PROJECT SYNDICATE

Openness in Extraction

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NEW YORK – More than a decade before becoming President of the United States, Herbert Hoover, a mining engineer, observed that, among the branches of property law, the distribution of mining rights most elegantly reflects the vicissitudes of social and political relations. According to Hoover, mining rights were a "never-ending contention," as old as economic and civil conflict, among four principal classes – overlord, state, landowner, and miner. "Somebody," he concluded, "has to keep peace and settle disputes."

Today, with the prices of major natural-resource commodities – including oil, coal, copper, gold, and iron ore – doubling, tripling, or rising even faster, the extractive industries are rapidly expanding. Profitable investments in the sector could lift millions of people out of poverty in the developing world.

But the risks are as real as the potential rewards. Resource industries are persistent sources of corruption, conflict, and degradation. Mineral and hydrocarbon deposits are often located in less-developed countries that suffer from pre-existing governance constraints, political instability, and major developmental and environmental challenges.

Transparency – full disclosure of everything from contracts to management of revenues and environmental commitments – is crucial for realizing the sector's economic potential, and avoiding conflict and collapse.

On May 17, the advocacy organization Oxfam America sued the US Securities and Exchange Commission to issue a final rule implementing Section 1504 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. Dubbed "Cardin-Lugar" after its bipartisan sponsors, Senators Ben Cardin and Dick Lugar, Section 1504 codifies one important aspect of transparency in the sector by requiring oil, gas, and mining companies listed on the New York Stock Exchange to report payments made to the governments of countries in which they operate. But the SEC has exceeded the deadline for implementing the rule by more than 13 months.

Cardin-Lugar's quiet passage through the Senate raised hopes that the law heralded higher standards for publicly-listed extractive companies, similar to those being considered in Europe and Canada. Transparent revenue flows allow all stakeholders – from equity investors to local communities – to follow the money, thereby reducing the risk of corruption and fiscal mismanagement along the revenue chain, and helping to ensure that extraction's benefits are shared.

“Maybe I am a little optimistic,” Cardin remarked in 2010. “But it is in the interest of the extractive companies to comply fully with the spirit of these provisions. You are going to have more stable governments where you are operating; you will have fewer pull-outs, closures, and disruptions; you will have a more sustainable market. One thing that is good for stock prices is predictability.”

Pessimists were concerned that industry lobbying would focus on a bureaucratic regulatory process whose opaqueness puts congressional politics to shame. Unfortunately, they were right: industry groups, led by the American Petroleum Institute and top mining companies, are aiming to delay and weaken the regulations, undermining the law’s spirit.

The industry’s argument – that transparency hurts business – is simply not true. The Vale Columbia Center on Sustainable International Investment identified 17 listed companies that disclose tax payments on a country-by-country basis in their reporting activity. The data, which were submitted to the SEC during the public-comment period last year, showed a positive correlation between transparency and financial performance.

Moreover, in a recent article, Lord John Browne, former chief executive of British Petroleum, agreed that, “It is rare for a company to lose business by being too transparent.” He added that, “Opacity can create political risk by allowing rumor to predominate over facts, and by allowing contracts to become entangled with the personal interests of officials.”

Rather than procrastinating, the SEC must recognize that Cardin-Lugar should be only the beginning of efforts to maximize resource extraction’s impact on sustainable development for states and communities. Reaping the benefits from foreign investment – including capital flows, technology transfer, infrastructure development, and linkages with local industries – depends on the policies, norms, and institutions in place to ensure mutually satisfactory outcomes for all stakeholders. Cardin-Lugar lays the foundation for improving capacity to enforce contractual obligations.

Furthermore, high prices and new technology are inducing miners to return to previously explored areas that are already ecologically fragile, or to more remote reserves, where the environmental effects of extraction are extreme. Extractive deals should include transparent obligations to mitigate and repair environmental degradation. In addition, payments and contracts between investors and states should be public, so that all parties understand the risks and benefits of the deal. The alternatives are increased conflict at the local level and movements to renegotiate deals at the national level. Both trends are already increasingly common.

Investors are uncomfortable with instability, not transparency. Neither unrest at mine sites nor revenue mismanagement by government officials is good for business; nor is the reality that deals perceived as unfair or corrupt may be renegotiated or canceled in response to public pressure. Secure markets depend on good governance, less poverty, and a healthy environment. Cardin-Lugar needs to be implemented and enforced as a first step toward achieving that goal.