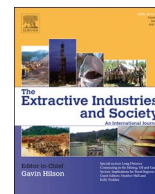




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Unlocking Central America's mineral potential: Leveraging transparency to address governance challenges

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ABSTRACT

This paper reviews governance challenges and opportunities in six Central American and Caribbean countries (Belize, Dominican Republic, Guatemala, Honduras, Nicaragua and Panama) as they develop new extractive projects. Despite important differences, governments in these countries share the need to improve their capacity to manage and control growing mining operations and potential revenues. In this paper we argue that mineral extraction faces challenges that go beyond traditional prescriptions to strengthen governance, such as environmental impacts and the cost born by local communities in terms of loss of land, water sources and culture; the right to free, informed and fair consultation; and polarization among the different stakeholders. Yet, we claim that transparency offers a starting point for governments to build trust and to demonstrate that they are prepared to address concerns surrounding mining operations, managing potential mineral windfalls and taking into consideration local community interests.

1. Introduction

The most important role of governance in the extractive sector is to maintain, strengthen or restore trust between citizens, governments and the private sector. A crucial incentive for countries to improve governance is to increase long term support from different stakeholders for extractive projects, attract qualified investors, and maximize benefits to local communities and the entire economy.

By analyzing governance challenges in the extractive sector of a group of selected countries in Central America and the Caribbean (Belize, Dominican Republic, Guatemala, Honduras, Nicaragua and Panama), we conclude that an effective way to move in the direction of enhancing trust is not just to improve fiscal transparency but also communicating in a more effective, efficient, and transparent way the benefits and potential impacts (positive and negative) of extractive activities. Targeted transparency policies in the sector can lead to greater vertical and horizontal accountability, providing stakeholders with timely access to the sector and project information that they need.

The six countries under review were selected based on the size of their projects potential contribution to the economy and the issues they raise (Soto-Viruet, 2013). The focus is on metal mining projects for most countries, and on the incipient oil sector in Belize. The paper

discusses the evolution of the sector in these countries, highlights legacies of specific mining projects, and provides a comparison of governance indicators as an overview of the main risks these countries will face as they develop this sector. Finally, this paper suggests specific ways in which targeted transparency policies can serve as a first step to address governance challenges.

These countries can be fitted into a regional comparison, but they are quite diverse. In terms of population, Belize is the smallest, with just over 350 thousand people, while Guatemala, the largest, has just over 16 million, followed by Dominican Republic with 10 million, Honduras 8 million, Nicaragua 6 million and Panama close to 4 million.¹ Indigenous groups are significant within most of these countries. Guatemala has the largest indigenous population, with approximately 5.4 million, followed by Honduras and Nicaragua with almost half a million each, Panama with over 200 thousand and Belize with over twenty thousand. According to the World Bank, these countries could be considered middle-income economies. Guatemala, Honduras and Nicaragua fall in the lower middle-income category with per capita product of less than US\$4000. Honduras and Nicaragua are also part of the Highly Indebted Poor Countries (HIPC). Meanwhile, Belize and Dominican Republic are in the upper middle-income bracket with a per capita income over US\$4000 but lower than \$8000. In 2015, Panama is

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the only high-income country with a per capita GDP over \$12,000 dollars.²

Although these countries are not traditional destinations for mining or petroleum investments, there are several projects to develop large untapped reserves of copper, gold, silver and nickel, which are potential new sources of fiscal income and foreign direct investment. For example, the six largest mines in these countries generated over US\$1 billion in revenue in 2012 (*Canadian Mining in Latin America*), Belize received US\$230 million in taxes from oil production in 2006–2015 and estimates of potential investment in the sector are close to US\$20 billion.³ Individual projects such as Pueblo Viejo in the Dominican Republic and Cobre Panama represent the largest foreign direct investment for these countries in history.

2. Natural resource abundance and governance implications

In the last two decades, a considerable body of literature grew on the observation that countries rich in petroleum and mineral resources often show poor economic performance. There are several explanations of this paradox stressing economic and political variables. Among the best known is the “Resource Curse” or “Dutch disease,” or the fact that mineral and petroleum revenues tend to appreciate real exchange rates, which makes cheaper to import rather than produce local goods, with the consequence of concentrating resources on extractive activities to the detriment of the rest of the economy (*Sachs and Warner, 2001*). On a purely market-based perspective, petroleum and mineral resources generate extra rents in function of their market price.

However, volatility also presents a significant obstacle to natural-resource based growth and has profound implications at several levels. Commodity market prices have moved significantly over the long-run, proving to be more volatile than manufactures (*Jacks et al., 2011*). This is significant since countries that experience a higher volatility in their economic fundamentals tend to have a lower growth (*Ramey and Ramey, 1995*). Also, volatility presents countries with the challenge of preparing budgets closely tied to wildly fluctuating commodities, whose price often crash around times of crisis, leading to fiscal revenue collapse (*Gelb, 1988*). Petroleum and mineral industries generate extraordinary rents that are relatively easy to tax, providing incentives for state capture by private interests. Among natural resources, oil and other fuels have proved to be especially impactful for the macro-economy (*Ferderer, 1996*), due to their volatility even in comparison to other natural resources, and electricity. This has been more acute after the oil shocks that started in 1973 (*Regnier, 2007*). In the period 2007–2015, oil prices have even proved to be twice as volatile as stock market equities (*Davig, 2016*).

In terms of institutional performance and governance, countries where oil is a significant driver of development tend to lead to poor welfare delivery and corruption, lead to social settings where poverty, inequality, unemployment and corruption are pervasive (*Karl, 1997; Shaxson, 2007*).

Rulers can become independent from tax paying citizens, finance government with rents, and foster corruption and lack of accountability (*Karl, 1997, 1999; Ross 1999, 2001; Eraga and Mesagan, 2016*).

Early evidence suggested that natural resources can also fuel civil war (*Bannon and Collier, 2003; Ross, 2006*). A recent stream of literature contends this fact explaining that there is not necessarily a causal link between commodity volatility and conflict (*Bazzi and Blattman, 2014; Humphreys, 2005*). Regarding oil and violence, some authors contend that the evidence suggests that oil and political violence are uncorrelated (*Cotet and Tsui, 2013*), whilst oil rents tend to stabilize centralized governments by deterring center-seeking wars

(*Paine, 2016*).

During the 1990s, research on the negative effect of abundant mineral resources concentrated on countries with a long history of mineral and hydrocarbon extraction (*Sachs and Warner, 1995*). *Gelb (1988)* and *Karl (1997)* put the focus on countries such as Algeria, Ecuador, Indonesia, Nigeria and Venezuela, highlighting policy and institutional failures in countries with abundant hydrocarbon and mineral resources. With the new millennium, attention shifted to new producing countries as the prices of oil and minerals recovered from a long period of stagnation, gaining relevance as potential drivers of growth and sources of fiscal income. For example, in 2005 the New Partnership for Africa committed G8 countries to increase efforts to improve governance in the extractive industries (*ECA, 2011*).

Most policy prescriptions to counter the “resource curse” are based on the observation that good governance (i.e. quality of institutions, rule of law, accountability and control of corruption) can reduce the potential negative effects of the extractive industries (*Humphreys et al., 2007*). Good governance and management practices have allowed countries such as Australia, Botswana, Canada, Chile and Norway to benefit from resource wealth (*Sala-i-Martin and Subramanian, 2003; World Bank, 2004; IMF, 2007*). Transparency in particular is seen as a key variable to enhance the quality of government, helping reveal dysfunctional processes and providing data to improve them (*Bellver and Kaufmann, 2005; Hale, 2008*). Information about rules, plans and projects can lead to informed consent, overview and opposition when rights are affected, leading to sustainable governance in the extractive industries (*Florini, 2007; Kaufmann et al., 2009; Søreide, 2012; RWI, 2013*). Transparency is also correlated to better economic outcomes and reduced costs of capital (*Esanov and Heller, 2011; Hameed, 2005; Islam, 2003*). These arguments have supported a growing awareness from international organizations, civil society actors and advocacy networks to push for participation and information in the extractive sector, including the idea that companies need to earn a “social license” to operate (*Gunningham et al., 2004*).

Practitioners have indicated that transparency provides exposure and visibility to the extractive sector, for example through the adoption of international Transparency Standards (*Rustada et al., 2017*). The Extractive Industries Transparency Initiative (EITI), launched in 2002, is an example of the centrality of transparency in the objective to develop mining resources together with governance mechanisms. These initiatives to turn transparency into accountability to solve governance issues in the extractive sector have been organized in four types: binding legislation, voluntary standards, stakeholder monitoring and targeted policies, and benchmarking and assessment tool (*Vieyra and Masson, 2014*).

Public policy for new producers should help address governance challenges through transparency and accountability. With the objective of earning and retaining public trust, attract qualified investors for the long run, maximize benefits to local communities as well as the entire economy, and build capacity in their institutions (*Marcel, 2013*).

3. Overview of the extractive industries development in the region

Latin America holds the second biggest natural resources in the world (*Walter, 2017*). Recent academic publications about the extractive sector in Central America have identified several elements that complicate the potential contribution of mining to development. One of them is the growing commodity demand and dependence on foreign capital for project development that accrues most of the benefits to global players while accumulating environmental and social costs at the local level (*Ciccantel and Pattel, 2016*). A second element in the expansion of mining projects in the region is the combination of technological innovation that allowed mining companies to profitably extract gold from lower grade deposits, but based on open pit operations and cyanide use, which increase environmental liabilities and local

² WDI, GDP per capita (current US\$), 2015.

³ Estimates from ministries of mines and mining industry associations for Dominican Republic, Guatemala, Honduras, Nicaragua and Panama.

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