Challenges of Investing in Countries Seen to Be the most Corrupt in the World – the Case of Natural Resources Industries

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The Issues:

The debate about whether natural resource industries are part of a sustainable future or a relic of a past industrial age has often been central to discussions about sustainable development and transparent governance, and probably will remain so. The critical question for these industries is: How are they performing in that debate? Past evidence would suggest that the answer is: Not too well. The economic consequences of this poor performance -- let alone the impacts on industry reputation -- have been shown to be significant enough to pose the next question with some urgency: What should be done to improve the situation?

When all is said and done, countries that have the greatest resource endowments, and thus associated petroleum, mining and forestry investments, tend to be seen as having also the highest levels of corruption. A relatively recent IMF Research Paper[1] provides stunning quantitative evidence of such relationship. Natural resource industries are in no way passive observers of these developments; if anything, it stands to reason that, given their command of the financial resources associated with the exploitation of natural endowments, they are or seem to be important contributors to this state of affairs.

The TI Annual General Meeting of 2000 was the first time that such a large group of industry leaders and stakeholders got together to debate issues of common interest. Some 50 people joined the session on the subject, where it was recognized that, although the matter was complex and shrouded in deep vested interests, distorted incentive structures, bad practices among many players, the issues merited further and more systematic review to generate corrective actions.

Even more importantly, all speakers shared the conclusion that this was a critical issue for industry advocacy and that the industry needed to do much better. All three speakers and participants stressed that the balancing of economic, transparency, environmental and social goals -- the essence of sustainable development -- was central to thinking on resource development.

The discussion that followed reflected what a few, selected leading companies have come to accept: the industry's continuing access to resources on viable terms -its "licence to operate" -is dependent upon demonstrating that the industry has the will and the capability to operate within transparent and sustainable development principles.

The public increasingly expects business to deliver the goods and services it desires not only at a price it can afford but also in a manner it finds acceptable. Furthermore, within the OECD, there is a public that is ageing rapidly. An ageing population is also more risk averse. Higher life expectancy and growing fatigue from international conflict have created higher and more discernible expectation from their multinational firms. The OECD Convention Against Corruption of Foreign Officials is an indication of this new stand, and exposes multi-national firms to new rules of the game that criminalize corruption, even if undertaken in third countries.

Those businesses that fail to meet the rising expectations of the public may well lose competitive position. Reputation is an increasingly important factor both to obtain influence over key public policies and to retain and enhance market share. The natural resource industry will not enter the new century well placed to compete economically and politically given its current reputation. Greater transparency, accountability and scrutiny of such firms is expected to continue, particularly in their dealings in countries from where they mine their raw materials.

It is recognized within the natural resource industries that it has a serious reputation problem that is an increasingly significant constraint on its activities. The depth of this problem is accurately captured by the way in which unsustainable over-exploitation of forests, fisheries or farmlands is commonly referred to as *mining* the forests, *mining* the seas, *mining* soils, and more broadly *mining* countries. In fact, *mining* has become a pejorative term in many circles. This reputation is a liability for the industry, and is deeply rooted in the public mind and is widely shared by opinion formers.

The Mining Industry:

More than most industries, mining relies on a high level of public consent in order to continue its activities since states tend to exercise a significant degree of control over access to and exploitation of mineral resources. Public policy plays a disproportionately large part in determining the economic success of the industry. The industry's present reputation undermines its capacity to influence public policies beneficially. A key challenge to the mining industry in the 21st century will be to change its reputation so as to obtain a better influence on important public policy decisions.

James Cooney (Placer Dome), while noting the interest of leading mining companies of accountable management and proper scrutiny, stressed the dual problem of working in countries or geographical areas with scant rule of law and competition from newer junior mining companies. While mining companies have little choice but to go where there are the relevant natural resources, they have on the other hand a measure of control over their action – individually or collectively.

All this suggested the need for: (i) improved anti-corruption standards on the part of all major players, including multilateral agencies; (ii) better “intelligence” gathering, so that relevant developments in countries are better known to all concerned (e.g. risks associated with corruption, governance development, good practices being instituted around the world, etc); and (iii) development of mutually agreed industry-specific principles, which are binding and commit all mining companies to some standards of behavior. J. Cooney noted that progress has been made on all these fronts, such as the beginning of debarment of corrupt companies in World Bank financed projects, the development of statistics on state of corruption in various countries, the broadening of ICME’s and other global mining associations’ mandate to deal with sustainable development and governance issues, following discussions with multilateral development banks, TI and other parties.

He recognized, however, that much more work was needed in this direction, if mining companies are to increase their transparency dealings and standards of behavior. Similarly, Cooney noted that there were still many “gray areas”, where mining company officials lack clear frameworks to make judgments when having to decide on individual transactions (e.g. donations, service provisions in public services) which far too easily could be circumvented with sophisticated mechanisms that make them seem to be legitimate and uncorrupt activities.

The Petroleum Sector:

C. McPherson (World Bank) referred to: (i) the paradox of plenty generated by oil investments; (ii) the inevitable impression from actual performance that mother nature seems to corrupt, and (iii) why governments waste natural resources and lead countries to be awash in oil but mired in poverty.

McPherson noted that with incomes of the order $35 billion/year for Mexico; $30 /billion for Venezuela; $22 billion for Nigeria, the potential for good and the temptation for abuse are immense. Unfortunately, actual outcomes have not been encouraging, since more often than not, growth experienced in oil rich states is below, even significantly below, world-wide average rates. This is the result of "Dutch Disease", excessive credit expansion, inefficient investment, political sensitivity, and corruption volatility and asymmetry. To address these issues he suggested to focus attention on: (i) petroleum revenue management; (ii) budgetary discipline; (iii) public expenditure management; (iv) institutional strengthening; (v) transparency and accountability.

He illustrated how these issues are planned to be addressed in the Chad-Cameroon oil pipeline project and concluded that responsible players need to sharpen their roles as follows: *Governments:* Policies, Legislation, Enforcement, Management; *Private Sector:* Investment, Compliance, Internal Codes of Conduct, "Partnering"; *International Institutions and Bilaterals:* Political and Financial Leverage, Technical Assistance; *Non Governmental Organizations*: "Watch Dogs", Monitors and Advisors.

The discussion that followed emphasized that corruption took place not only at the production and exports stage, where World Bank action seems to focus, but also as a result of extremely high, difficult to absorb investments at the “upstream” stage, as well as at the trading or “downstream” stage, where massive resources tend to disappear through price transfers that are difficult to track.[2]

Forestry:

N. Sizer (World Resources Institute) described issues emerging from experience such as timber production in Malaysia, pointing towards issues ranging from institutional weaknesses and competence levels of public agencies to basic policy issues and rules of engagement, more broadly

A number of studies and ongoing research conducted on the underlying causes of deforestation and forest degradation and most observers agree on the prevalence of corruption in connection with the phenomenon in many parts of the globe. Corruption is associated in particular- but not only- with illegal logging, interest-driven or politically motivated allocation of logging concessions, fraud and tax evasion schemes. The accountability of corporations and various actors engaged in corrupt practices is seriously weakened. Corruption renders inspection policies ineffective, most regulations and control mechanisms worthless and prevents the application of sustainable forest management practices.

However, the links between corruption and forest destruction are highly complex – they involve private companies, the government, local people, and increasingly, the global community. The complexities also cut through economic, political, social, legal and ecological systems. An in-depth debate has been sparked by Global Watch, World Resources Institute, and other institutions on how to approach these issues.

Conclusion:

The discussion concluded with general remarks by Peter Eigen (Chairman of TI) who said that these issues needed to be pursued further and that two steering groups should be formed – one in mining, and the other in petroleum (discussions are under way as noted above on a possible agenda in forestry).

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[1] "Does Mother Nature Corrupt? Natural Resources, Corruption, and Economic Growth” - - Katz, Leite and Weidmann, IMF Working Paper, July 1999

[2] "Does Petroleum Trade Matter - The Case of Sub-Saharan Africa"; M. Schloss, Finance of Development, March 1998