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To disclose or not to disclose: How global competition for foreign direct investment influences transparency reforms in extractive industries

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HIGHLIGHTS

- I investigate the underlying causes of EITI membership.
- I argue that leaders use the EITI to both maintain and lure foreign investment.
- EITI members have higher FDI levels compared to non-members.
- FDI levels increase once countries join the EITI.
- The results highlight a utilitarian use of the EITI by corrupt governments.

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ABSTRACT

In the last decade, the Extractive Industries Transparency Initiative (EITI) has grown in both popularity and influence. The ascendance of EITI is surprising because traditionally, leaders of resource-rich states prefer to tightly control their extractive industries. This paper investigates the underlying causes of EITI membership in order to understand its acceptance, even among some of the most authoritarian regimes. The paper argues that leaders of resource-rich countries use the EITI to consolidate their international prestige as eager reformers, which serves to both maintain and lure foreign investment. The cross-national and interrupted time series analyses reveal that EITI members not only have higher FDI levels compared to non-members, but these investments increase once countries join the initiative.

1. Introduction

Since Tony Blair launched the Extractive Industries Transparency Initiative (EITI) in 2003, 51 resource-rich countries have become members to this public-private partnership, which seeks to promote revenue transparency in the extractive industries. The EITI membership now includes important producers of hydrocarbons and minerals such as Iraq, Kazakhstan, and Nigeria. As EITI members, these countries voluntarily disclose their financial transactions with foreign companies in the extractive industries. The growing popularity of the EITI is remarkable and puzzling at the same time. Traditionally, leaders of resource-rich states tightly control their extractive sector due to its strategic importance for the economy. Methods of 'control' may involve stealthy contracts, preferential treatments, and off-the-books financial transactions, which are naturally kept hidden from the public eye. Yet an increasing number of resource-rich states also endorse the EITI process of disclosing revenues from the sale of hydrocarbons and minerals despite the potential political costs of transparency.

To understand the reasons of EITI's popularity, even among some of the most authoritarian regimes, this paper problematizes the underlying causes of EITI membership. So far, the literature on resource governance does not offer a systematic analysis of why governments would voluntarily disclose revenues from extractive industries. Contributing to the literatures on transparency and policy diffusion, the analysis in this paper shows that the decision to join the EITI is partly motivated by global competition for foreign direct investment. Specifically, based on series of logistic regressions, the research reveals that states that depend on foreign direct investment (FDI) for economic growth are more likely to be affiliated with the initiative. In addition, an interrupted time-series analysis shows that EITI-implementing countries experience

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higher levels of incoming FDI immediately following their membership. The results confirm that leaders of resource-rich countries use the EITI to consolidate their international prestige as eager reformers, which serves to maintain and/or lure foreign investment. Compliance with the EITI standard is an effective signal for countries to demonstrate their willingness to embrace open markets, which also explains the growing popularity of the initiative.

The paper is organized as follows: the first section focuses on the emergence of the norm of transparency in extractive industries and the EITI process. The next section analyses the reasons why countries might join the EITI, focusing particularly on material processes identified by the policy diffusion literature. The following sections present the model and the statistical analysis. The last section discusses the implications of the results for transparency promotion in resource-rich countries.

2. Promoting transparency in extractive industries

Revenue Transparency became a global norm in extractive industries thanks to the efforts of various advocacy networks, including Revenue Watch (RW) and Publish What You Pay (PWYP), who made constant efforts to highlight transparency as a remedy for corruption and mismanagement in the resource sector. In the early 2000s, these groups began to lobby international oil companies to disclose their receipts from host countries. In response to these demands, British Petroleum (BP) published a bonus payment of $111 million to the Angolan government for an offshore license in 2001. The subsequent backlash from the Angolan government at the time highlighted the collective action problem faced by multinational companies and eventually inspired the creation of the EITI in 2003.[1]

What does transparency imply for resource-rich countries? In the extractive industries, transparency broadly refers to public availability of information on how resources are managed, and applies particularly to public revenues, expenditures, awarding of contracts and licenses, public procurement, politician's personal wealth, appointments and promotions, clarity of roles and responsibilities, and open budget processes (IMF, 2007; Kolstad and Wiig, 2009, p. 526).

In theory, transparency has substantial political costs (Berliner, 2014) because it can make corruption riskier for those in power by allowing the public to monitor resource management and by initiating a fair selection process for the resource bureaucracy. Yet, leaders might tolerate certain transparency reforms when there is strong political competition (Hollyer et al., 2011) or a possibility of government turnover (Berliner, 2014). In certain cases, even authoritarian governments can favor transparency to improve local governance and efficiency (Lorentzen, 2014). However in resource-rich countries the existence of easy access to rents removes the necessity of such gestures. Leaders of these countries often prefer a secretive business environment that permits unfair access to rents and undermines incentives for institutional reform. As a result, the majority of resource-rich countries currently have non-transparent commercial relations and suffer from high levels of corruption (Revenue Watch, 2013; World Bank, 2013).

In this context, it is not surprising that transparency advocates in resource-rich countries presume a possible causal relationship between transparency and corruption. However, this relationship is yet to be empirically demonstrated and studies on transparency's impact on corruption reveal conflicting results. On one hand, various works highlight the positive aspects of transparency. For example Islam (2006) shows that countries with better informational flows also have higher governance levels. Similarly, when transparency is measured by the freedom of information, a negative correlation exists between corruption and transparency (Brunetti and Weder, 2003).

On the other hand, partial implementation of transparency may undermine its alleged positive impact on good governance. For example, making only revenues transparent might not address corruption in resource-rich countries, where off-the-books payments to government officials are not likely to be reported (Kolstad and Wiig, 2009, p. 525; Öge, 2014, 2016). Similarly, Fox (2007) distinguishes between clear and opaque transparency where the latter conceals the actual mechanisms of the decision-making process and reveals only to the extent demanded by international institutions. This opaque form of transparency, such as disclosing only aggregate data on resource revenues as opposed to individual receipts from each company, is not likely to have a moderating impact on corruption.

While the actual impact of transparency on good governance is open to debate, currently the norm is more popular than ever (EITI, 2014b). Yet, many developing countries lack the necessary mechanisms and/or incentives to ensure that the resource management process is transparent. In such contexts, external influences can play a significant role in transparency promotion. Firstly, international financial institutions (IFIs) increasingly use technical assistance to help key actors internalize the norm of transparency. For example, the World Bank helps local civil society groups to improve their monitoring skills. Similarly, the IMF published its "Guide on Resource Revenue Transparency" in 2007, which provides a list of best practices of resource revenue transparency as a guideline for both governments and civil society groups (IMF, 2007, p. vii). Secondly, transnational advocacy networks (TANs), such as PWYP, RW, and Transparency International (TI), help establish domestic civil society coalitions to push for more transparency in the management of resource revenues. Building up on the success of these networks, the EITI has been the most influential organization to promote revenue transparency in the last decade.

3. The Extractive Industries Transparency Initiative

The EITI is a coalition of countries, companies, and civil society groups that aims to establish global standards of transparency in extractive industries. The membership of the EITI increased consistently since it was launched in 2003, following the international support it received from the United Kingdom and the World Bank. As of April 2016, 51 resource-rich countries implement the EITI standard (EITI, 2013b).

The wide popularity of the EITI among resource-rich countries is partially due to its status as a public-private entity. The stakeholders of the EITI include affluent governments such as the United Kingdom, Germany, Qatar, and the United States, which provide political, technical, and financial support to the initiative, but are not necessarily EITI-implementing countries; global advocacy networks; and international companies including BP, Chevron, and ExxonMobil. Companies, in particular, are key actors in the EITI process. Currently more than 90 largest oil gas and mining companies officially support the EITI process. In certain cases, companies have played crucial roles in convincing resource-rich governments to implement the EITI standard. For example, ExxonMobil was instrumental in Equatorial Guinea's accession to the EITI (Committee, 2008). Similarly, BP was key to Azerbaijan's membership and Shell in Nigeria has actively supported the country's EITI membership since 2002 (Aaronson, 2011).

The EITI also established partnerships with the World Bank, the IMF, the European Bank for Reconstruction and Development and

[1] Interview with Dr. Francisco Paris, EITI Regional Director, 10 May 2011, Oslo.