The Extractive Industries Transparency Initiative

Contributing to a better investment climate

Corporate governance developments are an important driver for global investors to take into account in their decision making, as well as the more normal economic, business and regulatory concerns.

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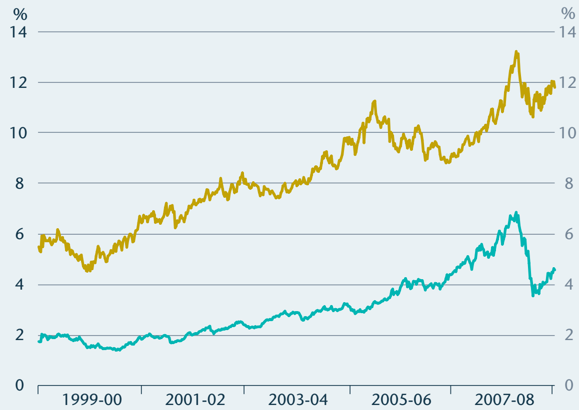
Chart 1
The growing importance of commodity stocks



Selected sectors as a proportion of world equity market:
Oil & Gas — Basic Resources

Source: Thomson Datastream

Transparency on resource revenues

Investors regularly evaluate a number of risks which could impact on their investments, whether economic, financial, or increasingly political. It is clear that certain companies operating in areas of political instability, or in countries suffering from violence, bribery and corruption, face business risks that can significantly affect their commercial prospects and thus returns to investors. Companies in the extractives industries - oil, gas and mining - are increasingly subject to these problems as they move to source more production from assets in countries with higher risk profiles.

Over eighty global investment institutions, which in June 2008 collectively managed over $14 trillion of assets, have therefore seen it in their interest to support the Extractive Industries Transparency Initiative (EITI). The EITI is a collaborative effort by countries, companies, investors and civil society to strengthen accountability and good governance in resource rich countries that are often affected by the ‘resource curse’. This phrase has been used to describe a paradox seen in some countries and regions. Sometimes those with an abundance of natural resources experience worse development outcomes and slower economic growth than countries with fewer natural resources.

The EITI aims to improve governance through the verification and publication of company payments and government revenues from oil, gas and mining. This increased transparency sends a clear signal that a government is committed to high standards. It also strengthens accountability and can promote greater economic and political stability. All of these factors can enhance the prospect for investment returns from companies operating in participating countries.

How does the EITI work?

The EITI has developed specific criteria for the implementation of a validation process that leads to the disclosure of companies’ payments and governments’ receipts from oil, gas and mining activities. The criteria require the commitment and participation of governments, companies and civil society in a multi-stakeholder group (MSG) that oversees implementation in each country.

There are two stages in EITI implementation. The first requires implementing countries to comply with four initial criteria in order to qualify for Candidate status. Once these have been met, then Candidate Countries have two years to complete the second stage of EITI Validation. The key requirements of Validation include the establishment of an MSG and the publication of a Country Work Plan with measurable targets and a timetable for EITI implementation. Also, implementing country governments must ensure the removal of any legal or regulatory obstacles, such as confidentiality clauses in contracts, which block companies’ disclosure of payments to governments.

The MSG is responsible for appointing an independent Validator to prepare a report that includes a review of progress against the Country Work Plan. It also includes the indicators specified in the EITI criteria and an overall assessment of the implementation of EITI. The Validator’s report is reviewed by the MSG, the government and the EITI Board. If the EITI Board concludes that the country meets all of the EITI criteria, the country will be designated as EITI compliant. To maintain this designation, further Validation exercises must be completed at a minimum of every two years. Where the Validation report shows that a country has made progress but does not meet all the EITI criteria, the country will remain a Candidate. Where Validation shows that no meaningful progress has been achieved, the Board may revoke the country’s candidate status.

Current status of EITI

The EITI is receiving broad support. Over 500 participants from 80 countries attended the fourth EITI Global Conference in Doha, Qatar in February 2009. Global financier George Soros, a keynote speaker at the Conference, expressed his belief that the countries implementing the EITI would have a competitive advantage in attracting greater investment in a global economy that has become highly risk-averse. The high standards of accounting and reporting inherent in the EITI are attractive to investors seeking to minimise risk, by ensuring greater openness and a more level playing field in the business environment.

In February 2009 the EITI reached a milestone when Azerbaijan became the first country to have completed an EITI Validation and be designated as EITI Compliant. With another 25 Candidate countries in the process of implementing EITI, the next few years will be crucial to the overall success of the initiative and its role in contributing to improvements in the investment climate in participating countries. The final mix of Asian, Middle Eastern and OECD countries that eventually adopt EITI will be an important measure of its success.