity-building efforts should be NGOs, government officials, legislatures, representatives of the extractive industries and media.

Developed countries should not only embrace this transparency initiative financially, but should also practise what they preach by implementing it themselves.

With the above problems addressed and the recommendations pursued, the EITI could become more effective as a transparency tool and help extract the maximum for poverty reduction and sustainable development in resource-rich countries.

ANNEXES

Annex 1. The EITI Principles

The EITI Principles, agreed at the Lancaster House Conference in June 2003, provide the cornerstone of the initiative.

We share a belief that the prudent use of natural resource wealth should be an important engine for sustainable economic growth that contributes to sustainable development and poverty reduction, but if not managed properly, can create negative economic and social impacts.

We affirm that management of natural resource wealth for the benefit of a country's citizens is in the domain of sovereign governments to be exercised in the interests of their national development.

We recognise that the benefits of resource extraction occur as revenue streams over many years and can be highly price dependent.

We recognise that a public understanding of government revenues and expenditure over time could help public debate and inform choice of appropriate and realistic options for sustainable development.

We underline the importance of transparency by governments and companies in the extractive industries and the need to enhance public financial management and accountability.

We recognise that achievement of greater transparency must be set in the context of respect for contracts and laws.

We recognise the enhanced environment for domestic and foreign direct investment that financial transparency may bring.

We believe in the principle and practice of accountability by government to all citizens for the stewardship of revenue streams and public expenditure

We are committed to encouraging high standards of transparency and accountability in public life, government operations and in business.

We believe that a broadly consistent and workable approach to the disclosure of payments and revenues is required, which is simple to undertake and to use.

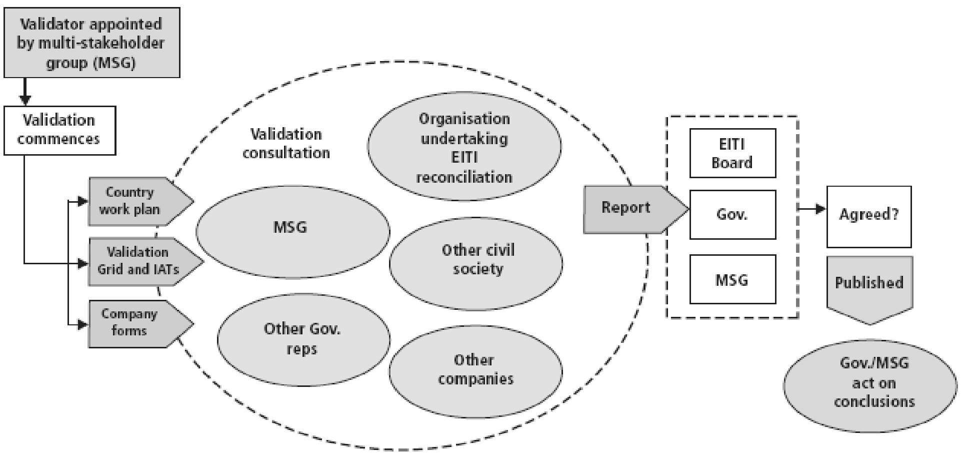
We believe that payments' disclosure in a given country should involve all extractive industry companies operating in that country.

In seeking solutions, we believe that all stakeholders have important and relevant contributions to make – including governments and their agencies, extractive industry companies, service companies, multilateral organisations, financial organisations, investors, and non-governmental organisations.

Annex 2: The EITI process

Sign Up
• Issue government announcement • Commit to work with all stakeholders • Appoint implementation leader • Compose, agree, and publish work plan
Preparation
• Establish multi-stakeholder committee • Engage Civil Society • Engage Companies • Remove obstacles to implementation • Agree on reporting templates • Approve EITI administrator • Ensure full participation from all companies • Ensure that company accounts are properly audited • Ensure that government accounts are properly audited
Disclosure
• Disclose revenues received by the government to the administrator • Ensure that payment and revenue figures are reconciled • Identify discrepancies and recommend improvements
Dissemination
• Make EITI report publicly available • Examine companies' implementation support • Review actions taken on lessons learned
Validation
• Country undertakes external validation

Annex 3: The EITI validation process



Annex 4: Multinational extractive corporations caught in the Prisoner's Dilemma

Focusing on the supply side of corruption, multinationals could be seen as facing a co-ordination problem which game theorists call the Prisoner's Dilemma. Assume that there are two foreign companies, A and B, competing to win a lucrative contract allowing them, for example, to extract oil in a developing country where neither of the companies has its headquarters. For the sake of simplicity, assume that the government in the host country will either give the contract to one of the two companies or will let them share it equally. Assuming that corruption is possible, each company will face the choice of either using bribes or refraining from doing so when competing for the contract. The Figure below presents the strategic game between the two companies in a matrix form.

		Company B	
		Not Bribe	Bribe
Company A	Not Bribe	2,2	0,3
	Bribe	3,0	1,1

Note: The arrows indicate the dominant strategies (vertical ones for company A and horizontal ones for company B).

Consider company A. If company B does not bribe, A is better off bribing the government and getting the contract itself, in which case it gets a payoff of 3, instead of not bribing and sharing the contract with B, in which case each would get a payoff of 2. If B does bribe, A is again better off bribing and making sure that the two companies share the contract and get 1 each, instead of not bribing and losing the competition, in which case A's payoff would be 0 and B's would be 3. Clearly, no matter what B does, it is always better for A to bribe. Thus, bribing is A's strictly dominant strategy. Since there is symmetry in the payoffs, similar reasoning is true for B as well. Regardless of whether A chooses to bribe or not, B is also always better off bribing. The equilibrium of this strategy game is achieved when both firms bribe and get a payoff of 1 each. However, if A and B could instead promise not to use bribes, they would still share the contract, but get 2 each. From a welfare point of view, the worst outcome (total payoff of 2) is achieved when both companies bribe while the Pareto optimal outcome (with a total payoff of 4) is achieved when neither company bribes and they share the contract. The equilibrium outcome (bribe, bribe) illustrates a country where corruption poisons the business environment and leads to an inferior welfare status of the society. In a sound business environment, where bribes are not used, the welfare outcomes are much higher.

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