

# Why the Extractive Industry Should Support Mandatory Transparency:<sup>1</sup> A Shared Value Approach

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## **ABSTRACT**

The Transparency Amendment, included in the Dodd-Frank Wall Street Reform and Consumer Protection Act, can be an important tool in curtailing the resource curse that so heavily burdens resource-rich developing countries by shedding light on opaque payments between the extractive sector and host countries. From the get-go, however, extractive industry companies have fiercely opposed the new mandatory disclosure requirements as set out in this regulation. The corporate opposition is for the largest part motivated by the fear of a competitive disadvantage that derives from the fact that the amendment is housed with the Securities and Exchange Commission (SEC) and thus only holds jurisdiction over those that report to the SEC. Although on the one hand watering down these corporate fears, this article draws on the “shared value approach” and empirical evidence

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to argue that there is a business case for transparency. This refreshing take on transparency regulation invites corporate leaders to reassess their current oppositional stance and to embrace new initiatives like the Transparency Amendment and to take a proactive stance in building a convincing global regulatory system of transparency.

“Publicity is the very soul of justice. It is the keenest spur to exertion, and the surest of all guards against improbity.”<sup>2</sup>

## INTRODUCTION

The Arab Spring forcefully made clear that citizen demands for transparency and accountability are on the rise in our ever more globalized world. No less so regarding the extraction of valuable natural resources in especially developing countries. Transparency demands in the extractive industries are tied to the paradoxical correlation between large resource endowments and endemic poverty as well as low growth in resource dependent countries. As corruption has been observed to play a critical role in this phenomenon generally termed the *resource curse*, two international instruments were set in place to undo this curse: antibribery law and regulation (such as the US Foreign Corrupt Practices Act [FCPA])<sup>3</sup> and transparency-based approaches (such as the Extractive Industry Transparency Initiative [EITI]). These instruments have had successes but leave room for improvement for they are either too limited in scope (antibribery instruments) or leave too much leeway in their rule-setting (EITI). Pressured by civil society, these have moved stock exchanges (in London and Hong Kong), the US Senate, and the European Commission (EC) to initiate laws and disclosure demands that utilize corporate transparency as a means to improve on corruption and governance most explicitly in developing countries. These initiatives, especially in the United States and of the EC, have been confronted with strong corporate opposition.

In this article, we will draw on the US case to exemplify this opposition. The Cardin-Lugar Transparency Amendment, Section

1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,<sup>4</sup> was signed into law on July 21, 2010 only to have its rules finalized, after consistent corporate critic, by the Security and Exchange Commission (SEC) on, August 22 2012. We argue in favor of the development of a transnational transparency regime containing strong and effective mandatory regulations of money flows between companies and governments within the extractive industry sector.

An argument for mandatory and enforceable set of disclosure rules can be made on different grounds as a human rights or democratic governance issue for instance. Although such values provide a backdrop to our argument, our aim is to consider a “business case” for the development of a transnational transparency. Against the corporate critic, we suggest building on theoretical and empirical studies that, in the long(er) term, these developments will be beneficial for companies while the short term costs and risks are limited. To that extent, this article reads as an invitation to corporate leaders to change their tack and provide proactive support to the further development of a transnational transparency regime—both for the poor’s and for their own sake.

To develop this argument, we draw on the shared value approach as introduced by Porter and Kramer (2011) and develop an account of a mandatory transparency regime as a crucial tool to transnational accountable governance. We will also draw on some outcome of the discussion surrounding the implementation of the Transparency Amendment and promising data on increased corporate profitability as a result of stakeholder engagement through increased disclosure to put flesh on the (theoretical) bones provided by the concepts of “shared value” and “governance through transparency.” We still maintain that, as a whole, there is a convincing business case to be made for transparency initiatives such as the Transparency Amendment.

The article is structured as follows. The second section will outline the background against which stringent transnational transparency demands have developed as demands for a second instrument to complement antibribery approaches and combat the resource curse. Subsequently, we describe the Transparency Amendment as a home-state regulatory innovation that seeks answers to the limitations of the currently applied instruments. Our aim here is to reflect on the amendment as such and the

corporate critics that followed during the SECs consultation period. We weigh the arguments made but only with the goal of establishing if there is a clear business case against the measures involved. In the fourth section, we seek to turn around the case of transparency by arguing that a business case can be made in favor of it. We do this by outlining a “shared value” approach as a conceptual lens through which to view the stringent home-state regulatory disclosure demands. Consequently, the second part of this section provides some empirically based upsides to effective transparency regulations. The fifth section concludes with some reflections toward the future.

### **COMBATTING THE RESOURCE CURSE: TOWARD A TRANSPARENCY REGIME**

One of the core questions facing the world today is how to maximize Foreign Direct Investment (FDI) in oil, gas, and mining for sustainable development in especially resource-rich sub-Saharan Africa. Turning the “resource curse” into a blessing is at the core of this challenge. This curse, denoting the paradoxical state of high endowment without reaping benefits such as economic growth poverty reduction, is commonly blamed on weak institutional governance systems and ubiquitous corruption. (Auty 1993; Sachs and Warner 2001)

The extractive industry is characterized by large rents associated to megaprojects, which companies and governments negotiate under a veil of obscurity, whereby national elites (and in different ways also local rebel groups) have been enabled to capture the lion’s share of the proceeds. This rent “taking” delimits the government’s dependency on tax collection for public finances, thereby disrupting the accompanying accountability demands. Of course the resource curse is a multipronged problem to be confronted with, but in this article, we are tackling the disruptive effect of the relation between extractive industry companies and host-state governments when it gets sealed in opacity. To combat this disruptive effect, behavior on both sides has to change. The original antibribery approach, as we recount, only managed to capture the bribe makers (companies), which could also rather easily circumvent the relatively stringent definition of

a bribe. To get to the source of the problem then, increasing transparency has become part of the resource curse agenda as a primary “bridging” mechanism to fight corruption by reducing obscurity on both bribe makers and bribe takers and therefore enabling effective monitoring and accountability to citizens.

### ***Criminalizing Corruption***

Initially, the resource curse agenda focused on the criminalization of outright corruption. The FCPA<sup>5</sup> of 1977 and the Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention)<sup>6</sup> of 1998 are two core pillars of this agenda. The convention largely ended the practice of many countries to make bribes tax deductible under domestic tax regimes as operational costs. Despite the successes of antibribery instruments, they did not effectively end or sufficiently curtailed corruptive practices in the extractive industry.

An important reason hereto concerns the limits of the FCPA and the OECD Convention directly. Firstly, “[i]t should be noted at the outset that the FCPA is designed to address *bribe-making*, not *bribe-taking*—a significant limitation that renders the statute relatively ineffective in countering the corruption at the root of the resource curse” (Firger 2010, p. 8, fn. 24). In addition, loopholes in the OECD Convention and the domestic legislation emerging from it allow companies to make payments (that under any common sense definition would be considered bribes) without facing criminal charges. As Moran (2011) accounts, OECD-based companies started setting up partnerships with family members, business associates, or personal friends of the elites in power in developing countries to arrange for favorable project deals. Payoffs for attaining concessions did not directly flow to public officials and thus could not be considered bribes under the OECD Convention. One option to counteract these loopholes concerns the implementation of broader transparency requirements for the industry. Transparency calls out companies that redirect their payments through the above mentioned sources. At the same time, it also brings those “bribe takers” (government officials) in the spotlight and thus provides a correction on the disrupted accountability mechanisms of many resource dependent countries. The transparency regime

thus functions as an additional stopgap to the resource-cursed countries. By itself, transparency, given the other structural challenges to sound revenue management in these countries, will not dissolve the curse;<sup>7</sup> however, “[t]he belief is that transparency is the essential first step in a multidimensional strategy to counteract the resource curse. (. . .) neither monitoring nor citizen participation can be effective without prior attention to the problem of information” (Karl 2007, p. 274).

### ***Toward a Transparency Regime: The EITI***

Following coordinated lobbying by the “Publish What You Pay” campaign, a coalition of 300 NGOs, the EITI, was launched in October 2002. The initiative, operative in 2007, consists of a broad coalition of companies, governments, civil society groups, investors, and international organizations. The EITI is premised on the idea that by increasing transparency in the extractive industry, the accountability of governments in resource-rich countries will improve, consequentially combating the resource curse. Under the initiative, governments are invited to sign up to a set of provisions that pair company disclosure of payments and governmental disclosure of receipts, which are to be independently audited according to international standards and be reviewed. Participation in the initiative is voluntary; however, once a country signs up, it is under the obligation to develop and apply disclosure regulation to all companies operating within its borders—foreign and domestic, public, as well as private and state owned.

The effects of the EITI are at face value positive: it has pushed governments to develop disclosure law and regulation and extractive industry companies to open their books. Less concretely, the initiative can also be credited to further the awareness of the importance of transparency to governance, in general, and to the resource curse, in particular. At the same time, because of its voluntary and discretionary nature, concerns have arisen pertaining to implementation and impact.

First, and most obviously, the voluntary approach limits the scope of the initiative. Notwithstanding the publicly expressed support, few of the candidate countries have moved to the “compliant” stage,<sup>8</sup> whereas companies and home countries are gen-

erally satisfied with providing limited administrative and financial assistance. The host country-based approach of the EITI does raise additional issues. As Frynas (2010, pp. 169–170) points out, evidence suggests that for a transparency initiative to succeed, a free press, a strong role of civil society, and timing of the initiative are essential. As most resource curse-affected countries have a high autocratic nature and bad governance is abound, the first two factors are clearly missing. With regard to timing, Frynas points out that external actors, such as even the World Bank in Chad, evidently loose traction over a resource-rich country when dependency on external revenue diminishes as an effect of increased own revenues (Frynas 2010). A lack of traction is even more apparent in the case of countries that are already established producers. The main concern however with respect to its voluntarism is that little pressure can be exerted on those countries where transparency probably would do most good. As Former British Petroleum (BP) CEO John Browne (2012) wrote in the *Financial Times*, “[t]he EITI cannot help when countries or companies are unwilling to sign up.”

Second, the downsides of the discretionary character of the implementation of the EITI are also evident. As said, participating countries have to subject all companies operating within their borders to a set of EITI-based disclosure demands. The caveat however is that companies have quite some space to lobby. This has resulted in a lower bar for transparency standards (mostly, aggregate and undifferentiated data disclosure) and per country varying disclosure requirements, making it hard to assess the disclosure reports on the revenue streams (Gillies 2011). Concluding, then, we can say that the voluntarism limits the potential scope of the club of countries, whereas the discretionary side to the initiative limits the utility of the disclosure requirements. These limits impair on the EITIs success, having one OECD working paper even concludes that no transparency effects of the EITI can be observed (Ölcer 2009).

These results of the EITI reflect the results of earlier studies regarding social reporting more broadly. Hess (2007) outlines the failures and pitfalls of voluntary social reporting initiatives and also argues for mandatory social reporting as necessary. Such voluntary systems are hampered in attaining their goal of organizational transparency, strengthened transparency, and/or

stakeholder engagement because they leave corporation too much room to manoeuvre to co-opt the process and turn it into a tool of stakeholder management. As criticisms on the value of information comprised through the EITI seem to reflect, voluntary—and in this case importantly discretionary—approaches can serve as a legitimizing and insurance tool, without improvements of social performance. Hess (2007) builds on the work of Fung et al. (2004) who argue that for transparency policies to be effective (generate a functioning “action cycle”<sup>9</sup>), the information produced through these policies should become embedded in everyday decision making of both the disclosers and users of the information as to become reciprocally reinforcing. By generating a fixed and detailed template for reporting, excluding exceptions, applicable to all covered companies, conditions for such ongoing use on both sides of the spectrum are created by the amendment. To reap the benefits of enhanced disclosure, data need to be standardized and comparable as to ensure effective information disclosure.

The EITI has been a host country-oriented initiative, largely leaving home countries—that could regulate their companies extrajudicial or otherwise—of the hook. This “gap” in the transparency regime and the limited success of the EITI has enabled civil society to make the case for a statutory approach in both the United States and Europe. In the following, we take up the Cardin-Lugar Transparency Amendment as the proposed way forward in the United States. After a review of the corporate lobby against the Amendment, we will seek to provide a business case in favor of the inclusion of it in a larger transnational transparency regime.

### **THE CONTROVERSY SURROUNDING SECTION 1504 OF THE DODD-FRANK ACT**

On August 22, 2012, the SEC finally published the final rules pertaining to the Transparency Amendment. The Transparency Amendment, based on and substantially similar to the Energy Security Through Transparency Act (ESTTA),<sup>10</sup> was signed into law more than 2 years earlier, on July 21, 2010 as part of the Dodd-Frank Act. Amending Section 13(q) of the Securities and

Exchange Act of 1934, Section 1504 imposes new disclosure and reporting obligations on extractive industry companies that are issuers of securities with the SEC, pertaining to their operations in foreign countries. The objective is to bring “greater transparency to extractive-related payments made to governments by resource extraction issuers”<sup>11</sup> so as to minimize corruption, one constitutive feature of the resource curse.

The amendment operates on the logic of governing through information. Thus, it mirrors but importantly complements the EITI as an instrument of transnational governance of the extractive industry. Under the template offered by the amendment, the scope and quality of the data are improved upon. Concerning scope, Section 2(A) of the amendment makes clear that the scope encompasses the information related to all payments “made by the resource extraction issuer, a subsidiary or partner of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government for the purpose of the commercial development of oil, natural gas, or minerals.” The quality of data will be improved through the requirement to disclose on a country-by-country and project-by-project basis instead of a much vaguer aggregate basis. Both these improvements increase the comparability and use of data crucial to Civil Society and investors alike. Lastly, under the final rules, disclosure demands gain bite because “underreporting” can become an act of fraud, punishable under Section 18(q) of the Exchange Act. This enforcement mechanism works as a double-edged sword. While the SEC itself can thus enforce penalties in case of fraudulent numbers, the data that companies communicate to the SEC will be available to those NGOs and civil society organizations that have battled for over a decade to get this system in place. These agents, but also institutional investors, can mediate the money flows between corporation and host state on the one hand and the reporting to the SEC on the other. With the threat of fraud proceedings, corporate leaders will have to seriously consider the role the research these investigative agents can play in calling them out.

The final rules came after fierce public debate following the stakeholder consultation between industry representatives and Civil Society, while the regulatory body even faced a lawsuit by Oxfam America.<sup>12</sup> The SEC barely diverted from the amendment in the end, thereby denying the critics of the corporate lobby.<sup>13</sup>

The main issue of contestation of the extractive industry companies with the originally proposed rules concerns the presumable deleveling of the playing field for public companies issuing with the SEC. As at face value, an unequal playing field is created, the argument that we are making that companies have good business reasons to support the development of transnational governance through mandatory transparency needs to consider this above mentioned issue. While these US-listed companies are held by the stringencies of the Transparency Amendment, nonlisted (private, state-owned, or companies listed on other Exchanges) companies especially from China, Russia, and India remain allegedly unaffected. The American Petroleum Institute (API), the most important representative for the oil and gas industry, went so far to threaten the SEC with a lawsuit over the SEC's analysis of the "potential negative impacts of the rules on efficiency, competition, and capital formation."<sup>14</sup>

API's critic included new disclosure costs faced by the covered companies, the conflicts of the new disclosure rules with local laws and existing contracts, the public availability of commercially sensitive information to be used by competitors, and the loss of contracts for host governments' opposition to transparency. The new disclosure requirements presumably created high implementation costs,<sup>15</sup> but this complaint has been forcefully denied, for one because the required data are often already collected for tax reasons or simply because payments to governments are accounted for in an appropriate manner anyways.<sup>16</sup> The debate also emerged in Europe, with the same ramifications.<sup>17</sup> In their attempt to minimize costs, the API proposed a "minimalist" definition of the term "project" (considering projects as activities within a particular basin or province) and to only require disclosure of payments considered "material" by a "reasonable investor" (information on which an investor would base its decision to invest).<sup>18</sup> These changes would have strongly decreased the meaning of the amendment and would have effectively implied a copy of the EITI.

The SEC also ruled that the competitive disadvantage as a result of conflicts between SEC requirements and local laws was not convincingly made, or, at least, they did not allow for the exemptions in such cases demanded by companies.<sup>19</sup> As the Vale Columbia Center on Sustainable International Investment (VCC)

argued in a memo to the SEC, while little evidence exists of such conflicts, many host countries work with model contracts that contain a clause that explicitly provides room for disclosure demands from the companies' home country regulators.<sup>20</sup> An exemption rule would have enabled companies to use their significant influence to pressure host countries into drafting of laws holding a "secrecy" clause. The request for an exemption clause is thus question begging if anything.

The link between an increase of disclosure and a loss of competitiveness has not been proven. The idea that companies will lose out on bids because of host countries preferring nondisclosing companies or that the disclosed information is commercially sensitive and can be used by competing bidders (as claimed by ExxonMobil CEO Ken Cohen (2010)) is debunked by the facts. First of all, the most commercially sensitive information—geological data, costs, profits, references to future transactions or trade secrets—are simply not covered by the amendment, whereas fiscal terms (bonuses and entry fees) in a bidding process are generally known among the competing companies. The industry thus has yet to clarify how "after-the-fact taxes and other payments [. . .] reveal the bidding terms for a new oil block" (Lissakers 2011). In addition, the fear that foreign governments pass over disclosing companies has never been confirmed by the reality, for instance, the Angolan government ascription of several deep-water oil concessions to companies that fall under Dodd-Frank: Eni, Total, Statoil, BP. Companies like Statoil, Newmont Mining Corporation, and Talisman, while adhering to robust disclosure practices voluntarily, have seemingly not suffered on their bottom line.

We can also note that even if some disadvantage might be suffered, the range of companies that could profit is relatively small. As a matter of fact, even the Chinese major companies that have been claimed to be ones of the big winners of this loss of comparative advantage by US-listed companies will be affected by the Transparency Amendment: Chinese National Offshore Oil Corporation, the largest offshore oil and gas producer in China; China Petroleum and Chemical Corporation, the largest oil refiner and chemical producer in China and the second-ranked domestic producer of crude oil and gas; PetroChina Company Ltd, the principal holding company of China National Petroleum Company

(CNPC); and Chinalco, China's largest producer of aluminum are all listed on the New York stock exchange. At the same time, these companies often partner with covered companies when operating abroad (like CNPC and BP in Iraq). Neither have Chinese companies' refuted demands of host countries under domestic EITI regulations.

Moreover, the situation of the stronger transparency demands for the US stock exchanges is not unique. The London Stock Exchange<sup>21</sup> and the Hong Kong Stock<sup>22</sup> Exchange have already been pushing for more transparency, whereas the South Korean parliament discussed an amendment to the Overseas Resources Development Act based on the US Transparency Amendment in 2011.<sup>23</sup> The EC has proposed disclosure rules that are even more comprehensive than Section 1504, also covering companies that are not listed on a stock exchange. Next to these developments, the International Accounting Standards Board considers mandatory financial reporting on a country-by-country basis that would be implemented in 120 countries including China. All of these recent developments on the international scene regarding a push for more disclosure on the part of the companies show that a de-leveling of the playing field as a result of the Transparency Amendment might only happen, if it does, in a least extent.

We lastly like to note that there is a cynical ring to the competitive disadvantage argument. The amendment aims to limit the current leeway that companies have to "reconfigure" bribes as payments or bonuses to project partners. The corporate argument thus asks for obscurity to continue competing on terms of financial "constructions" with the less scrupulous competitors. The *Financial Times* commented in an editorial competitive disadvantage that "[i]f realistic, it would be a concern. But that case has not been proven: an ability to bribe is not the only competitive edge in the industry. Nor is it one either Europe or the US permits. Keeping it hard to expose would not make it more legal" (*Financial Times* 2012).

Because the evidence of a business case *against* the Transparency Amendment appears little robust, the importance of the Amendment, as a further step toward a transnational transparency regime to end the resource curse, trumps these considerations.

In the next paragraphs, we take the argument one step further, claiming that a business case in favor of the amendment could be formulated.

### **BEYOND OPPOSITION—TRANSPARENCY FOR “SHARED VALUE”**

With the final rules set by the SEC and with the EC and the EU member states following in their footsteps, the extractive industry will have to change its strategy. As we have recounted, from a perspective of effective transnational governance, there have been good reasons to move toward mandatory home state-based regulations on company disclosure with global reach. In this section, however, we provide for an argument that a business case can be made for the development of a global transparency regime. Our argument, however, is dependent on a prior step. As the corporate critic shows, the worry is that US-listed companies will lose out once obliged to comply with the disclosure rules. This position betrays what Porter and Kramer (2011) call “narrow” capitalism, which engages solely with economic value creation in the short run. The high sunk cost and long-term exploitation of oil, gas, and mining sites intrinsic to the extractive industry beg for a long-term value insurance—something that is threatened by common consequences of the resource curse such as political instability and social uproar. As the Transparency Amendment is designed to combat the curse, it should in the long run provide for the security of corporate operations (and value creation) in resource-rich countries.

#### ***Front-runner Companies Adopt a Shared Value Approach***

Porter and Kramer (2011) provide for a normative lens to make this argument with their “shared value” approach. They see their approach as nothing less than a “cultural shift” away from narrow capitalism that premises current Corporate Social Responsibility (CSR) practice. As opposed to CSR that companies have dealt a position at the “periphery” of business operations—either as a generically formulated ethical plea,<sup>24</sup> as a fringe market opportunity, or as a necessary expense to insure the company’s

reputation against external pressures—shared value builds on the understanding that societal needs are at the core of doing business. As the authors say, “[s]ocietal needs not just conventional economic needs define markets and social harms can create internal costs for firms” (Porter and Kramer 2011, p. 5). Ameliorating social conditions accordingly should lead to better business conditions through a positive feedback loop as companies get a better standing within the community. Such a model of simultaneous economic and social value creation moves beyond the immediate short-term costs. Importantly, the integration of social value creation into the core of business strategy will limit a troubling trade-off intrinsic to peripheral CSR, which is overruled when it does not align well with a profit perspective. Yet again, it is this “narrow” view on value creation that blocks longer-term prosperity.

The “cultural shift” sought by the shared value approach carries further than companies restructurizing. It refutes a simplistic opposition of public versus private, mandatory versus voluntary approaches and instead replaces it with a more pragmatic view on value creation. As such, it can account for the need of mandatory regulation to curtail what is a collective action problem—a problem that cannot be solved by one individual affected alone but needs all individuals included—facing the development of a global transparency regime. As Frynas (2010) recounts, BP pioneered a transparent approach in 2001 when it announced to publish information on their Angolan operations, from product-sharing contracts with Sonangol to total taxes and levies paid. Although BP found support in the world of NGOs, no other oil company followed suit, while the Angolan government was far from pleased with the unilateral disclosure steps taken by the company. In sum, “BP’s experience in Angola demonstrated the collective action problem with regards to governance initiatives: most companies would benefit from improved governance in host countries, but companies may be reluctant to pursue governance initiatives because they may potentially suffer individually as a result” (Frynas 2010, p. 167). The EITI, the establishment of which is said to have been informed by the BP case (Frynas 2010), provides a first step away from such collective action problems.

From a traditional “narrow” capitalist perspective, the Transparency Amendment burdens companies to attain what critics

call “lofty” social goals. The idea of the feedback loop between social and economic value, on the other hand, places these “lofty” goals within a business strategy. The creation of social value turns into strategy, whereas the means—either public or private, mandatory or voluntary—to it becomes less relevant. From the vantage point of social value creation then, the private stops being the public’ opposite: “[t]he principle of shared value creation cuts across the traditional divide between the responsibilities of business and those of government or civil society” (Porter and Kramer 2011, p. 12). In the end, “[f]rom society’s perspective, it does not matter what types of organization created the value” (Porter and Kramer 2011, p. 12). This then opens up to the view that companies should see ample reason to engage in a constructive way with these regulatory necessities beyond mere compliance. The calculation is rather straightforward: once transparency is considered to create social value (or, from a corporate perspective, even only an idea of value) and thereby improving the socio-political conditions under which companies operate, there is good reason to support the development of transparency measures. In the relevant case, however, there is a short-term comparative advantage in place for companies should they not sign-up to transparency initiatives, hence there is a need to ensure the participation of unwilling companies. A nondiscretionary and mandatory setup such as provided by the Transparency Amendment provides for such inclusionary effect. Under a shared value approach, the issue of regulation moves from being perceived as unwanted interference to a possibility of contributing to the creation of value.

Rest on us to account for the way transparency creates shared value. To clarify, let us shortly specify the function of transparency in the transnational governance of natural resource extraction. As we noted in the second section, transparency is considered the essential first step to give back to citizens their right to know, to know how the government manages the wealth of their nation and how much companies exploiting the resources of their nations pay for this right. Leif Wenar even contends that the exploitation of natural resources should only be allowed if, and only if, the people have reasonable access to the relevant information concerning the sale (Wenar 2008). As transparency, broadly defined, is “the degree to which information is available to

outsiders that enables them to have informed voice in decisions and/or to assess the decisions made by insiders” (Florini 2007, p. 5), it becomes a core tool to enable governance structures regulating the transnational relations between companies and host-state governments characterizing the extractive industry sector.

The full weight of transparency within transnational governance however becomes clear in the constitutive role it plays in underpinning three critical higher level values of governance. Transparency is, besides a core societal value in its own right, a constitutive feature of, and therefore essentially linked—a *sine qua non*—to accountability, sustainability, and fairness. Transparency enables (1) *accountability*, in the sense that governments and companies can be held accountable for their commitments; (2) *fairness*, in the sense that governments can assess whether their contracts and laws are fair and comparable in terms and benefits to those in other countries with similar endowments and in terms of enabling people to scrutinize the revenue distribution by governments; and (3) *sustainability*, in the sense that transparency encourages a sustainable allocation of risks, benefits, and responsibilities among the relevant stakeholders.

Simplistically put, from a business perspective, then transparency provides general governmental (and by implication corporate) accountability, but at the same time enables the company, through its behavior, to communicate the fairness with which it operates its business. It can be expected that an accountable company operating on fair conditions will face sustainable outlooks based on a concomitant local support (the so-called “social license to operate”) and investor trust in its business strategies.

Shared value invites companies to embrace the regulatory step provided by Congress as it is a step that no single company or a group of companies could make voluntarily. To move forward on the resource curse also means to move forward on long-term corporate value. In this context, the business case for public transparency regulations can be situated. Good regulation at the same time however creates options for willing companies to exploit their competitive advantage under the new rigidity of the market. Taken in its full scope, shared value “highlights the immense human needs to be met, the large new markets to serve, and the internal costs of social and community deficits—as well as the competitive advantages available from addressing them”

(Porter and Kramer 2011, p. 15). For those designated “frontrunner” companies, the Transparency Amendment’s beneficial side could even come out in the way these companies manage to create competitive advantage out of their position. These are the “indirect and unintended competitive consequences of regulation” Leone (1981, p. 117) contends based on an analysis of the differential impacts of government policies and regulations on companies. Shared value is a business model as much as a societal model at the same time.

We note that the use of standardized and comparable data can, not only serve stakeholders—as reflected above—but also these frontrunner companies. Comparable data provided through a mandatory system provide for a background against which companies can either be compared, rewarded, or punished and so create opportunities to benefit from disclosure practices. Under such a system, singular frontrunner companies do not have to fear negative effects on their more advanced disclosure—a fear not quelled by the EITI (otherwise all companies would push for a higher standard)—as the mandated standards place all at the same level. This creates opportunity for frontrunner companies to exploit their comparative advantage on disclosure (and related policies toward their stakeholders): “[f]or example, if a firm is performing better than a competitor on a certain social indicator (or can demonstrate its own improvement over time), then it may benefit through improved reputation, which, in turn, can have a positive impact in consumer markets as well as treatment in the regulatory environment” (Hess 2007, p. 466). In our case, the positive impact initially will not be on consumers but will be materialized by the generated local support that can function as a type of informal insurance to adverse regulatory change or direct contract breaches. Such improved conditions can subsequently tilt institutional investors’ interests toward these type of frontrunner companies. This argument is more developed in the next section.

### ***Being Transparent Is a Good for Business***

The (theoretical) argument just mentioned on the business case for transparency within a shared value framework draws on empirical evidence of a developing understanding of the importance of

sustainable corporate operations. This empirical evidence is detailed further in this section and illustrates the fact that transparency can be singled out as a political risk mediator both at a general and local level, a reputational risk mediator, a service to (also nonethical) investors seeking clarity for their investments, and lastly, as a directly profitable strategy. Transparency can, thus, create economic value for the company in different ways.

First, in recent years, investors' perception of political risk has heightened and was ranked as top concern of multinational enterprises in a survey undertaken by the Economist Intelligence Unit (EIU) for a report of the Multilateral Investment Guarantee Agency (MIGA 2011). The report notes however that political risk is considered a function not so much of the regulatory regime in place but the potential instability of it. The survey of 60 multinational corporations (MNCs) by the EIU (see Appendix 2 of the Report, page 76–84) notes adverse regulatory changes and contract breaches as the highest perceived risks, with the highest impact and losses on their investments. Considering then that opacity on fiscal terms, hiding information from stakeholders can contribute to a climate of mistrust, with the potential of leading to social unrest, insatiable claims, political pressure and lobbying on the government to change the regulatory regime. From this perspective then, the fears expressed in the survey, strongly resembling the fear of an “obsolescence bargain” (Vernon 1971) that companies seek to protect themselves against, are to some extent of their own making. Opposition to a further development of transparency regimes thus goes against the corporate interest in regulatory stability.

In addition, the same report mentions that “heightened attention through legislation to these issues by a number of countries that are sources of FDI in the developing world—for example, the FCPA in the United States and the Bribery Act in the United Kingdom—help to reduce such risks” (MIGA 2011, p. 19). Interestingly, like the Transparency Amendment, the FCPA was initially accused of harming the competitiveness of compliant companies. Today, it is promoted as a crucial instrument to the curbing of political instability and concomitant risk. The Transparency Amendment in line with our argument in the first part of this article could well be understood as a complementary tool to secure the goal political risk reduction.

The improved system of transparency provision that the amendment entails can also provide for a minimization of political risk vis-à-vis the local communities that are impacted by a project. As we set out above, transparency through project-by-project disclosure facilitates the communication of the fairness of a company's operations and payments with the local communities. Extractive industry companies often operate in remote and poor areas where their impact on the community is deeply felt. Disclosing a company's contributions to the local economy, by for instance revealing the taxes paid to the government, can then be essential to maintaining important stakeholders' relationships and a "social license to operate."

The economic value of risk minimization vis-a-vis stakeholders has been shown, from a broader perspective, by Henisz et al. (2010). This article provides direct empirical evidence that increasing cooperation and reducing conflict with stakeholders enhance the financial valuation of a firm by decreasing the political risk associated with the investment. As they claim, "efforts to win the cooperation of and reduce the conflict with external stakeholders [. . .] can be conceived of as investments in political and social capital. Such investments reduce opportunistic hold-up by a broad range of political and social actors thereby enhancing the probability that a business plan can proceed on schedule and on budget and, ultimately, generate sustainable shareholder value" (Henisz et al. 2010, p. 2). Their case concerns the gold mining sector, which has had much experience with costly delays and disruptions in project development and execution as a result of stakeholder conflict. Gold mining companies have therefore increasingly recognized the need to secure a social license to operate economic value creation, "to maintain the right formally and directly granted by the government but informally and indirectly granted by a broader set of external stakeholders to transform the gold and generate rents from that process" (Henisz et al. 2010, pp. 10–11). The study quotes Yani Roditis of Gabriel Resources, a gold mining company, saying: "It used to be the case that the value of a gold mine was based on three variables: the amount of gold in the ground, the cost of extraction, and the world price of gold. Today, I can show you two mines identical on these three variables that differ in their valuation by an order of magnitude.

Why? Because one has local support and the other doesn't" (Henisz et al. 2010, p. 3).

The mining sector seemingly thus has taken an interest in so-called "above ground" risks to their projects. In effect, variation in political and social support is increasingly considered "a source of competitive advantage or economic rents" (ibid. 26). Concluding their analysis, Henisz and his co-authors state that "the social license to operate is more than rhetoric. It is operationalizable, empirically testable and strategically relevant. For these mining firms, pursuing cooperation from and minimizing conflict with stakeholders is not just CSR but enlightened self-interest" (ibid. 29).

Furthermore, an ongoing corporate strategy of transparency can also salvage reputations in case of revenue misappropriation as it allows for disassociation from the host government. As a consortium of investors stated, "legitimate, but undisclosed, payments to governments may be accused of contributing to the conditions under which corruption can thrive. This is a significant business risk, making companies vulnerable to accusations of complicity in corrupt behavior, impairing their local and global 'license to operate,' rendering them vulnerable to local conflict and insecurity, and possibly compromising their long term commercial prospects in these markets" (ISIS Asset Management et al. 2004).<sup>25</sup> A forceful approach to transparency that includes project-by-project disclosure therefore not only mitigates the negative externalities of opacity, like political and social instability, but can also provide a tool of legitimization in case of misappropriation and corruption.<sup>26</sup> This hypothesis links in to other empirical analysis such as that of Godfrey et al. (2009), which shows that "institutional" (i.e., directed at society at large) CSR expenditure by a company works as a kind of "insurance" in case of a negative event. By increasing its social and reputational capital of the company, CSR provides the goodwill that tempers the negative reactions and potential sanctions of stakeholders to such an event and as such insulates companies from harsh negative financial effects. As Paul Bugala of Calvert Investment states, "[t]ransparency is the first step in establishing the significant goodwill necessary to encourage local communities, made up of Indigenous Peoples or others" (Oxfam America 2012, p. 18).

Lastly, in a contribution to move the SEC to confirm the stringent disclosure rules of the Transparency Amendment, the VCC

(Toledano 2012) published a memo reflecting a small-scale empirical study. The study focused on the relation between disclosure practices and financial performance so as to clarify reasons for a role of transparency in investment decisions. With a caveat that the study only shows an association of results in the study and that transparency alone will not be a panacea to all investment—related worries, the results do provide some support for a business case in favor of expanding on transparency measures within the extractive industry. Seventy companies were categorized according to their disclosure advancement, ranging from “nontransparent” (payments are disclosed aggregated at the company level) to “transparent” (payments are disclosed on a country by country basis) to “advanced transparent companies” (payments are disclosed on a country by country basis disaggregated by tax type). This categorization was subsequently coupled to three indicators to measure financial performance: the Price–Earnings Ratio (price investors pay for a dollar of earnings), Return on Equity (profitability of company), and Return on Capital (efficiency of capital allocation into profitable investment). As the results show, transparent companies are associated with a better performance along all three ratios. Of course, these results only reveal a correlation and association of results with transparency. The study does not claim to bring evidence of a causality effect. There is a second part of this study, in which the performance of extractive sector companies along the lines of reported cases of human rights violation and environmental damage is analyzed. When counting disputes and allegations within a framework provided by the International Council on Mining and Metals (2006), it turns out that nontransparent companies reported 43% more issues than the more transparent counterparts. This gap was particularly observed in the case of corporate complicity in the perpetuation of “Civil conflict,” “Corruption,” and “Corporate power”—interestingly, those are all categories that present various relevant facets of what is at stake in the resource curse. The most obvious explanation hereof is that companies seriously engaging with transparency are also prone to behave better along other values, but we might want to add that transparency can also add to a form of trust from a community toward a company, making them less susceptible to indictments.

Although we cannot draw very hard conclusion from these two studies, they do provide a hint of the type of feedback loop as

theorized by the shared value approach. A financial “upside” of transparency is paired with what we can call a “social” upside. The aggregate of above empirical evidence shows that next to a theoretical and normative point to support the Transparency Amendment, there are empirically founded reasons for business to support the creation of a robust transnational transparency regime.

### **CONCLUDING REMARKS**

Transparency in the extractive industries is a key first step in creating stable and accountable government and, therefore, a crucial element in a strategy to curtail the resource curse. In this article, we have argued that instead of opposing the development of a global transparency regime, extractive industry companies—especially those that want to portray themselves as good corporate citizens—should support these measures for their own long-term good. The conceptual lens of the “shared value” approach should shift the debate to the ample reasons why extractive industry companies should support transparency measures mandating far-reaching disclosure demands. The corporate lobby against the Transparency Amendment expressed fears about the loss of competition against nonlisted or not US-listed, especially state-owned companies. But if the main concern for the extractive industry companies is competitive disadvantage, the more so there is reason to strive for a global regulatory regime for transparency. It thus makes little sense for companies to fight European regulations when mandatory disclosure is already in force in the United States. Companies should rationalize their demands and ask for a harmonized globalized regulatory regime.

A main and convenient instrument to move toward a full level playing field in terms of transparency conditions is the corporate supported EITI. As the mirror image of the Transparency Amendment, the EITI offers an opportunity to limit the potential negative competitive impacts for those companies under more demanding rules. Although currently hampered by flaws in its setup, the EITI offers relevant space for what can be termed “reversed lobbying” by companies. As Revenue Watch Institute’s director Karin Lissakers posits in light of the US debate:

“If the oil companies are serious about wanting competitors not covered by the new U.S. law to have to follow the same rules, they

should support making individual company disclosure of payments to governments a requirement of the Extractive Industries Transparency Initiative” (Lissaker 2010).

Companies should also push their governments on investing into such a functioning global regime. One limitation to the EITI we noted concerns the fact that supporting home countries faces few formal requirements within the EITI. Besides offering their public endorsement of the initiative, these countries have not developed any structural means to support the implementing countries. Technical and financial assistance to auditing and monitoring systems in implementing countries would be a necessary contribution to enhancing the impact of EITI. The original ESTTA bill provides for a promising note calling the US President to engage with other governments in building a transparency regime.<sup>27</sup>

A global transparency regime provides a crucial curtailment of the resource curse and as such might provide a first step to move toward accountable governments in resource-rich countries and a long overdue reduction in poverty in these countries. These aims are valuable in and of themselves, but the development of the transparency regime underpinning them is dependent on the input of the extractive industry. In this article, we hope to have provided at least some reasons to some companies to make such global regime possible.

## NOTES

1. The authors would like to thank Angelos Chryssogelos, Malgorzata Staniaszek, and Jacky Mandelbaum.

2. Jeremy Bentham, *The Works of Jeremy Bentham*, published under the Superintendence of his Executor, John Bowring (Edinburgh: William Tait, 1838–1843). 11 vols. Vol. 4. Chapter: Bentham’s Draught for the Organization of Judicial Establishments, Compared with that of the National Assembly, with a Commentary on the same. (Observation 11). Accessed from <http://oll.libertyfund.org/title/1925/116653> on April 25, 2012.

3. The FCPA can be regarded an instrument against the resource curse *avant la lettre*. It was itself geared at combating corruption by US companies—not too tackle the wider phenomenon described by the

resource curse. This does not take away that it is by now often taken to provide a tool to correct a core component of the curse.

4. Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 1504, 2010 <http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf>

5. See: <http://www.justice.gov/criminal/fraud/fcpa/docs/fcpa-english.pdf> As such the FCPA pertains only to those under US jurisdiction. However, the act was the engine of the worldwide attention for corruption.

6. OECD, 2011, Convention on Combatting Bribery of Foreign Public Officials in International Business Transaction and Related Documents, <http://www.oecd.org/daf/briberyininternationalbusiness/anti-briberyconvention/38028044.pdf>

7. With transparency seemingly at times considered a remedy to all ills, criticism has emerged considering the reach of revenue transparency on the revenue side as a cure to the resource curse. As Frynas states, “there appears to be an assumption among researchers that transparency of revenues is a secondary concern. In summary, there is no scientific basis for the assertion that revenue transparency leads to better social or economic outcomes” (Frynas 2010, p. 173). If it is secondary only is up for debate. It is clear however that revenue transparency is (even if only temporarily) a necessary component for a transparent spending regime.

8. At the time of writing, there are 34 “candidate” countries (Madagascar, Equatorial Guinea, and São Tomé e Príncipe are currently suspended), whereas only 13 have established themselves as “compliant” countries (Yemenis temporarily suspended from its compliant status). This is however a relative big increase given the fact that by mid-2011, only Liberia and Azerbaijan were EITI-compliant. See for all countries: <http://eiti.org/countries>

9. The cycle is a continuous back-and-forth of improvements between users and disclosers of information.

10. The ESTTA was introduced by Senator Richard Lugar on September 23, 2009. <http://www.govtrack.us/congress/bills/111/s1700/text>

11. Senator Cardin’s letter to the SEC of December 1, 2010 at <http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specialized-disclosures-94.pdf>

12. See for the lawsuit: <http://www.oxfamamerica.org/press/pressreleases/oxfam-america-files-lawsuit-against-securities-and-exchange-commission/?searchterm=law%20suit%20SEC>

13. This does not mean that legal threats to the SEC are in the past. While finalizing this article, the API (among others) pressed forward their promise on challenging the SEC's efficiency analysis in court. The exact file can be found here: [http://www.100fstreet.com/wordpress/wp-content/uploads/2012/10/Complaint%20-%20API%20and%20Chamber%20of%20Commerce,%20et%20al.%20v.%20SEC%20\(D.C.%20District%20Court\).pdf](http://www.100fstreet.com/wordpress/wp-content/uploads/2012/10/Complaint%20-%20API%20and%20Chamber%20of%20Commerce,%20et%20al.%20v.%20SEC%20(D.C.%20District%20Court).pdf)

14. See the detailed and technical-legal account of the API in their comments to the SEC of January 19, 2012, <http://www.sec.gov/comments/s7-42-10/s74210-121.pdf>

15. Up to 50 million dollars, for instance, according to ExxonMobile. Letter of October 25, 2010: <http://www.sec.gov/comments/s7-42-10/s74210-112.pdf>

16. The SEC foresaw an "annual increase in the paperwork burden (. . .) to be approximately 52,932 hours of company personnel time and to be approximately \$11,857,200 for the services of outside professionals." See: <http://www.sec.gov/rules/proposed/2010/34-63549.pdf> The Economist (2012) noted that 50 million boils down to 0.1% of Exxon's 2010 profit. The Economist (2012) and Revenue Watch (2011) noted that much data is already collected.

17. The EC communicated a cost estimation of only 0.05% of annual revenues in the first year of implementation and a decreasing cost thereafter. Commission Staff Working Paper, Part II: [http://ec.europa.eu/internal\\_market/accounting/docs/sme\\_accounting/review\\_directives/20111025-impact-assessment-part-2\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/sme_accounting/review_directives/20111025-impact-assessment-part-2_en.pdf)

18. See: *supra* note 13, p.3.

19. See among others the APIs claim along these lines referring to China, Cameroon, Qatar and Angola. See page 25 of API's letter of January 28, 2011: <http://www.sec.gov/comments/s7-42-10/s74210-10.pdf> These claims have however refuted by the Cameroonian organization RELUFA: <http://www.sec.gov/comments/s7-42-10/s74210-96.pdf>

20. The memo (<http://www.sec.gov/comments/s7-42-10/s74210-52.pdf>) builds on Maples and Rosenblum (2009).

21. In March 2006 the Alternative Investment Market (AIM), part of the London Stock Exchange listing smaller companies, introduced a new listing requirement for extractive companies to "disclose any payments aggregating over £10,000 made to any government or regulatory authority or similar body made by the applicant or on behalf of it, with regards to the acquisition of, or maintenance of its assets". There is no requirement to disclose on a yearly basis. <http://www.publishwhatyoupay.org/activities/advocacy/stock-market-rules>

22. In 2010, at the request of pension funds, the Hong Kong Stock Exchange imposed new listing requirements to mineral companies: companies have to disclose certain information related to business operations such as taxes, royalties and other material payments, on a country by country basis as well as information on project-specific risks. Since the introduction of the standards, 9 extractive industry companies have listed on the exchange, including Chinese and Russian companies. <http://www.bakermckenzie.com/ALTokyoHKSEImplementsNewListingRuleJun10/>

23. See: <http://www.publishwhatyoupay.org/where/coalitions/south-korea>

24. Colin Crouch compares CSR to the *Noblesse Oblige* that French aristocrats saw themselves to be under: they accepted the fact that with their position came a certain form of responsibility toward the poor but what the content of this responsibility and how and when it was exhausted was within means of their voluntary decision. See: Crouch 2009.

25. The ISIS Management (Now: F&C Asset Management) is a coalition of 57 major North American, European and South African investment houses that manage US\$6.9 trillion in funds.

26. According to PWYP US, Newmont Mining Corporation follows up on this insight, stating that “by publishing their payment information, the focus of citizens and local communities shifts from them to the government.” See: <http://pwyputa.org/resource-center/resources/q-disclosure-provision-doddfrank-wsr-cpa>

27. See section 3: “It is the sense of Congress that—(1) the President should work with foreign governments, including members of the Group of 8 and the Group of 20, to establish domestic requirements that companies under the jurisdiction of each government publicly disclose any payments made to a government relating to the commercial development of oil, natural gas, and minerals. [. . .]”

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