Chapter 5: Promoting Conflict-sensitive Business in Fragile States: Redressing Skewed Incentives

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Chapter 5
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Introduction
One of the central challenges facing the international community today is to reconcile the forces of economic globalization with the achievement of sustainable peace and development. The liberalization of global trade and investment has led to an unprecedented surge in foreign direct investment (FDI) worldwide, including in emerging markets and the developing world. In the aggregate, increased investment has been positively correlated with reduced conflict risk and increased national economic growth, creating jobs and raising living standards. However, and contrary to the confident expectations of ardent globalizers, increased FDI has not delivered these benefits evenly or everywhere. Indeed, in many parts of the developing world, globalization has not only failed to deliver, it has actually served to perpetuate the vicious cycle of conflict and underdevelopment.

This is particularly true in sub-Saharan Africa. Although the region’s share of global FDI continues to be modest in absolute terms, on a per capita basis it is significant, not only in strict economic terms but also with regards to its wider impact. Tellingly, the vast share of the region’s FDI inflow is directed towards the extractives sector in countries such as Nigeria and Angola. Despite this, these countries continue to rank poorly in terms of political stability, good governance, per capita wealth and other indicators of development and human security.

In explaining the linkages between natural resource dependency, underdevelopment and conflict, much attention has been paid to the economic agendas of criminal groups, warlords, and corrupt elites operating on or
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beyond the margins of law. However, the focus of this analysis is the otherwise legitimate extractive companies and financial institutions who are the central agents of global trade and investment. Their activities in fragile and war-torn states are problematic not only because they may violate established norms, as some do, but also because they often operate beyond the reach of current normative and regulatory frameworks.

Changing the behaviour of extractive companies, and of market actors generally, requires changing their calculation of value and risk. This means not only changing corporate cultures and business practices but also the broader incentive structure in which they operate. As described in the second part of this chapter, the current structure of opportunity is shaped by a governance deficit that is good for extractive company and investor profit but bad for the wider peace and prosperity of developing countries. Remedy lies in realigning the gross imbalance in costs and benefits. In the section on ‘The spectrum of regulatory responses: Ad hoc, uneven and incomplete’, I identify three major approaches in the emerging spectrum of regulatory responses: voluntary self-regulation by companies, mandatory regulation by states, and mixed forms that supplement regulation with market rewards. All three are examined in terms of their ability to alter the conduct of particular companies as well as the prevailing incentive structure. Here, I argue that approaches that focus only on the behaviour of extractive companies is to mistake the symptom for the disease. Like other market actors, extractive companies do not operate in a vacuum but in a web of incentives and risks that define the market context in which they operate. Where elites are ‘corrupt’, rebels ‘greedy’ or companies ‘indifferent’ to the externalities they perpetuate, fault also lies in the structure of economic opportunity, not just the particular agent’s moral failings, however egregious. If the goal is to reduce the negative developmental, conflict and human rights impacts of natural resource extraction, then efforts that focus on the conduct of particular companies need to be supplemented with policies that address the wider marketplace. I conclude by offering some recommendations of how this might be accomplished.

The global market for natural resources: A permissive playing field for a race to the bottom

It is taken as conventional wisdom that companies and investors prefer a business-friendly environment: one in which national authorities are stable and legitimate, security risks are low, property rights secure, and regimes of taxation and trade favourable. Indeed, the absence of these conditions is a central reason why FDI inflows to manufacturing and tertiary sectors in areas like sub-Saharan Africa remain so small.3

Yet, in many fragile states, where administrative capacity and rule of law is weak or absent, even where violent conflict rages,4 some market actors remain undeterred. These include a range of opportunists – arms traders, private security firms and black marketeers – whose raison d’être is to seek profit from
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anarchy. Likewise undeterred, however, are multinational extractive companies and their affiliates, who, alongside national governments, are a central focus of this discussion.

The global marketplace for natural resources is shaped by an incentive structure that is highly permissive of aggressive, often predatory, resource exploitation, even in otherwise high-risk settings. Increasingly, the last untapped reservoirs of lucrative and strategic natural resources upon which the extractive industries depend are in regions of the developing world experiencing instability or even violent conflict.

Given the seemingly insatiable global demand for resources, and oil and gas in particular, this trend cannot but continue. In Africa alone, international oil companies are set to invest $50 billion over the next decade in resource-rich developing countries such as Nigeria, Angola, Equatorial Guinea, Gabon, Sudan, Cameroon and São Tomé e Príncipe. Cumulatively, this is the largest investment in African history and one that is estimated to double the continent’s oil production over the next decade (Gary and Karl, 2003, p1). The entry of China in the scramble for Africa’s oil and gas reserves has added a new sense of urgency to an already intense inter-state competition.

While the financial, security and reputational risks to companies are high, they are outweighed by the prospect of enormous profits.

These market factors help explain why multinational extractive companies and their affiliates go where other companies fear to tread. Alone, however, they do not explain why it is that the otherwise ‘legitimate’ behaviour of these companies often exacerbates corruption, instability and violent conflict. Here, the critical variable is poor governance. Where market regulation is weak, there are few barriers to untrammelled profit seeking. Company competition for lucrative natural resources drives a race to the bottom, both in encouraging the further lowering or evasion of regulatory standards and in enhancing the negative externalities that society bears. This regulatory deficit is manifest at all levels: company, state and inter-state.

**Company conduct and misconduct and violent conflict**

There can be little doubt that extractive companies invested in fragile parts of the developing world, whether public or private in name, routinely – and often egregiously – engage in self-regarding, even predatory economic activities. There are a variety of ways in which the financial and operational decisions of extractive companies have perpetuated instability and conflict. Some have been the unintended but problematic consequences of legal activities, some the result of illegal conduct. In most cases, however, violence and instability have stemmed from company disregard for the conflict risks that attend their activities. First, the lack of full disclosure of the concession payments, royalties and bonuses paid by companies to host governments creates powerful incentives for official corruption, reinforcing predatory elites, while denying affected citizens critical information by which they might better hold their leaders to account. During the Angolan civil war of the late 1990s, for example,
this sort of fiscal opacity enabled the Angolan government to divert some $5 billion in public monies from the state budget (Global Witness, 2004b). In some instances, signature bonuses paid to the Angolan government were used for covert purposes, including suspicious arms deals and elite self-enrichment, all of which severely undermined accountability, civilian security and human rights (Human Rights Watch, 2004, pp28, 50).

Second, in war-torn countries, where the security of plant and personnel are obvious priorities, but local law enforcement is weak or non-existent, companies may seek security however they can get it. In some cases, this has entailed making protection payments to local warlords or rebel groups. In so doing, companies secure a semblance of safety, but at the cost of sustaining combatant capacity to fight. More commonly, companies may contract private security companies or local security forces without screening out those with dubious human rights records and/or a volatile relationship with local communities that may engender further abuse and violence. In one fateful instance, Occidental Petroleum’s use of Colombian military forces to secure its pipeline from rebel attacks resulted in a raid on a civilian community in 1998 that left 19 civilians dead.7 While such arrangements may be technically legal and required by host governments, companies that undertake them risk supporting security forces they can neither control nor hold accountable.8

Third, core business activities can also have untoward effects at the operational level. For example, in Bougainville, PNG, the establishment of a major mining operation in a remote and ill-governed region generated a significant inflow of ethnic outsiders seeking jobs, at the same time as its activities degraded the local environment and disrupted traditional livelihoods. These impacts, which were neither anticipated nor compensated for, upset the existing balance within Papuan society and fed into existing grievances. The result was a spiralling cycle of violence in which the company became a proxy target for anti-government protest and a reluctant party to repressive government countermeasures (Regan, 2002, pp133–166; Zandvliet, 2005, pp185–206). It is worth noting that even well-intended efforts to secure a social licence to operate can fuel rent-seeking and violence (BBC, 2004). The practice of providing direct monetary compensation to affected communities for land use or environmental damage has proven particularly harmful.9

Numerous reports have made clear that otherwise legitimate companies have engaged in questionable business deals with corrupt and repressive governments and elites who abscond with national wealth and perpetrate massive human rights violations, often in the context of armed conflict (International Crisis Group, 2002; BBC, 2004). More troubling, there have also been documented cases of companies dealing in what one analyst has dubbed ‘booty futures’; that is, the direct company financing of rebel groups in return for future exploitation rights once military victory is achieved (Ross, 2002).

One of the most striking examples of this sort of investment occurred in Congo Brazzaville, the details of which were brought to light by a high-profile trial in France. During the 1997 civil war, the French national oil company
Elf-Aquitaine used its assets and influence to provide Sassou Nguesso, the final victor, with military assistance from Angola in return for the future rights to Congo’s substantial oil reserves. At the same time, Elf executives also organized an oil-backed loan (mortgaging future oil production at high rates of interest for up-front money) for Sassou’s opponent President Pascal Lissouba, with which he could purchase arms. Financing both sides of the conflict to secure ‘booty futures’ on Congo’s oil was part of Elf’s so-called ‘Africa System’, a long-standing arrangement to protect oil profits and extend influence in Africa through kickbacks and pay-offs to trusted African leaders. In so doing, Elf was at least partially responsible for a civil war where systematic rape was prevalent, thousands died and hundreds of thousands more were displaced.

**The absence of host-state governance**

The willingness of some companies to engage in these more dubious sorts of enterprise is not only a function of the profits to be had, but also of a weak regulatory environment in which the costs and penalties for misconduct are few and the rewards perversely high. One part of this weak regulatory environment concerns host states. Often they are politically indifferent or too institutionally weak to prevent or mitigate the negative economic, environmental and social impacts of natural resource extraction. The very resource dependence of these countries has ‘cursed’ them with an increased vulnerability to price shocks and lopsided investment. Resource windfalls also beget corruption and rent-seeking, and a temptation to disregard the social contract between the government and the governed, all of which may generate powerful social grievances. In the context of sub-Saharan Africa, resource wealth has reinforced patrimonial rule and emboldened repressive regimes, even while stripping state capacity to maintain basic order and public services.

For these reasons, many host governments are ill-equipped to manage their countries’ natural resources responsibly, let alone ensure responsible conduct of multinational companies on whom a considerable portion of their revenues depend. Even where appropriate regulatory frameworks exist, the incentives and means to implement, monitor and enforce them may be weak, particularly in remote and ill-governed hinterlands, where mining and drilling operations are typically located. For example, with the assistance of the IMF and the World Bank, the DRC government introduced a new Mining Code in 2003. As Human Rights Watch has reported, while in many respects a model code, implementation has been slowed by lack of resources and enforcement capacity, especially in mineral-bearing regions, where violent contests over resources continue. The code has also been thwarted by continued practices of political patronage that bypass the mines ministry, and ignore the law, in the awarding of concessions. In the worst cases, contests over title to resource concessions and revenue distribution have contributed to violent conflict and extensive human rights abuse (Human Rights Watch, 2005). In effect, the potential for larger social harm is so great because the domestic constraints against harmful business activities are so few.
Globalization without governance

Poor governance at the national level is compounded by a deficit of global governance. While globalization has opened up a wide range of decentralized, transborder opportunities for trade and investment, governance is still viewed as the domain of states and remains chiefly limited to activities within their sovereign borders. The global regulatory architecture provided by the WTO and the OECD exists to facilitate unencumbered trade and investment. These arrangements are not designed to address, let alone remedy, the negative non-commercial externalities – borne largely by marginalized populations in the developing world – that cross-border transactions routinely incur. Likewise, home governments, who remain preoccupied with maintaining global competitiveness, have been reluctant to exert meaningful regulation over their internationally operating companies. Taken together, national and international trade and investment policies have yet to address meaningfully the corrosive effects of natural resource extraction in fragile and war-torn states. Indeed, until recently, the various forms of risk mitigation and protection (including export credit assistance, overseas investment insurance and project finance) provided to extractive companies by national export credit agencies (ECAs) and multilateral lenders such as the International Finance Corporation have ignored conflict and human rights impacts (Goldzimer, 2003; Gary and Karl, 2004; Hildyard, 2005, pp235–262). As such, financing agencies have served to reinforce the already permissive incentive structure.

The spectrum of regulatory responses:
Ad hoc, uneven and incomplete

Like other new areas of global governance, efforts to address the negative security and developmental impacts of trade and investment have been prompted by NGO advocacy campaigns. As discussed elsewhere in this volume, NGOs such as Global Witness, Partnership Africa Canada, Human Rights Watch and Amnesty International have led the way in exposing the conflict trade in timber, gold, diamonds and other lucrative minerals, as well as the linkages between oil and gas extraction, corruption and poor governance (see Chapters 3 and 4). Their investigations, backed by public ‘naming and shaming’ and threats of consumer boycotts of implicated companies and sectors, have pressed companies that value reputation to adopt more responsible business practices, while keeping the spotlight on the unethical activities of those who continue to regard operations in weak and war-torn states as ‘business as usual’.

NGO policy research and advocacy has also played a critical role in placing these issues more prominently on the policy agendas of home and host governments and international organizations, including the UN, the African Union, the EU, the OECD and the World Bank. NGOs have also played an important and continuing role in developing global governance in this area through their participation in a number of multi-stakeholder initiatives,
including the UN Global Compact, the Voluntary Principles on Security and Human Rights, the Kimberley Process for the certification of rough diamonds, and the Extractive Industry Transparency Initiative. Their decision to engage with companies represents a departure from traditional NGO advocacy policy of keeping distance from those whose practices they deem complicit in human rights abuse and underdevelopment. It may also represent their awareness of the abiding limitations of ‘naming and shaming’ in altering the powerful global market incentives in which business actors are, for better and for worse, still embedded.

NGOs have also been in the forefront of developing a new paradigm of conflict-sensitivity through which companies operating in fragile states can better manage the security and developmental impacts of their activities. The term ‘conflict-sensitive business practices’ – like the term ‘conflict-sensitive development’, from which it was adapted – underscores the fact that no intervention is neutral (Anderson, 1999). Private investment, like donor assistance, can even trigger unanticipated harm. Broadly speaking, conflict-sensitive business practices refer to proactive and responsive efforts to ensure that routine company investments and operations in weak states, including those at war and those emerging from conflict, do not contribute to ongoing violence, corruption or human rights violations. They also include positive efforts by companies to contribute actively to peace-building, human security, and sustainable development. While the full range of such practices is still being explored, they include efforts to stem the illicit conflict trade; the use of conflict-impact assessments that anticipate ways in which investments and operations may exacerbate instability; proactive engagement with affected populations; a responsible use of security services; and a commitment to transparent and accountable business dealings with host governments and communities (International Alert, 2005).

The current regulatory landscape is still a long way from embedding conflict-sensitive business practices into routine trade and investments. What regulation exists has emerged largely from ad hoc responses to specific challenges and opportunities. As such, it is an uneven patchwork of issue-driven, problem-focused initiatives that vary widely in terms of their objectives, the actors and activities addressed, and the strategies for doing so. For example, the Kimberley Process for certifying rough diamonds and EU efforts to regulate tropical timber were undertaken in response to specific instances of violent conflict, particularly in Sierra Leone and Liberia, in which the unregulated trade in lucrative commodities was identified as a barrier to conflict resolution. By contrast the current focus on transparency of natural resource revenues, although informed by specific conflicts, has also been shaped by parallel international efforts to tackle the debt crisis, reduce aid dependency, and promote accountability and good governance.

While commodity controls have been targeted at curtailing illicit exploitation and trade (particularly by non-state armed groups and transnational criminal networks), transparency initiatives are aimed at reducing the development and security risks of otherwise of legal business actors in the extractive sector.
This accounts for the diversity of regulatory approaches employed: from the prohibition of ‘criminal’ and ‘rebel’ actors to voluntary self-regulation through multi-stakeholder engagement and consensus building with ‘otherwise legitimate’ companies.

This differential treatment of market actors may be justified as an effort to distinguish and protect legitimate trade and investment from criminal activities. However, it has been criticized as an unacceptable double standard, one that protects the powerful and well-connected – chiefly multinational companies in the developed world and key host governments in the developing world, while often criminalizing comparable economic activities conducted by actors already condemned as ‘rogues’ for strategic or political reasons. Differential treatment of this sort may lead to policies that address only a part of the problem.

The classic case in point is the definition of ‘conflict diamonds’ adopted by the UN. From an ethical point of view, conflict diamonds might be classified as ‘all diamonds that are extracted, traded, marketed or consumed in violation of internationally recognized labour and human rights standards and in ways that exploit, profit from, or contribute to violent conflict, whether for pecuniary and strategic gain’ (Winer, 2005, pp.71–72). From a strict legal perspective, they might be defined as ‘all diamonds that have been extracted, traded, marketed or consumed in violation of the laws and customs regimes of at least one of the countries in which they move’ (Winer, 2005). However, the UN adopted an even narrower definition of conflict diamonds as ‘rough diamonds used by rebel movements or their allies to finance conflict aimed at undermining legitimate governments’ (UN, 2001). By this standard, rough diamonds that are extracted by state actors – regardless of whether done legally or in violation of law and regardless of whether the proceeds are used to finance armed conflict – do not qualify and would not be, indeed have not been, subject to UN Security Council sanctions. By making the critical element one of agency rather than activity, this sort of regulation may target some of the most egregious offenders but it leaves unaddressed the fuller dimensions of conflict trade.

Very often, discussions of regulatory responses to conflict-promoting business activities are cast in terms of a ‘voluntary versus mandatory’ dichotomy. While the distinction is analytically useful, the dichotomy is not (Lunde and Taylor, 2005, p.318). For one, it obscures a number of promising hybrid initiatives that combine market inducements with legal sanction, such as the Kimberley Process, which though voluntary, has binding effects throughout the diamond trade (Smillie, 2005, pp.52–53). More important, however, where the objective is to change the incentives that enable conflict-promoting business activity, then what matters is not whether the approach is voluntary or mandatory, but whether it can promote positive change among market actors.

As will be detailed below, although voluntary codes and other forms of industry self-regulation do suffer from self-selection and weak enforcement, they have provided important guidance and even a market niche for progressive companies seeking to improve business practice in challenging operating
environments. By the same token, while mandatory or legal regulation is essential to the creation of a level playing field for conflict-sensitive business and for addressing the most egregious conduct, it cannot remedy the many conflict-promoting yet still legal market activities. At present, there is little normative consensus among key stakeholders as to what sorts of activities are unacceptable, let alone those that should be prohibited by law. And even where relevant international and domestic legal norms do exist, they too may suffer from weak or selective enforcement.

As other analysts have stressed, efforts to curtail the negative impacts of unregulated trade and investment in fragile and war-torn states confront a ‘malign problem structure’, in which a heterogeneous set of actors operating across jurisdictions have strong incentives to evade regulation, and where the costs and benefits of regulation are asymmetrical (Lunde and Taylor, 2003). However, just as different market actors have varying sensitivities to risk and opportunity, their receptivity to different forms of regulation is also highly variable. For this reason, efforts to promote conflict-sensitive business need to take advantage of the full spectrum of regulatory options.

**Voluntary codes and industry self-regulation: Necessary but not sufficient**

That one can even speak of progressive companies today signifies an important change from the past. Pressed by advocacy groups, shareholder activism, and UN efforts to address the economic dimensions of armed conflict, an increasing number of extractive companies, particularly large multinationals, are embracing the notion that good corporate citizenship extends beyond the boardroom and the company gate (Haufler, 1995).

For progressive firms operating internationally and concerned with their reputational capital, obtaining a ‘social licence to operate’ among local and national stakeholders in host countries is now seen as an essential component of sound business planning. Fiscal transparency, positive community relations, environmental protection, and sponsorship of health and education initiatives have already become standard elements of today’s corporate social responsibility (CSR) agenda. More recently, some companies have begun exploring ways to extend traditional CSR to embrace conflict sensitivity, and thereby to address broader issues of peace, security, human rights and sustainable development, particularly in war-affected settings in which they operate. This change was prompted in part by the difficult security risks some companies have encountered when operating in conflict-affected countries. It has led these companies not only to adopt conflict-sensitive codes of conduct but also to join in broader industry and multi-stakeholder efforts to prevent and manage conflict. Among such initiatives are the Voluntary Principles on Security and Human Rights, the UN Global Compact’s Dialogue on Private Sector Actors in Conflict Zones, and the Extractive Industry Transparency Initiative. These initiatives have the advantage of providing sustained engagement of key stakeholders: local and international NGOs, human rights advocates,
governments and international organizations (including IFIs), and companies. They have helped to build some badly needed confidence, legitimacy and consensus, and to target attention to practical and policy challenges.

While these codes remain mostly aspirational benchmarks, a few companies have started to commit resources and personnel to match them with meaningful implementation and to make public reports on progress. They have also transformed the way these companies conceptualize and assess the risks posed by doing business in unstable or war-torn countries. In addition to traditional risk assessments that focus on the threats to company operations and investments, some companies are now seeking to identify the possible security and welfare risks posed by their own operations to surrounding communities, and to undertake appropriate preventive measures. In moving to incorporate some elements of conflict-sensitive business practices, such as revenue transparency or responsible security, corporate codes of conduct have the potential to set rudimentary benchmarks, sensitize the internal corporate culture to the value of conflict prevention and to help build skills and capacity for improved policies on the ground.

While the benefits of voluntary initiatives are important, they tend to be obscured by criticism of their shortcomings. These shortcomings are real and consequential. One weakness is the partial, self-selective nature of voluntary self-regulation. The few companies that elect to endorse them are typically large multinationals based in OECD countries that value reputation and their ‘social licence to operate’ and are easy targets for advocacy groups. Small, ‘junior’ companies and independently operating entrepreneurs are less visible, and are thus better insulated against naming and shaming. As such, they have few, if any, incentives to sign on. This asymmetry of reputational risk leaves progressive multinational companies vulnerable to undercutting by more numerous rivals less committed to responsible, conflict-sensitive practices and human rights norms.

As documented by the UN Panel of Experts on the Illicit Exploitation of Natural Resources in the DRC, this undercutting is precisely what occurred during the DRC conflict: large multinationals were effectively squeezed out by less visible, less scrupulous junior companies unconcerned by reputational or security risks or by the corrosive effects of their activities on the safety and well-being of the Congolese people. Many fear this pattern will be replayed on a larger scale where large and politically insulated state-owned companies from non-OECD countries such as China, India and Malaysia are heavily involved in resource extraction.

Industry-driven efforts have thus far proven to be unable to affect the behaviour of state-owned, junior and rogue companies. This problem has been compounded by the reluctance of some multi-stakeholder initiatives to engage with problematic companies. For example, the founding participants of the Voluntary Principles on Security and Human Rights, eager to protect the integrity of the initiative and undecided about membership criteria and performance obligations, resisted the inclusion of Talisman Energy in the process. This reluctance stemmed from Talisman’s controversial role in the
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Sudan conflict, although Talisman had by then undertaken several good-faith efforts to improve its CSR profile. While formal exclusion of companies from the process does not prevent them from endorsing and implementing the principles unilaterally, as Talisman now does, it risks slowing their broader adoption and reduces the opportunities for companies to share best practices. Indeed, six years after the establishment of the Voluntary Principles (VP), only 16 companies are signatories.19

A second shortcoming is that company and industry self-regulation has led to a proliferation of voluntary codes for responsible conduct, none of which have global reach and authority. For some companies, the bewildering array of codes has led to confusion and to code-fatigue, as well as to concerns of continually moving goalposts, all of which undermine their efforts to set and operate by clear, predictable expectations. Company-adopted voluntary initiatives may also lack credibility if they do not rely upon internationally adopted standards to establish clear benchmarks for distinguishing good performers from non-compliers.

Third, self-regulation often lacks transparent reporting and reliable performance requirements, without which voluntary codes remain unenforceable. Indeed, voluntary initiatives, whether company, industry or multi-stakeholder-based, are subject to varying levels of implementation, while performance assessments depend largely on self-reporting that cannot be verified. Even where non-compliance is reported, however, companies incur no penalty beyond damage to reputation, which may or may not be a matter of concern.

The credibility and effectiveness of voluntary codes and standards could be greatly improved if companies that have adopted them were to commit themselves to the creation of clear, common and verifiable performance obligations. Strengthened self-enforcement not only would demonstrate a serious commitment to conflict-sensitive business practice and human rights norms but would also enable more reliable assessments of actual progress. Not least, it would help identify non-compliers, thereby enhancing the reputational, and possibly financial, rewards to those companies with demonstrated records of sound corporate conduct. Recently, these criticisms have prompted the UN Global Compact to take steps toward establishing meaningful benchmarks and reporting mechanisms.20 New measures have been adopted that include the prospect of sanctioning non-compliers through public suspension or exclusion of non-complying member companies. While promising and needed, these efforts remain untested, and in any event will still fall short in affecting companies that remain insensitive to reputational risk.

Fourth, voluntary efforts to ‘do good’ by individual companies may be undercut not just by other less scrupulous companies, but by host governments unconcerned by, or unable to address, issues of corruption, criminality and conflict. The first obligation of a company is to abide by the laws of their host countries. In vulnerable and war-torn states, however, where rule of law is compromised and government capacity is weak, there are strong incentives for corruption and economic criminality.
In such settings, companies that seek to be law-abiding have been unable to exert their influence to redress the many egregious economic activities of partners and competitors that exacerbate violent conflict. As some companies have observed, their ongoing efforts to promote transparency in dealings with host governments have been stymied by host country perceptions that transnational companies were unilaterally imposing alien norms or interfering in the sovereign affairs of state. This was the case for British Petroleum (BP) when, pressed by international NGOs, it published documentation of a signature bonus paid to the government of Angola. The Angolan authorities retaliated with threats to revoke BP’s concessions, a threat made credible because of the presence of other companies willing and able to play by Angola’s rules. As much as one may think that large multinational extractive companies have leverage over their host partners, the truth of the matter is that, acting alone, they do not. The problems of collective action and the ability of host governments to play companies against each other are abiding constraints.

In sum, however useful they have been in reforming internal corporate culture and establishing some useful benchmarks, voluntary business initiatives for socially responsible and conflict-sensitive conduct have not coalesced into a cumulative, systemic impact on the ground. At best, they may reflect the changing incentives of individual companies that adopt them. But they do little to alter the actual rewards and penalties of the overall marketplace.

**Mandatory regulation: Towards binding rules and a level playing field?**

Given the many inherent shortcomings of industry self-regulation, there is a strong case to be made for more robust forms of regulation, at both the national and international level. Unlike voluntary codes, mandatory regulation governing corporate activities in weak and war-torn states holds the promise of altering the incentives of the wider marketplace, while creating a level playing field.

Ideally, national governments should be the primary agents of regulation of extractive activities that are undertaken within their sovereign borders, ensuring that these activities are transparent, socially responsible and environmentally sound. Increasingly, a number of host states in the developing world have undertaken to strengthen the appropriate legal and institutional capacities, by adopting new anti-corruption laws, reforming mining codes, and by improving environmental oversight. Nigeria and Indonesia, for example, have taken legal action to hold extractive companies accountable for environmental damage. However, in most vulnerable and war-torn states, where rule of law is weak or absent and where regime survival is at a premium, state authorities have neither capacity nor resources, nor often the political will, to pursue effective regulation. The result is market failure, often of a most egregious kind. For this reason, as well as because of the transnational nature of extractive activities, those seeking remedy have looked to some form of international governance.
A common set of authoritative and legally enforceable global rules would accomplish several things. First, rigorous sanctions would make accountability of economic actors meaningful and curtail the current climate of impunity. Second, common rules would reduce the collective action and free-rider problems that currently impede the extension of improved corporate conduct to the broader set of market actors, while also injecting clarity and predictability into what is currently an unwieldy and confusing array of voluntary corporate codes. Third, having rules with global coverage would end the current jurisdictional double-standard that allows companies to conduct themselves abroad in ways that would never be permitted at home. Less obvious, perhaps, an international legal framework for responsible business conduct abroad would make companies less vulnerable to retaliation by unaccountable host-country partners, and perhaps, too, increase their leverage to promote host-country accountability (Petrasek, 2002).

Thus far, however, neither governments nor international organizations have committed themselves to address the global regulatory deficit by undertaking to build such a regime. This is hardly surprising, given the prevalence of economic liberalism and its attendant suspicion of all things regulatory, particularly among the industrialized countries that are the main beneficiaries of market-driven globalization and the chief consumers of natural resources. But sovereign economic self-interest is not the only obstacle. Indeed, a central and still unmet challenge is to define the normative content of such a regime. As the recent debate over the UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights has dramatized, beyond the recently agreed international prohibition on corruption, there is little consensus among governments, corporations, and civil society on the precise scope of unacceptable economic activities in fragile and war-torn states or on the extent to which business entities should be legally obliged to refrain from them.23

A company operating in repressive, weakly governed or war-torn states might have a duty of heightened care, but the legal implications of this duty are far from clear. Should companies be disbarred from investing or operating in all conflict-torn states? Specifically, should there be an international moratorium on resource exploitation in countries where warfare or corruption has effectively destroyed domestic regulatory capacity? Should conducting transactions with known rebel and insurgent groups be criminalized? Should there be different standards governing those invested in a stable country that descends into war as opposed to those seeking entry into known war-zones? How would such provisions be reconciled with state sovereignty and what would be their humanitarian impacts? It is precisely these sorts of thorny issues that make the creation of clear international norms on the wider responsibilities of business entities in war-torn states so problematic yet so urgent.

The strengthening of mandatory regulation does not, however, rely exclusively on the creation of a full-blown international regime, nor does it have to proceed from scratch. As several studies have recently demonstrated, there is a range of existing and emerging international norms and national
legal instruments that could provide the building blocks for a more coherent global framework (International Peace Academy and Fafo, 2004; Open Society Justice Initiative, 2005). Here the challenge lies in extending their coverage and strengthening their enforcement.

**Current remedies under international law**

Under current international law, there are few provisions that directly address economic activities that profit from or promote conflict. While designed for other purposes, anti-corruption and anti-bribery measures offer a second area in which existing international and national regulatory mechanisms could be better deployed against conflict-promoting extractive industry activities. As has been widely reported, and as many court cases have proven, in fragile states transactions between extractive companies and unaccountable host governments are widely accompanied by bribery of public officials, money laundering, tax evasion, and outright theft. Many of these are recognized as crimes, duly codified in domestic law and in a number of international conventions. Despite several prominent court cases and a growing number of legal investigations of alleged wrong-doing by corporations by some home jurisdictions, legal convictions against companies for corruption offences have been rare.

While political interference is one reason for poor enforcement of this legal remedy, another lies in the technical, legal and jurisdictional hurdles involved in prosecution. Technically, opaque accounting rules and complex bank secrecy laws can impede the collection of evidence, while high legal thresholds, such as the US Foreign Corrupt Practices Act’s requirement of proof of intent to commit bribery, are difficult to meet (Open Society Justice Initiative, 2005, p21). The UN Convention against Corruption goes some length to address these problems by requiring signatory governments to criminalize a wider range of bribery-related offences, to render mutual legal assistance in the collection and transfer of evidence for use in court, and to undertake measures to assist asset recovery including the tracing, freezing and confiscation of proceeds of corruption. As with the more established OECD Anti-Bribery Convention, however, the UN convention suffers from a lack of robust oversight and monitoring, a weakness that hampers efforts to reduce the current climate of impunity.

Because international criminal law, international humanitarian law, and international human rights law have been extensively codified, have comprehensive international coverage, and enjoy broad international consensus, they provide another, arguably more reliable, basis for concerted action to hold economic actors accountable, thereby increasing the costs and reducing the impunity of conducting business in host countries where domestic protections are lacking. Despite the broad acceptance of international human rights norms, just whether and how these translate into obligations for companies and other non-state actors remains a matter of contention (Clapham, 2006).

Within the business community, the fact that these statutes have been designed by and agreed among states has often led to a mistaken belief that
they cover only offences committed by state actors. While it is true that states have the primary responsibility for preventing crimes against humanity, for observing the laws of war, and for promoting and protecting human rights, individual non-state actors can be held accountable for these offences.

Under these norms, there are no provisions that directly address economic activities that directly cause or promote instability or conflict. As such, the mere presence of a company in a fragile or war-torn state is not an actionable offence. These norms do, however, include provisions that directly address certain economic activities that profit from conflict. The Rome Statute of the International Criminal Court defines pillage, plunder and spoliation as actionable war crimes. While company executives have been prosecuted under these provisions in the past, the narrow scope and high legal thresholds of these offences will continue to make such prosecutions rare.

Company executives and employees can, however, be held accountable where they are found to be complicit in the perpetration by others of war crimes, crimes against humanity, and other grave violations of human rights such as genocide, ethnic cleansing, torture, forced detention, use of child soldiers, slavery and extra-judicial killing (International Peace Academy and Fafo, 2004). While the concept of complicity is subject to differing interpretations in different jurisdictions, a common legal definition has been codified in the Rome Statute (article 25). This subjects individuals to prosecution for war crimes and crimes against humanity if that person purposefully aids and abets the commission of such crime, including providing the means for its commission. Complicity in such international offences has been further extended by the notion of ‘joint criminal enterprise’ invoked in indictments by the International Criminal Tribunal for Yugoslavia and the Sierra Leone Special Court, under which even remote accomplices to an offence committed by others can be held accountable where the acts committed were a foreseeable outcome of the conspiracy.27

As yet, there have been no international criminal prosecutions against economic actors for aiding and abetting war crimes and crimes against humanity. However, the chief prosecutor of the International Criminal Court signalled that such prosecutions are within his remit, while the Special Court of Sierra Leone has issued indictments that explicitly charge former Liberian president, Charles Taylor, and his associates of complicity in the ‘joint criminal enterprise’ of waging war to gain control of Sierra Leone’s diamond wealth.28

**Current remedies under national law**

Holding companies liable for actions that aid and abet violations of international criminal and human rights law is also within the power of national governments. Several cases are now pending in France, Belgium, The Netherlands and the US that seek to prosecute individual businessmen and large multinational corporations for their complicity in offences committed by others abroad. Most of these are civil suits brought against large extractive companies in US courts under the Alien Torts Claims Act (ATCA), a statute that explicitly provides civil redress in American courts for violations of ‘customary international law’ committed abroad.
Both Unocal and Total were sued by Burmese plaintiffs for aiding and abetting forced labour and forced displacement of civilians by the Burmese military in connection with their joint-venture pipeline project. In other cases, suits have been brought against companies for their complicity in murder, torture and false imprisonment committed by host-country security forces in their employ and for the provision to government forces of plant and assets that were then used in the commission of ethnic cleansing and other acts of aggression against civilians.

While the Unocal and Total cases were settled out of court, and while no ATCA case has yet resulted in a conviction, interim court decisions have helped to clarify actionable standards of complicity liability of companies for grave human rights abuse. To cite one such judgement, a lower federal court found that Unocal’s involvement met the standard of providing ‘knowing practical assistance … that had a substantial effect on the perpetration of a crime’ by the Burmese military, suggesting that doing business with others who commit atrocities, where such an outcome was plainly predictable, does expose companies to complicity liability (Hoffman, 2005, p404).

These suits have also signalled to companies operating in fragile and war-torn states and partnering with abusive host governments that they will face expensive and reputation-battering court cases for their failure to exercise prudence in their investment and operational decisions. Indeed, while companies continue to protest publicly that they have no legal duty to promote and protect human rights in the countries in which they are operating, the prospect of protracted legal trials has prompted an increasing number of companies to become more proactive in adopting human rights and conflict-sensitive principles and altering their practices accordingly. More robust legal sanction may therefore be enhancing the appeal and strengthening the scope and effectiveness of voluntary codes and standards.

Ultimately, the effectiveness of legal forms of regulation should not be judged by the number of cases pending nor the convictions achieved. Indeed, if an increased incidence of prosecutions and compensation settlements after the fact were all that was accomplished, the harmful security and development impacts of extractive companies in weak and war-torn states would not have been prevented in the first place.

The real value of legal prosecution is to clarify minimum standards of unacceptable economic activities and to reduce the incentives to companies for entering into transactions where the risk of involvement in violations of those standards is present and unavoidable. The fact that bringing civil or criminal action against companies for offences committed abroad continues to face a host of daunting jurisdictional and procedural challenges offers companies (and their well-heeled counsel) a variety of risk-reducing stratagems, including transferring legal incorporation to more lax jurisdictions and using foreign-based corporate subsidiaries, that add more obstacles to efforts to pierce the corporate veil. In short, while legal action can have profound and reformative effects on the incentive structure of some market actors, these effects are likely to be incremental and uneven.
Mixed forms of regulation: Making markets responsive

While voluntary and mandatory forms of regulation have differing strengths and weaknesses, they do share a common shortcoming: a lack of market inducements that reward companies that adopt meaningful conflict-sensitive business practices. From an extractive company perspective, voluntarily scaling up due diligence of foreign business partners, signing on to implement emerging best practices in revenue transparency, anti-corruption, human rights and conflict prevention, devoting the human and financial resources needed to sustain engagement in the plethora of voluntary multi-stakeholder and community engagement initiatives on these issues, while also tasking lawyers to track the emerging complicity liability risks, are both a costly and uncertain investment, the benefits of which have yet to be felt.

It is particularly expensive for the small-scale prospecting companies that are typically the first to enter fragile states, which may be one reason why this category of companies has such a poor track record of socially responsible business practice (Sherman, 2002; Balch, 2005). But these costs remain a concern for major multinational extractive companies as well, particularly as they find themselves competing against more insulated state-sponsored rivals from weakly governed jurisdictions, such as China, India and Malaysia. These costs can be prohibitive, even to progressive companies with a demonstrated commitment to responsible business practices. Likewise, while legal prosecution does impose economic costs, both direct legal costs and indirect reputational costs that may translate into lost investor confidence, its salutary effects are undercut by the lack of positive inducements. Given this fact, and given the enormous profits to be had from natural resource exploitation, some companies – especially those protected politically – may reckon that it is more profitable to take the liability risk and continue ‘business as usual’ than to expend resources and efforts on developing responsible conduct, the bottom-line benefit of which appears neither immediate nor certain.

Arguably, company participation in industry-wide or multi-stakeholder initiatives can help reduce the overall costs to companies, by pooling resources and by allowing newcomers to share best practices developed by others. The greater challenge, however, is to supplement these initiatives and regulatory prohibitions designed to mitigate negative company impacts with economic inducements that reward good business practice. While promising steps have been taken, those in a position to proffer such rewards, namely government, international financial lenders and regulators, shareholders and consumers have yet to deploy their full political, regulatory and financial influence accordingly.

Strengthening market inducements through supportive public policy

The most notable example is the Kimberley Process Certification Scheme (KPCS). Established in 2003, the KPCS seeks to regulate the previously uncontrolled global trade in rough diamonds, and to curtail the opportunities for illicit trade that have financed insurgent groups. The product of an inclusive,
multi-stakeholder process, the KPCS is a voluntary agreement among industry actors, financial institutions, NGOs and governments in diamond producing and trading states. It provides common standards and a requirement for participating members to supply certificates testifying to the legitimate origin of the rough diamonds they trade, together with an auditable chain of warranties from origin to destination, and a system for peer monitoring to ensure the integrity of these measures. Participants have committed to trade only with other members of the process and to reject the importation of diamonds that lack the required certification. While initially weak, the monitoring and enforcement provisions have steadily improved (Global Witness, 2004a). Notably, these measures have required participating governments to undertake domestic legislation to provide penalties for non-compliance. Although implementation on the ground in diamond producing countries continues to face technical and political challenges, the measures undertaken through the KPCS have significantly reduced market access of non-participants as well as participating non-compliers. While the KPCS is technically a voluntary arrangement, its requirement that participants trade only with other members of the process, and its ability to suspend non-complying members, has radically altered the balance of incentives governing the international diamond market. Indeed, for those who seek to trade in this market, its effects are essentially obligatory. Indeed, by late 2004, some 43 countries, representing 98 per cent of the diamond trade, had signed on to the scheme.31

In the area of money laundering, positive dynamics have been generated by the OECD Financial Action Task Force (FATF). Launched in 1989 by the OECD to help combat the rising threat of the global trade in illicit drugs, the FATF was initially targeted at identifying and correcting vulnerabilities in the international banking system that enabled drug cartels to launder their ill-gotten gains. It was later amended to address money laundering associated with a wide range of serious crimes, including terrorist financing. The centrepiece of the FATF is a set of 40 recommendations that set standards that require governments to criminalize the laundering of the proceeds of such crimes, including legislation to seize and confiscate them, and obliges financial institutions to identify all clients, report suspicious transactions, and keep records of their transactions.

Like the Kimberley certification scheme, the FATF is based on a voluntary agreement and relies on a cooperative system of technical assistance and mutual monitoring. And like Kimberley, it derives its effectiveness from provisions that threaten the denial of market access to non-complying jurisdictions. Since 2000, the FATF has done this by publicly blacklisting 'non-cooperative' jurisdictions, including those outside the OECD that lack adequate legislation to ensure that their financial institutions have the needed due diligence measures in place. Blacklisted countries are liable to a number of countermeasures, the most notable of which is the suspension of banking transactions with other FATF members. As these members are OECD states, this sanction effectively threatens to cut off critical access to major financial centres, thereby posing serious economic consequences.
Although such measures have not yet been imposed, the mere threat of market loss has proven sufficient enough an incentive for targeted countries to undertake the necessary reforms. Indeed, of the 23 jurisdictions designated as ‘non-cooperating’ in 2001, only three remain so. The progress of both the KPCS, in regulating the global trade in rough diamonds, and the OECD FATF against money laundering, demonstrate that voluntary agreements to implement a core set of regulatory standards can effect positive change when supported by effective oversight, transparent performance assessments and meaningful market inducements, particularly the denial of market access to non-compliers.

**Strengthening market inducements through shareholder activism**

Tying good performance to the threat of market loss is one way that economic inducements can be deployed in support of conflict-sensitive business practices. Another avenue for increasing financial support for conflict-sensitive business is through a targeted leveraging of investor influence. Where companies are publicly held, shareholder associations, pension funds and institutional investors have significant leverage that can be brought to bear to improve business conduct in vulnerable and war-torn countries. As socially responsible investment has become more popular, there has been a steady increase in the number of shareholder actions to press companies to improve their conduct and limit their non-commercial risk vis-à-vis the environment, community impacts and human rights, particularly in war-torn or repressive states.

The most common objective is ‘avoidance’, that is shareholder and institutional investors that pressure company boards to avoid investments that have undesirable impacts. This sort of shareholder activism played a critical role in effecting the withdrawal of the Canada-based Talisman Energy from its problematic pipeline project in war-torn Sudan, as well as in Talisman’s subsequent strengthening of its CSR profile. More recently, shareholders of major extractive companies including ExxonMobil and Freeport MacMoran have tabled resolutions that seek to address negative human rights impact of their operations in Indonesia.

Investor activism has also put pressure on companies from the outside, through the leverage of capital markets. In 2000, in protest against PetroChina’s poor labour, environmental and human rights record, a diverse coalition of NGOs joined forces with institutional investors to block PetroChina’s gaining listing on the New York Stock Exchange. While the Initial Public Offering (IPO) went ahead, the disciplined boycott cost PetroChina some $7 billion in expected public investment (Social Funds, 2000). In the US, this sort of targeted investor activism has been echoed by the policy and legislative changes in several state-run public pension funds that bar these funds from being invested in companies with problematic projects in troubled places, in some cases requiring divestment.

Companies have been less than comfortable with shareholder activism for socially responsible investment, particularly those resolutions that would impose significant costs, like the costs of wholesale divestment. However,
shareholder and investor demands for improved accountability have also taken the form of informal engagement, whereby investors and shareholders work with companies not only to mitigate risks but to identify and adopt practical standards to promote and ensure conflict-sensitive investment practices. In several cases, this sort of push has led companies to adopt conflict-sensitive principles, such as the Voluntary Principles on Security and Human Rights and the revamped International Finance Corporation (IFC) safeguards, to participate in the UN Global Compact, and to support other policy processes such as the Extractive Industries Transparency Initiative (EITI), all of which do much to strengthen the credibility and efficacy of these tools, as well as to broaden their reach. As socially responsible investment becomes more widespread, and provided that these standards can be translated into meaningful change on the ground, investor support of conflict-sensitive business holds real promise, not only for identifying and penalizing non-compliers, but also for identifying and rewarding top performers.

The financial leverage of shareholders and institutional investors can alter the economic incentive structure in which some companies operate, but can do little to level the still uneven global playing field. For one thing, these actions remain largely limited to the level of individual companies and funds. For another, the opportunities for shareholder activism vary from country to country, and in some places are non-existent. This was the case with Talisman, where shareholder pressure compelled the company to sell off its problematic Sudanese assets to India’s National Oil Company – a company more insulated against such pressure. What worked to reform one company’s policy and practice therefore did little to change business as usual in war-torn Sudan (Mansley, 2005, p220).

Making project insurance and financing a reward for good conduct
Shareholders and institutional investors are not the only, or even the primary, source of financing for the extractive industry. Particularly with high-risk infrastructure and extractive projects, those projects most implicated in conflict, the support of the private-sector financing arms of multilateral development banks, such as World Bank’s IFC and Multilateral Investment Guarantee Agency (MIGA), and national export credit agencies (ECAs), is critical. These agencies provide companies various forms of risk mitigation and protection, including export credit assistance, overseas investment insurance and project finance. Though modest in absolute terms, this financing adds a vital margin of safety for company operations in unstable places. And by increasing investor confidence, this support has a multiplier effect by opening up new avenues for companies to obtain larger amounts of private financing that would otherwise not be forthcoming.34

As recently detailed in a study by International Alert, however, these bodies have been slow to develop meaningful environmental and social standards, and even slower to make conflict-sensitive business practices a systematic feature of their lending and oversight policies (Crossin and Banfield, 2006).
Overall, their approach to political risk still prioritizes risks to operations and investment posed by challenging contexts, while insufficiently addressing the conflict and human rights risks posed by extractive operations themselves. As part of the World Bank, both the IFC and MIGA share its broader mandate to reduce poverty and promote sustainable development. However, as recently as 2006, an internal investigation into a troubled IFC-backed gold mining project in Guatemala found that the IFC had no policy on conflict assessment and failed to take into consideration the local human rights and security impacts of the project. Similarly, MIGA came under intense NGO criticism in 2006 for approving a $13.3 million political risk guarantee to Anvil Mining for a project in the still-volatile Katanga region of the DRC, despite Anvil’s problematic role in an October 2004 massacre by DRC troops and concerns about fiscal improprieties with local authorities (*The World Today*, 2005). As with the IFC, MIGA was faulted for its failure to require companies it supports to conduct rigorous, independent conflict-risk assessments in the screening phase and for failing to undertake due diligence to verify company commitment and capacity to do so meaningfully. Without such conditions, not only do these lenders fail to ensure that the projects they back ‘do no harm’, but – by providing loans irrespective of conflict risk – they perpetuate disincentives for companies to take the necessary steps to avoid exacerbating conflicts.

Largely in response to NGO criticisms, and the World Bank’s own Extractive Industries Review in 2004, both the IFC and MIGA have recently undertaken steps to extend their standards beyond environmental and social risk assessments and to address the conflict and human rights risks posed by extractive companies to the communities in which they operate. The IFC Safeguards and Guidance Notes, for example, were recently amended to explicitly address the security risks associated with extractive projects, in particular by requiring companies to undertake due diligence of security agents they employ. Meanwhile, an audit of MIGA’s due diligence in the Anvil case – and of extractive projects more generally – criticized MIGA’s failure to ensure that the company was actually fulfilling its stated commitment to the Voluntary Principles on Security and Human Rights. The audit also contained a series of useful recommendations to strengthen MIGA standards for security and human rights, for more thorough and reliable diligence at the screening and underwriting stage, and to proactively engage with companies to ensure compliance with these requirements. It remains to be seen whether MIGA will take on these recommendations.

But as some NGOs have noted, despite a long consultative process, the IFC standards fall short of requiring companies to undertake a full-spectrum conflict assessment, including prior consultations with affected communities and the determination of criteria for no-go areas. Nor do they offer clear and verifiable benchmarks for compliance. Given the wide discretion the IFC maintains on implementation, and on what course of action would ensue if a company failed to comply, the IFC standards are still far away from making conflict-risk assessment a hard condition for the provision of World Bank risk
insurance, guarantees and project support (International Alert, 2005, p18). This said, both the revised IFC safeguards and the MIGA recommendations are positive and important first steps to bringing the Bank’s weight to bear on improving the conduct of companies it supports.

As International Alert has stressed, given the size of ECA financing, and given that ECAs are funded by the taxpayer, ECAs should be obliged to ensure that they are underwriting socially responsible trade and investment, particularly where their governments have otherwise strong foreign policy commitments to sustainable development and international security (International Alert, 2005). Overall, however, ECAs have an even weaker profile than the IFIs on promoting sustainable and conflict-sensitive business practice or integrating explicit standards into their lending procedures.

There are numerous case examples of ECA-backed projects that have had negative social and environmental impacts, including those that have fuelled corruption and exacerbated violent conflict. In part this is due to the narrow mandate of ECAs, which is to promote and protect their countries’ trade and investment activities abroad. In a handful of countries, such as Canada, Norway and, to a lesser extent, Switzerland, some steps have been taken to integrate social impacts into their due diligence processes, and to link up ECA activities with broader aid and conflict management policies. In most countries, it is still the case that a company that obtained its concession through rebel groups or corrupt side-payments to host officials, or that routinely employs security staff with poor human rights records, or that disregards community and environmental security, has as good a chance at getting ECA backing as does a company that has signed onto and shows commitment in implementing CSR standards.

Given that ECAs compete with each other much as companies do, however, those undertaking unilateral reform initiatives face losing investment opportunities to less reformist ECAs. As with individual company initiatives, unilateral ECA policies in support of improved sensitivity to non-commercial risks, like instability and conflict, are unlikely to alter conditions on the ground. The much welcomed current review of the OECD Common Approaches for ECAs has some potential to make the guidelines more sensitive to conflict issues, but given the consensual nature of the OECD and its narrow remit on these issues, meaningful change of ECA policies will require additional push and commitment by governments.

**Recommendations: Globalization with governance**

The economic forces that underpin armed conflict are deeply embedded in the prevailing international economic order. As such, addressing conflict-promoting economic activities through improved national governance in affected countries of the developing world, though essential, will accomplish little unless the global regulatory deficit is also addressed. Policy makers seeking to devise regulatory and policy mechanisms to reduce the pernicious,
conflict-promoting effects of commerce confront what some analysts have described as a ‘malign problem structure’. It is a structure that consists of a heterogeneous set of market actors with strong incentives to evade regulation, a lack of empirical and normative consensus as to which activities are legitimate and which illegitimate, competing and ill-defined regulatory jurisdictions and frameworks, and asymmetrical costs and benefits of regulation. The multidimensionality of the problem also means that there is no obvious, single and authoritative international forum or agency that could provide a ‘policy home’ in which diverse initiatives could be brought together (Lunde and Taylor, 2005, pp330–337).

To date governments, particularly those of the developed world, have relied on voluntary codes to address the problem, thereby relying on an ideal of enlightened corporate self-interest that does not yet widely exist. To be sure, company and industry self-regulation have added value by making corporate cultures more sensitive to the reciprocal nature of the risks of doing business in fragile states; by building guidance from best practices; and by building confidence between multiple stakeholders.

However, initiatives like the Voluntary Principles on Security and Human Rights and the Extractive Industry Transparency Initiative cannot remain aspirational: governments, NGOs, the UN and international financial institutions need to ensure that they are backed up by clear criteria for participation, transparent and measurable performance obligations, transparent reporting, independent monitoring and enforceable provisions for suspending or expelling non-complying members. As the case of the Kimberley Process demonstrates, and as the UN Global Compact has learned, doing so would not make them any less voluntary. But it would make them credible.

Given the fiercely competitive nature of the global market for natural resources, it cannot be expected that improved conduct will naturally trickle down from progressive companies to laggards. Indeed, as long as the playing field remains as uneven and ungoverned as it is, there is a greater likelihood of backsliding. These structural impediments are currently exacerbated by two contingent factors. First, the windfalls to host governments from the historically high prices of oil, gas and gold may make them less receptive to undertake needed improvements in the management of their natural resource wealth, whatever incentives or penalties may be proffered.

Second, the increased role in extraction by state-owned companies from non-OECD countries, such as China, whose terms of trade and investment are indifferent to the non-commercial negative impacts on host countries, may erode the position and influence of progressive companies, no matter their current market size and influence. Taken together, these factors underscore the collective action problems that can lead to ‘market failure’ in the provision of peace and sustainable development. They also point to the critical need for improved inter-state frameworks that discourage operations and financial flows that may contribute to or prolong conflict, while also promoting investment that encourages recovery from conflict.
A central impediment to improved global governance of market actors operating and investing in weak and war-torn states is the lack of normative consensus on the sorts of activities that need to be regulated. For some, the controversial history of the aforementioned UN Norms on the Responsibilities of Transnational Corporations might be taken as an object lesson in the difficulty of building such consensus, particularly in the absence of some galvanizing crisis. Arguably, however, what made the UN Norms so problematic was the ambitiousness of their scope and their uncritical inclusion, alongside core rights, of economic and social rights that are still far from being widely accepted by governments, let alone by private sector actors. As such, this debate makes clear the need to begin by focusing on core norms, as embodied in international criminal and humanitarian law and on ratified international conventions. On core issues, such as anti-corruption and transparency, environmental protection, community empowerment and welfare, responsible company security policies and protections against the most egregious violations of human rights, there may in fact be more multi-stakeholder consensus than the critics concede.

This is not to say we should abandon the search for internationally agreed, authoritative standards that can assist governments to govern companies operating in fragile states. In an era of global interdependence, where economic development is led by private sector actors, achieving a universal framework on the rights, responsibilities and liabilities of these actors is an essential and much needed antidote to a global marketplace that is currently too permissive towards the social and human costs of profit. Moreover, the continuing absence of clear norms provides less scrupulous actors a convenient cover for equivocation and evasion. For these reasons, it is imperative that affected communities, NGOs, companies and governments continue to work through the UN, regional organizations, IFIs and other international bodies on building these core norms.

As discussed above, however, mitigating many of the negative impacts of extractive and other companies in the developing world need not await the creation of a brand new framework; progress can be and is being made through the extension and clarification of existing legal and regulatory frameworks and their applicability to market actors, while also improving their implementation and enforcement. Here, there are a variety of practical steps that can and should be taken.

First, more must be done by governments in the developed world to create robust criminal and civil mechanisms to hold companies based in their jurisdictions accountable when found complicit in violations of international humanitarian law, environmental and anti-corruption conventions. The current muscularity of the US Alien Tort Claims Act and of other extraterritorial legal mechanisms elsewhere for providing redress to victims, while holding companies accountable for their actions has proven to be an effective way of signalling to companies and the investment community that they cannot operate with impunity abroad. No less important, these legal actions have helped clarify the legal standards of complicity liability of companies in a way that no international treaty could. States that demur from replicating these legal remedies in their
own jurisdictions may find their home companies being brought to bar in the US or elsewhere and their own sovereignty compromised.

As for improved enforcement of existing treaty obligations, signatory states must ensure meaningful implementation. They must provide adequate resources, not only to strengthen their own capacities to monitor and curtail, for example, private sector complicity, money laundering and bribery, but also to strengthen the same capacities in the developing world. One practical step would be to increase the resources available for the investigation of corrupt practices under the OECD’s 1999 Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the more recent UN Convention against Corruption. Doing so might help to increase the possibility of successful prosecutions of corrupt practices in developing countries by companies headquartered in the developed world, if only by reducing the not unjustified perception in poor countries of double standards on corruption that favour rich countries.

Second, national and international financial institutions that currently set the rules for global economic development need to take far bolder steps to ensure that globalization has truly global benefits. The recent and positive steps of IFI private sector financing arms to address some of the negative environmental, social, human rights and conflict impacts of the companies that they finance need to be given added momentum. Ensuring due diligence of measures to mitigate these impacts is a start but, in the absence of clear benchmarks and sanctions, it is only a start. The provision of project financing should be made conditional on a demonstrable adherence by recipient companies to observe established standards, such as the Voluntary Principles for Security and Human Rights.

At a minimum, companies should be required to undertake conflict and human rights impact assessments and demonstrate due diligence with regard to partners and suppliers. Doing so would provide additional investor leverage over a larger range of companies, particularly state-owned enterprises that seek increased access to shareholder financing. This kind of conditionality could be extended by integrating broader CSR performance requirements into the listing rules of securities and exchange commissions and the assessment criteria of private rating agencies.

IFIs and national export credit agencies need to be guided by policies that effectively link their policies and practices to broader agendas of sustainable development and conflict prevention. This can be promoted through improved intra-agency coordination, both within donor governments and between them and IFIs. Specifically, these critical allies of extractive industry projects in the developing world need to adopt leading standards of conflict risk and human rights impact assessments and make clear that companies that fail to adhere will not receive their risk insurance, guarantees or project finance.

At the same time, these lenders could enhance incentives for compliance by setting up a public ‘white list’ of good performers and rewarding them with preferential terms of lending. As international donors routinely use the services of private banks for the management and disbursement of public monies,
they could create standards by which to ‘white list’ those banks that have demonstrated their adherence to basic transparency standards and integrity safeguards. By giving accredited banks preference in providing financial services to governance and multilateral organizations, such an arrangement would create significant market leverage for improved compliance of private banking institutions with national and international prohibitions against money laundering and terrorist financing. Such white listing could also be applied to the selection criteria of government procurement programs.39

There is much that extractive companies can and should do to make their financial and operational activities truly conflict sensitive. Alone, however, even successful company efforts can do little to alter the conduct of less scrupulous competitors, let alone improve the security and welfare of citizens of fragile states. Achieving these outcomes requires more dedicated government action. Even in a highly globalized world, where non-state actors – be they NGOs, corporations, or criminal and terrorist networks – have greater influence than ever before, national governments remain the essential sources of power, legitimacy and influence. This is particularly true of governments in the developed world, whose countries are the chief consumers of the world’s natural resources. For too long, these governments, even those otherwise committed to sustainable development, the protection of human rights and the prevention and resolution of violent conflict, have hidden behind the corporate veil, behind sovereignty, behind flaccid inter-governmental processes, and behind company assurances that they are doing well and doing good. Fostering demand for improved business conduct in fragile states is the responsibility of governments. On an uneven playing field, they remain the only authoritative referees.

Notes

1 For analysis of the conditions that facilitate investment to promote economic growth, employment and other benefits, see Dollar et al (2004).
2 Nigeria has earned $300 billion in oil revenues over the last 25 years, yet per capita income remains below $1 per day (Gary and Karl, 2004).
3 In 2004, Africa’s share of global FDI inflows was 3 per cent; most of these inflows were in natural resource exploitation (UNCTAD, 2005).
4 The concept of ‘fragile state’ has various definitions. Core features include: loss of territorial control, low administrative capacity to provide basic security and public goods, neo-patrimonial politics, arbitrary and repressive rule, and weak legitimacy. For a fuller discussion see Torres and Anderson (2004).
5 Twenty-five per cent of China’s current oil imports come from African countries, notably Algeria, Angola, Chad and Sudan, and increasing stakes in Equatorial Guinea, Gabon and Nigeria (Bajpaee, 2005).
6 A recent survey by the UN Special Representative on Business and Human Rights notes that of 65 cases of alleged company misconduct regarding human rights in 27 countries, two thirds involved oil, gas and mining companies, all concerned low and low-middle income countries, all of which scored poorly on standard
indicators of good governance, and two thirds of which were experiencing violent conflict or emerging from it. As the survey was based on recent NGO reports, and may have selection bias, it is broadly suggestive of the salience of the problematic impacts of the extractive sector in weak and war-torn states. See ‘Promotion and protection of human rights: Interim report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises’, 22 February 2006, E/CN.4/2006/97, p8.


8 See, for example, the controversy stemming from payments made by Freeport-McMoran to the Indonesian military (Global Witness, 2005).


10 Elf played a similar role supporting contending factions in Angola. See Elf Indictment, p84 (Global Witness, 2004a).

11 For further analysis of the developmental consequences of the resource curse, see Karl (1997). In the context of fragile and war-torn states, see Ganesan and Vines (2004).

12 For discussion of these conceptual issues, see also Goredema (2002).

13 For example, the UN Global Compact’s Dialogue on the Private Sector in Conflict Zones. See www.un.globalcompact.org

14 For a comparative survey of company performance on revenue transparency, see Save the Children UK (2005).

15 Ironically, too, those who do sign on to CSR codes are often subject to a higher level of continued scrutiny and criticism than those who do not.


17 In the case of Sudan, allegations of complicity in war crimes and crimes against humanity led Talisman Energy to divest its share in a controversial pipeline joint venture with the Khartoum government. This share was subsequently snapped up by the Indian state-owned oil company, with little perceptible change in the security situation faced by southern Sudanese. See also French, 2004. Indeed, in a recent transparency ranking of oil and gas companies, Chinese and Malaysian state-owned companies ranked lowest. See Save the Children UK (2005).

18 Confidential interview by the author.

19 Thus far, the VPs have also failed to establish clear and enforceable membership, performance and reporting requirements for participating companies. See Amnesty International (2006).

20 The Compact’s new governance framework and integrity measures can be found at www.globalcompact.org

21 For example, since 2003 the EITI has been endorsed by 14 countries and implemented by eight countries. See www.eitransparency.org


23 See www.oecdwatch.org, and www.ohchr.org
24 See the case study of the case brought against Elf Aquitaine in Open Society Justice Initiative (2005). This report also notes that 36 per cent of all the US Securities and Exchange Commission enforcement actions under the Foreign Corrupt Practices Act since 1977 have involved bribery related to natural resource extraction.

25 These include the UN Convention against Corruption, the OECD’s 1999 Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, and various domestic laws, such as the US Foreign Corrupt Practices Act.

26 According to a study conducted by US law firm Shearman and Sterling, the number of criminal and civil investigations for potential violations of the US Foreign Corrupt Practices Act has risen from 7 in 2002 to 16 in 2004. Criminal prosecutions are still rare and none have yet been brought against US companies operating in foreign jurisdictions (Open Society Justice Initiative, 2005).

27 For a discussion, see Schabas (2005), pp427–428.


30 For example, though established in 2000, the Voluntary Principles on Security and Human Rights had not developed beyond the declaratory stage until 2004–5. See www.voluntaryprinciples.org. For a sample of such protests, see company testimonies critical of the UN Draft Norms on The Responsibilities of Transnational Corporations and Other Business Enterprises With Regard to Human Rights at www.ohchr.org.

31 For more, visit www.kimberleyprocess.com


33 In response to the ongoing slaughter in Darfur, several US states adopted legislation that prohibits pension funds from supporting any company with an investment connection in Sudan. In so doing, they have closed a loophole by which some US companies have sidestepped the 1997 US sanctions against direct US company investment. ‘How states are aiming to keep dollars out of Sudan’, New York Times, 29 February 2006.

34 Post-conflict support makes up approximately 13 per cent of MIGA’s portfolio, and between 1988 and 2003 it issued 56 guarantees worth $1.5 billion for investments in 16 conflict-affected countries. For the year ending 30 June 2005, MIGA supported 12 projects in conflict-affected countries, including its first project in the DRC (MIGA, 2005, Annual Report, www.miga.org). According to Gary and Karl, ‘The amount of investment that ECAs support globally is significantly greater than the total amount of lending from the World Bank, IMF, and other multilateral institutions combined, according to the IMF. In 1998, ECAs supported exports totalling $391 billion or eight percent of total world exports. Export credit agencies have been instrumental backers of extractive industry projects in developing countries, including oil projects in Africa’ (Gary and Karl, 2004, p21). Every dollar provided or supported by an ECA can attract two or more dollars of purely private financing (Maurer and Bhandari, 2000, p4).
35 The IFC safeguard policies were created to address social and environmental risks in co-financed development projects in high-risk settings. They have become internationally recognized benchmarks and were subsequently integrated into the Equator Principles.


38 See, for example, the official complaint to the IFC’s Compliance Advisor/Ombudsman regarding the Baku–Tbilisi–Ceyhan (BTC) Main Oil Export pipeline project, CEE (Central and Eastern European) Bankwatch (2004), www.bankwatch.org.

39 For further elaboration of this recommendation, see Winer (2003).

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