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The potential role of EITI in fighting corruption and IFFs

Query

Please provide information regarding the potential of the Extractive Industries Transparency Initiative (EITI) to fight illicit financial flows (IFFs), especially on: a) whether EITI reports can be used to detect such flows; b) specific cases where EITI data helped identify corruption; and c) the potential legal barriers for the new EITI standards which include the publication of beneficial ownership.

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Summary

This expert answer focuses on the potential of the data contained in the EITI reports to help improve governance and fight corruption. The first section explains why extractive industries are especially prone to IFFs. The second section explains the main mechanisms through which EITI aims to contribute to fighting corruption and improving governance. This section also explains the most important changes made to the EITI standard in 2016. The third section looks at ways in which the EITI report data has been used, but also points out its current shortcomings. The final section gives a short overview of the legal barriers for EITI implementation.

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1. Extractive industries and IFFs

Extractive industries are known for generating high economic rents. The government's share of these rents can be very large in times of high commodity prices, but the nature of these rents also involves challenges for policy makers and can work against transparent governance and management given their price volatility, uncertainty, exhaustibility and the fact that the revenue comes mostly from abroad (Revenue Watch Institute 2011). As a result, many resource-rich countries fall prey to the "resource curse", in which poor policy choices and corruption aggravate levels of poverty and conflict and strengthen autocratic rule (Revenue Watch Institute 2011). According to the World Bank, around 3.5 billion people live in resource-rich countries. Despite their vast oil, gas and/or mineral deposits, many of these countries have historically shown below-average growth combined with high levels of persistent poverty and corruption (Ernst 2013).

Moreover, every year huge sums of money are illegally transferred out of developing countries, taking away resources that could be used to finance public services and weakening their financial systems and economic potential (OECD 2014: 20). Data from Global Financial Integrity shows that IFFs have grown unchecked over the last decade, rising at an average rate of 6.5% a year between 2004 and 2013. In this period alone, IFFs rose from US$465 billion to almost US$1.1 trillion a year (Kar and Spanjers 2015: 5). The positive connection between IFFs and the extractive sector also becomes obvious when looking at the main sources of IFFS: resource-rich countries such as Brazil, China, Mexico, Nigeria and Russia are the top 10 sources of IFFs (Kar and Spanjers 2015: 8).

Despite the growing interest in the topic of IFFs, the study of these flows is still relatively new. Academic literature on the issue is rare and measurement has been particularly challenging. There are currently very few estimates of these flows, and those that are available are often criticised for their methodology and for either under- or over-estimating the dimensions of the phenomenon.

There is, however, anecdotal evidence suggesting that a significant share of IFFs is likely generated in the extractive sector through trade mispricing and targeted use of transfer pricing (Toigo 2016). The Africa Progress Panel, for example, suggests that the Democratic Republic of Congo lost at least US$1.35 billion between 2010 and 2012 from just five mining deals that involved a structure of complex and secret company ownership (Africa Progress Panel 2013: 1).

Le Billon (2011: 3) explains the close connection between the abundance of natural resources and IFFs through some of the intrinsic characteristics of the extractive industry. According to this author, the extractive sector is particularly prone to IFFs given that:

1. extractive industries fall under high-level discretionary political control such as a president or executive committee and are often prone to secrecy
2. state companies in extractive sectors often blur lines between personal and public interests
3. limited competition in extractive sectors leads to fewer corporate checks and balances
4. extractive sectors often require high degrees of technical expertise and make mispricing, and falsifying reports easier

Despite the academic considerations and anecdotal evidence suggesting that the extractive sector is particularly prone to practices such as embezzlement, theft, tax evasion and trade misinvoicing, there are currently no estimates of the proportion of IFFs that stem from the extractive sector. Moreover, given the various definitions of IFFs and the fact that these flows can stem from both legal and illegal sources, there is very little evidence that can link EITI directly to IFFs.

For this reason, this response takes a broader approach and looks at the ways in which EITI's data can and has been used to promote better governance and accountability, and at the existing

barriers for the use of EITI's data as a corruption/IFF tracking tool.

2.   EITI's potential impact on governance

The Extractive Industries Transparency Initiative (EITI) was launched in 2003 to promote better governance in resource-rich countries through the full publication and audit of company payments and government revenues from oil, gas and mining. As a voluntary commitment of stakeholders with shared goals, the global EITI structure comprises resource-rich countries, international and national extractive companies, civil society, investors and supporting countries (Ernst 2015). EITI's coverage has grown rapidly since the initiative was launched: as of September 2016, the EITI standard is being applied in over 50 countries.

EITI's two main objectives include:

*   to disclose and reconcile extractive industries' revenues paid to, and received by, governments (taxes, royalties and signature bonuses)
*   to promote and strengthen the multi-stakeholder dialogue approach, inform public debate, and promote understanding

Despite its relatively modest objectives, the initiative contributes to strengthening accountability in the extractive sector by: a) establishing a reporting standard that is agreed to by domestic governments and corporations; b) providing a policy platform to encourage multi-stakeholder dialogues; and c) creating international networks of civil servants, corporate executives, CSO activists and development practitioners with shared standards and commitment to good natural resource governance (Mejia-Acosta 2014).

EITI may therefore be seen as "one part of a much larger whole that is pushing the globe to good governance by improving governance in the extractive industries' value chain" (Keblusek 2010: 22). The fight against corruption and IFFs, however, goes beyond the scope of the initiative.

Evidence of the effectiveness of the standard to curb corruption, however, is still mixed: David-Barret and Okamura (2013: 6) show that after countries sign up to EITI, their corruption scores improve both over time and in comparison to matched-pair countries that do not join. A 2016 study, on the other hand, finds no evidence of improved corruption scores as a result of EITI membership. Moreover, the results reveal that member countries of the initiative are, on average, associated with higher corruption scores vis-a-vis non-EITI members (see Kasekende, Abuka and Sarr 2016). Most authors agree that the active involvement of civil society in the EITI process can theoretically help reduce corruption levels (see David-Barret and Okamura 2013; Etter 2014; Ernst 2015).

The 2016 EITI standard reform

In early 2016, the EITI standard was revised and adapted to face new challenges. Some of the changes to be implemented between 2017 and 2020 also have the potential to support the fight against corruption and tackle the proliferation of IFFs. The most promising features supporting this goal include (see Rogan 2016):

1. Reinforced transparency: in the long term, extractive industry transparency should not be confined to the EITI, but become an integral part of how governments manage their sector. To this end, the EITI standard has been refined to outline two possibilities for EITI disclosures: (i) "conventional EITI reporting" with data collection and reconciliation by an independent administrator; and (ii) "mainstreamed EITI reporting" where public disclosures of the information required by the EITI standard are made through existing government systems.
2. Beneficial ownership: the 2016 EITI standard contains new provisions on beneficial ownership (provision 2.5). By 1 January 2017, all countries will need to agree a roadmap for complying with the requirement on beneficial ownership. By 1 January 2020, all countries have to ensure that privately-held companies disclose their beneficial owners as part of their EITI reports. This information must include the

identity of the beneficial owner, the level of ownership and details about how control and ownership is exercised.

3. Implementation review: due to low level of implementation of past EITI recommendations, the new standard includes provisions requiring multi-stakeholder groups (MSGs) to document the level of progress in addressing recommendations and the rationale for disregarding any recommendations from EITI reports. Plans for implementing recommendations should also be outlined in the MSG's workplan.

4. Open data policy: the provisions on data accessibility introduced in the 2013 EITI standard were strengthened to promote open data. MSGs are now required to agree on a clear policy on the access, release and re-use of EITI data and encourage implementing countries to publish EITI data under an open licence, and to make users aware that information can be reused without prior consent.

The call for disclosing information about beneficial ownership and the move towards open data are expected to increase EITI's potential to help deter and detect corruption, conflicts of interest, tax evasion and IFFs related to these practices (Westenberg 2016).

3. EITI data as a tool to track irregularities in the extracting sector

Countries implementing the EITI standard publish reports that disclose how much revenue governments actually receive from the extraction of natural resources. In the EITI report, companies disclose what they have paid in taxes and royalties, and the government discloses what it has received. These two sets of figures are compiled and compared by an independent reconciler, chosen by a multi-stakeholder group in each EITI implementing country. With EITI reports, citizens can see how much their government is being paid for the natural resources in their country (Ernst 2015).

The seemingly simple exercise of publishing what companies pay and what governments receive has already helped uncover irregularities in the extractive sector. Some examples include:

- Lack of tax payments: through its 2012 and 2013 reporting, Ghana identified a US$55 million discrepancy in payment reporting from Anadarko WCTP Ltd. to the Ghana Revenue Authority; Nigeria has also recovered US$2.4 billion from missing tax payments and royalties (see EITI 2012 and EITI 2016); and the Democratic Republic of the Congo highlighted that US$88 million are missing and found that one tax collecting company was unable to account for royalty payments totalling another US$26 million (Kasimova 2014). Similar situations have been uncovered in Nigeria, Indonesia and the Democratic Republic of the Congo.

- Unreported contracts/licences: Burkina Faso's 2012 EITI report identified an agreement between the government and a mining company that was not reported in accordance with the laws and regulations governing the sector (EITI 2016).

- Outdated information: the EITI report found that the government of Albania has not undertaken studies of oil and mining geological reserves in the last 25 years. Geological studies and maps from the 1980s and 1990s exist but are not publicly available. Also, the report noted that the accuracy of this data is limited due to advancing exploration and extraction technologies as well as a lack of official and accurate data on production extracted throughout the country since the date of the latest geological studies (EITI 2016).

- Lack of control and monitoring in production and exports: according to the EITI report, phosphate exports from the state-owned Société Nationale de Phosphates de Togo (SNPT) were not overseen by the customs office. Only the company maintains data on the export of phosphate, and no government agency can confirm the accuracy of this data. In addition, the EITI report revealed that iron exports made by the company MM Mining are subject to payment of mining royalties post-export. This means that royalties were not due

until the company had exported and reported on the quantity and value of the exports to the Directorate General of Mines and Geology (DGMG). Taxes were then calculated and settled accordingly (EITI 2016).

- Lack of transparency in government transfers: in the Philippines, local governments are entitled to receive a 40% share of three key revenue streams collected by the central government: royalty income from mineral reservations, energy resources production and mining taxes. The 2012 EITI report found that the central revenue collection agencies were not able to provide information on the contribution of each payment stream from the mining sector, but lumped these transfers together with other payments before distributing them to local governments. This limited the ability of local governments to assess the value, impact and desirability of mining activity in their area (EITI 2016).

Some organisations have managed to put EITI data to good use by triangulating it with other sources. At country level, PWYP Indonesia is a good example of how EITI data can be used to strengthen accountability[1]. This organisation enriched the data derived from EITI reports with project-level payment data, information on corporate commitments for local communities and corporate social responsibility payments to assess whether the resource-rich districts in the country achieved better socio-economic development outcomes than their peers. PWYP Indonesia also used GIS technology and EITI data on mining licences to compare the territory on which mining and palm oil companies were legally permitted to operate with where these companies were actually operating. Through this exercise, the organisation found that many companies were operating outside the licenced territory (Lumbantoruan 2016).

Although the examples listed above highlight EITI's potential to uncover certain irregularities and shortcomings in the extractive sector, it is important to keep in mind that these anomalies do

not necessarily indicate corrupt behaviour. Moreover, many of these cases can be the result of legal loopholes, bad reporting practices, lack of financial resources and not the direct result of corrupt behaviours. Therefore, these "red flags" identified through the use of EITI data and reports need to be interpreted as potential risks for corruption, but should not be read as evidence of corrupt acts in themselves. Further investigation would be required to determine whether this is the case.

EITI data limitations

The examples above show that EITI's data can and has already been used to increase accountability, track misconduct, or even bring to light potential cases of corruption. To do this, however, the data contained in the EITI reports needs to be triangulated with other sources. Identifying, accessing, collecting, analysing and triangulating these new sources of data to the EITI reports to track potential cases of corruption or identify IFFs, can thus be a time and labour intensive process, which greatly limits the potential uses of EITI data.

The Natural Resource Governance Institute (NRGI) even recognises that EITI's data is often underutilised by global and in-country actors (NRGI 2015). There are, however, important factors that limit the use of this data for anti-corruption purposes.

First, information on extractive projects are scattered across different company and government websites, databases compiled by regulators, international organisations, industry and civil society. Some of it is in PDF form, some in spreadsheets and some computer searchable databases, but these are rarely linked to each other. Some platforms have recently emerged to try to centralise this data in a single platform. The Open Oil project, for example, allows anyone to search public domain documents filed by oil, gas and mining companies to financial regulators in different countries. This platform currently

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[1] See http://www.publishwhatyoupay.org/the-importance-of-project-by-project-disclosure/

contains over two million contracts and financial statements and is updated daily[2]. This platform, however, is more suitable for qualitative rather than quantitative research, as it does not provide any structured and machine-readable documents.

Second, the quality of EITI's data is not ideal. The NRGI sees the current format of the reports, which are mostly published as PFD files, as one of the main barriers to using the data, because the current format makes it difficult to extract and use. Publishing this information in open data formats, like Excel or CSV, could benefit all stakeholders by facilitating analysis that can help answer important questions and potentially improve sector policies (NRGI 2015). However, currently only a few countries, such as Tanzania and Zambia, disclose EITI data in open formats[3].

Third, EITI members (countries and companies alike) typically disclose partial or scant revenue information, which allows at best for only minimal transparency. In this light, the Revenue Watch Index 2010 report recommends a radical move towards full disclosure of standardised financial and contractual information (in a detailed and disaggregated manner) to achieve greater transparency.

Lastly, by focusing solely on transparency on the revenue side, EITI ignores corruption associated with a lack of transparency in expenditures rather than revenues (Kasekende, Abuka and Sarr 2016: 118). Given that corruption can also occur in other critical steps of the value chain, such as in the procedures to award contracts and licences, or during the collection of taxes and royalties, the universe of corruption cases likely to be detected relying only on EITI data is very small.

4. Potential national (legal) barriers for EITI implementation

Legal frameworks differ greatly across countries. It is therefore not possible to provide a full

overview of possible implementation barriers at the global level. Moreover, the modifications to EITI standards are so recent that there are currently no assessments of possible implementation barriers for the new requirements, including the disclosure of beneficial ownership information.

A 2012 study, however, identified confidentiality requirements as one of the most common legal obstacles for EITI implementation as they often prevent the disclosure of data relevant to EITI reporting purposes (Ravat and Kannan 2012: 55-56). This study differentiates between two different sources of confidentiality requirements, i.e.:

- domestic laws, including the constitution and statutes, rules or regulations
- contractual obligations concerning data disclosure

Distinguishing between these two sources is important as one presents more challenges than the other: while confidentiality requirements from local laws are mostly uniform in terms of their application, or are applied based on specific rationally-based criteria (such as type of industry, type of company, etc.), contractual confidentiality requirements, based on the terms of individual contracts, are likely to differ more widely (Ravat and Kannan 2012: 55).

Implementation issues related to confidentiality requirements have been documented in a number of countries ranging from low-income nations (Central African Republic and Liberia), to middle (Azerbaijan, Ghana, Mongolia, Nigeria, Yemen) and high income countries (Norway). The main hurdles, as summarised by Ravat and Kannan (2012: 55-57) have included:

- Contractual confidentiality requirements: confidentiality clauses present in production-sharing agreements were an obstacle to

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disclosure of data for EITI purposes in Azerbaijan and Yemen. The issue was resolved when the governments of these countries waived these requirements.

- Inadequacy of legal framework for data disclosure: in some countries, legal loopholes might compromise EITI implementation. In these cases, the gaps in national laws must be filled and new EITI-related legislation needs to be explored. For the case of Ghana, for example, laws guaranteeing freedom of information were recommended.
- Legislative requirement of confidentiality: given the legal requirements for confidentiality, a decree had to be passed in the Central African Republic to grant the national EITI secretariat the authority to call for data disclosure for EITI purposes. Confidentiality in all commercial contracts was waived to that effect.
- Conflicts of local laws: in the case of Norway, the Customs Act and the Tax Assessment Act allowed the Norwegian tax administration and customs office to disclose the necessary data for EITI reports. Nevertheless, the Petroleum Act had to be amended to include EITI reporting requirements.

Besides these legal hurdles encountered in the past, the increased demands for data disaggregation and beneficial ownership information required by the EITI standard after the 2016 reform might bring up new clashes with existing privacy laws. In Timor-Leste and the Kyrgyz Republic, for example, preventive reforms addressing potential disclosure issues in the case of further moves towards disaggregation of data were adopted before the last modifications to the EITI standard.

As all EITI implementing countries are required to implement the new demands on beneficial ownership by 1 January 2020, other governance related risks can be expected to receive attention. The quality of corporate governance and the infrastructure that supports it are two likely contenders for such increased interest. The identification of capacity and legal constraints to the full implementation of the new EITI standard is likely to occur in the coming months.

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