CANADA-EU MINING COUNCIL

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The Extractive Industry Development Forum:

How Financial Transparency and Economic Governance Can Help Achieve Development Goals

A policy dialogue organised by the Canada-EU Mining Council and the European Centre for Development Policy Management with the financial support of

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Report

Introduction and context

On 18 November 2011, the Canada-EU Mining Council (CEUMC) and the European Centre for Development Policy Management (ECDPM) organised a round table discussion on financial transparency and economic development, following the release by the European Commission (EC) of the Transparency Directive and the Communication on Budget Support on 12 October 2011 and 25 October respectively.

The objective of the meeting was to discuss how initiatives by the European Union (EU), such as the one on financial transparency and on budget support, could effectively contribute to a better governance of the extractive industry and resource-rich countries towards sustainable and inclusive development, notably in Africa. In doing so, the synergy and complementarity with other approaches in pursuit of similar objectives was also addressed.

The meeting gathered a number of stakeholders working in the field of development and industrial policy and extractive industries, i.e. representatives of the European Commission, EU Member States, mining companies, think tanks and NGOs. It provided opportunities to stakeholders to exchange views and engage in a dialogue with the European Commission and key representatives of extractive industries on the Transparency Directive and the Communication on Budget Support. The open door part of the day principally dealt with the two European initiatives on transparency: the directives and the budget support communication. The purpose was to discuss the practical relevance of transparency for the extractive industry and assess how financial transparency could contribute to enhance better private and public governance in resource rich countries. The closed-door session discussed possible follow-on work and the establishment of an *Extractive Industry Development Forum.*

The EC Transparency Directive

Panellists outlined the key elements of the regulatory set up as proposed in the EC's Transparency Directive and Accountability Directive. The Directives focus on listed and large non-listed companies of the extractive resource industry and the forestry sector. They would require companies to report both on a project-by-project and country-by-country basis. The reporting format would reflect the Extractive Industries Transparency Initiative (EITI) disclosing format and would retain the concept of materiality in relation to the recipient government. The concept of materiality and the definition of projects are yet to be agreed. In order to avoid high costs associated with project reporting if a too narrow definition of "project" is used, the policy proposal is to follow company's reporting system and definition of project. The proposal, however, exempts companies from reporting in countries where the disclosure of certain information is prohibited under the national law. Such companies will nonetheless be asked to provide explicit information on where and why these exemptions are made. While the EU and US regulations cover approximately 60-80% of the market, panellists highlighted that there was a need for a multilateral approach in which all partners involved would engage for more transparency.

Members of the private sector present held a firm belief in transparency as an important development tool and were strongly supportive of the country-by-country initiative. It was pointed out that transparency and good company activities should be viewed within a bigger perspective. The promotion of sound and sustainable business activities is not just about counting the capital flows but also assessing whether the money is effectively transferred back to local communities. Although generally supportive of the Proposals, private sector actors pointed to the fact that the directives do not clearly demonstrate whether royalties, taxes, licence fees etc. would indeed also flow to the community on the ground. Moreover, the prevalence of different rules in different countries as well as the different levels of materiality might pose a problem. Project level accounting may make the reporting processes much more complicated, since there is an inbuilt difficulty to report on project level given that companies do not really pay taxes at this level.

Representatives of NGOs emphasised the critical importance of accountability and transparency, in particular in Africa, where it is estimated that capital flights far exceeded the aid inflows to the continent. They also pointed to the positive contributions by the donor community to improve governance and strengthen institutions. The EC directives were welcomed as being fairly far reaching, even going beyond the US Dodd-Frank regulation. However, they questioned the need for exemptions since there was no evidence of backlash against multinationals due to partner country legislative restrictions on information disclosure. It was pointed out that the US legislation does not have such an exemption. They emphasised the need for country-by-country and project-by-project reports to be made accessible to local communities so that these communities would be able to compare data between the companies operating in their area and companies in other regions. Compliance would have to be ensured by member states and auditing would be a key element to assess where companies can improve performance.

Discussions focused on the definition of projects, since it was felt that adequate reporting would specially benefit the local communities. Although this was widely acknowledged, private sector objections against project-by-project refer to the additional administrative burden and differences in the definition of projects as these vary between the extractive and the forestry sectors, between different countries, and among companies. One key challenge is to ensure that the local communities get their share of the money, which is often not the case. This is due to poor national level governance, but also to local capacity and institutions that are often not geared to respond to demands or needs from the local population. Another challenge may be mistrust. While there are other contributions than financial ones that mining companies could make to local communities, these were sometimes viewed with suspicion. In some cases, such social initiatives were perceived as being defensive actions rather than voluntary contributions aimed at promoting sound ethical or development goals.

Transparency in the EC Communication on Budget Support

But there are other ways for the EC and the EU Member States to promote transparency and better (economic) governance. Panel and participants discussed the policy proposals on renewing budget support to developing countries. Through this aid modality, donors try to strengthen budget processes, improve public financial management and contribute to macro-economic stability. But, while there are positive results to show for improving financial management and enhanced expenditures on public goods, there is little to show for improved transparency (for example of the budget) and domestic accountability. Therefore, the EC has made provisions to strengthen transparency when providing budget support. Countries receiving aid through their treasury should be able to demonstrate how they will ensure more transparency in the budget processes. The EC will also promote more cooperation with the member states, and communicate better on objectives and results of this aid modality.

The discussions centred on the so-called fourth "eligibility criterion" on transparency in the EC Communication. Would the application of such criterion not become a conditionality that would prevent some partner countries to benefit from budget support? There was little evidence from past research that imposed conditionalities have a positive impact. The primary aim of budget support is to promote development objectives such as the Millennium Development Goals (MDGs). Yet there is a risk that imposing transparency requirements could function as political conditionality and exclude partner countries from benefiting from the type of assistance that they need most. Such conditionality would somehow prevent donors to contribute to strengthening public finance systems, institutions and policies for development.

The Communication also addresses the linkages between budget support and the need for domestic resource mobilisation in Africa and elsewhere. This goes beyond taxing extractive industries, but touches on the wider policy challenge of gradually creating a sustainable fiscal revenue basis for broadening public service delivery. It was recognised that in themselves transparency initiatives, such as the Dodd-Frank Act and the EC's Transparency Directive, cannot contribute to improved policies and institutions, but they are one step in the right direction. External partners – such as donors – can complement and contribute to both strengthening the demand and the supply side for better governance. There is an increased awareness about the nature and importance of the interaction between state and society, and about the institutions and organisations it takes to contribute to development oriented dynamics and policies. More transparency combined with capacity support can help strengthen the demand side from accountability stakeholders such as civil society, parliaments, the media, etc. Donors can also directly strengthen the supply side of good governance through policy dialogue with partner government, technical and financial assistance. They should, however, refrain from *crowding out* the domestic demands for improved governance by demanding and fragmented aid efforts. In fact, donors can be more pro-active on transparency of all aid flows and communicate this in more user-friendly ways.

Other issues addressed included corruption and *leakages* in the system, addressing capital flights, and how to engage with the informal sector when seeking to broaden the tax base. Again, tackling these issues would require concerted efforts from governments, civil society, the private sector and the international community. One point of discussion related to the use of tax exemptions for the purpose of attracting investors. Such policies ought to be transparent, but also fair and sustainable. To ensure that multinational companies act according to national and international regulations, stability of the fiscal rules was seen as a critical element. Governments have to provide the right incentives. They should help create an environment that enables various stakeholders to participate in public debate and seek agreement on economic and fiscal reforms.

Towards an Extractive Industry Development Forum

How can public authorities, stakeholders from the private sector and the extractive industry, civil society actors and the international community contribute more effectively to improved transparency, to better economic governance and development? Is there scope for more effective cooperation? What are collaborative practices that are inspiring to help answer the previous questions? And how can we continue to explore answers to these questions. These were the key issues addressed during the closed-part of the day.

Participants agreed that some of the existing global initiatives, such as the Extractive Industry Transparency Initiative (EITI), the Forest Law Enforcement, Governance and Trade (FLEGT) processes, or developments in countries such as Liberia offer examples of global initiatives that combine elements of transparency with context specific strategies. Such initiatives cannot be copied, but when understood more properly, can help effective multi-stakeholder partnerships in other contexts. This was one of the conclusions to come out of the round-table. Participants also identified some challenges to tackle, as well as opportunities to engage in collaborative efforts to improve economic governance and enhance development.

Challenges:

Some of the general and more specific challenges relating to transparency at different levels relate to the fact that :

- enhanced transparency does not result automatically in improved (economic) governance;
- most developing countries face multiple constraints including those of capacity and those related to high concentration of power and resources;
- transparency initiatives are still promoted in fragmented ways (despite energetic efforts by multilateral and other actors to cooperate, harmonise, etc.);
- the demand and supply side for improving governance are not always well covered (opportunities for strengthening domestic development or accountability actors and processes are insufficiently utilised);
- the efforts at promoting transparency in the extractive industry sector as a whole are not yet compatible with the challenges, especially in Africa and particularly in fragile countries;
- a lack of US/EU consultation or dialogue has resulted in non-harmonised or more cumbersome transparency requirements for extractive industries in both continents;
- the number of external actors (for example in the area of aid) is still increasing, with an ever greater risk of further fragmentation and lack of transparency;
- there are still serious concerns about the negative impact of resource mismanagement, transfer pricing, tax exemptions and the missed development opportunities for the private sector due to corrupt procurement systems.

At the same time, it was recognised that there was an increasing number of initiatives – from the global down to the local levels – in support of transparency. Various opportunities to strengthen transparency, but also to strengthen the linkages between transparency and economic governance, include:

- a realisation from different stakeholders that promoting transparency can result in positive outcomes beyond the confines of those taking the initiative;
- a realisation that multiple actors ranging from public, private and civil society sectors and working at different levels are already active in these fields, and can purposefully create linkages either in promoting transparency, or by using transparency as the entry point for tackling broader accountability and governance challenges;
- the stronger ownership over transparency and development issues (including an interest in domestic resource mobilisation, the global and domestic drivers of corruption) in existing and new regional and global partnerships;
- Experiences on the ground that demonstrate the effectiveness of well designed external support for collaborative and context specific efforts that also take into account regional and global drivers (such as market forces, incentive mechanisms, reputation issues, etc.) – a lot can be learned from multi-stakeholder initiatives such as the EITI and the EC's FLEGT initiative;
- the expanding knowledge base of what works and what does not work in different areas of external cooperation (trade, aid, regional and global forms of collective action, etc.);
- an interest within the extractive industry sector of how transparency and improved governance can contribute to local and national sustainable development;
- the demands from various private stakeholders, including from within the extractive industries, for effective forms of multi-stakeholder cooperation addressing both supply and demand side challenges;
- the expanding opportunities for platforming and collaborative learning at national, regional and global levels.

Participants exchanged on potential coherence, synergy and complementary among these different initiatives. They agreed on the need to create an *Extractive Industries Development Forum.* In fact, both CEUMC and ECDPM gladly took it upon themselves to create this platform for dialogue. A multitude of actors and policy makers can engage in sharing experiences, build on existing forums (such as the International Council on Mining and Metals - ICMM, the African Tax Administration Forum - ATAF, etc.) and explore areas of multi-stakeholder collaboration at global, regional, national and local levels.

For comments and further details about these topics and processes, please contact:

Isabelle Ramdoo, ECDPM, ir@ecdpm.org ; James Small, CEUMC, jmsmall@ceumc.com

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