Philip Swanson

Fuelling Conflicts

The Oil Industry and Armed Conflict

Economies of Conflict: Private Sector Activity in Armed Conflict

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Preface

Oil companies investing in a developing country adopt a position of political neutrality, at least formally. Yet, in civil wars, governments and ruling elites – particularly in the developing world, where the bulk of new reserves are to be found – depend upon oil to finance their war-fighting capacity.

Do their long-term investment and production cycles mean that oil companies view armed conflict simply as a cost of doing business? The increasing attention paid to corporate social responsibility suggests that this poses an important challenge for the industry: Is it possible to invest or operate in countries experiencing armed conflict and to avoid complicity in that conflict? What constitutes complicity in such situations?

This report explores the relationship between oil and armed conflict. It was commissioned by Fafo's Programme for International Co-operation and Conflict Resolution (PICCR) as part of a research project entitled *Economies of Conflict*. The project examines the links between certain private sector activity and armed conflict, focusing on the question, How does certain private sector activity help sustain armed conflict and what can be done about it?

The objective of *Economies of Conflict* is to contribute to policy and practice in the private, public and NGO sectors. As with past PICCR projects, we have chosen an inductive approach, seeking to contribute to these arenas through an analysis of experience and lessons-learned. To this end, we have commissioned studies from practitioners and researchers with a keen sense of what has worked – and what has not worked – in practice. This has been made possible by the financial support provided to *Economies of Conflict* by the Government of Norway, for which we are grateful. Thanks also to officials of Norway's foreign ministry who have shown particular leadership on this issue.

The significance of the oil and gas industry for Norway, and the leadership that Norway has shown in the areas of conflict resolution and corporate social responsibility, come together in this report. Nonetheless, the issues raised below demand the attention of the industry as a whole, as well as home and host governments around the world. My thanks to Philip Swanson, the author of this report, for his analysis of the oil and gas industry, armed conflict and the implications for corporate social responsibility. Of course, the views and recommendations expressed in this report are those of the author alone and do not necessarily reflect the views of Norway, its Government or officials, or Fafo.

Mark Taylor
Programme Director, PICCR
Series Editor – Economies of Conflict

Executive Summary

This report examines how oil and gas industry activities in developing countries may contribute to or help perpetuate such conflicts. It emphasises the dynamics that can occur even when oil companies may be attempting to be good "corporate citizens".

Oil, States and Armed Conflict

Some 70% of world oil production currently takes place outside OECD countries, and over 40% outside either the OECD or the Middle East. Investments by major oil companies can contribute significantly to the GDP and government revenues of oil-rich developing countries. However, large investments in natural resource exploitation and export also tend to give rise to a number of negative dynamics in the economy, government and society of the host country. Even if unintended, these dynamics can be very powerful, with consequences for social stability.

Governments typically receive oil wealth via several different routes, including bonuses, royalty payments and income tax. In many cases, a combination of these payment methods is used. Together they can be used to obscure the direction and volume of oil revenue flows. Taxes and other payments related to resource extraction and export by international oil companies often account for well over half of government revenues in oil-rich developing countries. Access to large and relatively easy petroleum revenues can give host governments a false sense of economic security that undermines the need for responsible economic and fiscal management.

A large influx of easy oil revenue into a non-transparent system invites corruption, in turn creating incentives to further limit transparency and accountability. Under such conditions, much oil wealth apparently has disappeared into off-budget accounts. Such "looting" of a country's natural resources by its governing elites can provide the incentive and means to remain in power.

Given a regime's dependence upon oil revenues for its power, any threat to such revenues is likely to be met with significant resistance. In the short term, host governments will be concerned about any cut in the flow of oil, which effectively represents a cut in government revenue. In the longer term, oil-dependent governments are concerned about the willingness of international oil companies to remain in the country. In some cases, the desire to maintain security for oil extraction may lead to the brutal treatment of those opposed to such operations.

Whether or not the dynamics suggested are fully or even partly responsible for government violence towards its population in a particular case, large oil revenues at least provide the means for a government disposed toward violence to carry out such activities with relative impunity. A government's willingness to resort to the use of force to protect its continued access to oil revenues is likely to be reinforced by an increasing estrangement between the government and its citizens. In fact, oil wealth tends to reduce a government's dependence upon its citizens – corporate or individual – for tax revenues. When a government depends less on its own citizens for its revenue, it may become less accountable and may depend less upon them for its legitimacy.

Oil company operations can create or exacerbate tensions between the central government and oil-producing regions, especially if a disproportionate share of benefits is seen to accrue to the former and a disproportionate share of costs to the latter. Tensions can also arise if the region feels that the central government's share of oil revenue is "unfairly" large.

Armed Conflict and the Company

Most international oil companies have taken a "neutral" stance on the nature of host-country regimes, noting that companies should not get involved in politics. A number of NGOs have pointed out that large economic investments provide economic and political comfort to host countries, including *de facto* "recognition" of rogue regimes.

Violence associated with oil company operations most often results from the use of force by government security forces against local protesters who opposed oil industry operations. A number of NGOs, as well as missions by the UN and various oil company "home" country governments have reported numerous allegations of violent human rights abuses committed by government forces in and around oil producing regions in a number of countries. However, the secrecy surrounding security arrangements that many international oil companies have concluded with host governments makes it difficult to assess company complicity in such activity.

There are also documented cases of human rights abuses by oil company security forces or by the private forces hired by the oil companies. However, such cases usually are more clear-cut regarding oil company blame. Hopefully, they will also be the easiest abuses to avoid in future, since the oil companies presumably have more control over their own forces.

A number of oil companies have been accused of providing logistical assistance to government military campaigns against political or ethnic oppositions. Common accusations are that companies have allowed militaries to use airstrips, helicopters, roads and other oil company infrastructure for offensive military purposes. In some cases host governments even appear to be using oil company security as a cover for waging military campaigns against political or ethnic enemies. Some of the most serious accusations levelled against international oil companies have involved direct or indirect assistance in procuring weapons for host country governments, and in some cases even for rebel groups.

For the oil companies, the direct effects of armed conflict are similar to those on other industries, e.g., threats to personnel, installations and supply lines, with the related costs of protecting each of these aspects of the business. However, once conflict erupts in a particular region, it usually will be significantly more expensive for oil companies to abandon their activities than it will be for most other investors. This is due to the large and long-term nature of oil company investments, as well as the location-specific nature of natural resources.

Oil companies may assume that their operations will be relatively shielded from civil conflict, in some cases by all parties to the conflict. Due to the large potential revenues that their oil extraction represents, it is not in the parties' interest to permit armed conflict to devastate oil company investments. For a company already heavily invested, a cost-benefit analysis may indicate that the profit from oil extraction could out-weigh the economic costs of doing business in a conflict zone. For some companies, armed conflict may be almost a cost of doing business.

One of the most important negative effects of conflict on an oil company now takes place in the product and capital markets of the developed world. The threat to company reputation can have negative impacts on profits, share prices and the ability to raise capital. Oil companies with easily identifiable brand names at the service station pump are ultimately vulnerable to the sort of boycott campaigns that already have threatened companies in some other industries. Companies also may be increasingly susceptible to shareholder activism, especially by large institutional investors such as pension funds, many of which have adopted codes of conduct.

Policy Options and Instruments

Because oil companies often provide a large portion of host country budgets, they are among the few entities with potential leverage over such governments. This is why some observers see oil companies as potential agents for positive change. However, oil companies face a possible loss of competitive advantage in the event that a host government decides to punish a company for taking a stand on human rights issues by rewarding one of its industry competitors. It is conceivable that a coalition of companies could form a "united front" for policy reform. However, in such a case these companies still could face non-cooperation from the growing number of technically proficient oil companies from developing countries that currently are not under the same Corporate Social Responsibility (CSR) pressures from NGOs, customers and shareholders.

Transparency

One of the main enabling factors for corruption and diversion of funds to off-budget military expenditures in host countries is lack of financial transparency. A key finding of this study is that a major area for policy focus should be on increasing the transparency of payments by oil companies to host governments. This would make it easier for host country citizenry to achieve a better understanding of the amount of money actually received from the development of their natural resources and to hold their governments accountable on this basis. *Oil companies should be required to make a full public accounting of their payments to individual host countries.*

In many cases of alleged violence by government security troops, the foreign oil companies involved have either denied knowledge of abuses or insisted that the actions were not approved by the company. However, it is often impossible to assess company complicity, or to say whether governments have acted outside security agreements, since such agreements usually are secret. *Companies should commit themselves to making public their security agreements with host countries.*

Given the impact of local violence on the security of oil company staff and operations, it would seem to be in companies' best interests to pay more attention to such issues. It seems highly unlikely that companies are not already performing various risk assessments and assessments of the political or security situation. *Companies should publicly commit themselves to performing systematic risk assessments based on those suggested in the Voluntary Principles on Security and Human Rights.*

Policy Instruments

Companies would seem to have a significant market incentive to respond to or avoid NGO criticism, because negative publicity can damage their image with consumers and shareholders. A major drawback with NGO pressure, however, is that it does not seem to be applied evenly to all companies. NGOs have targeted those companies they perceive to be most likely to respond to their criticism. The absences or ineffectiveness of pressure by NGOs is especially evident when it comes to the large, technically proficient *non*-OECD oil companies that are offering increasingly credible competition to the majors in developing countries. Many of these currently face comparatively little pressure from their customers and shareholders to address CSR issues, thus giving NGOs little leverage to affect them commercially.

Voluntary codes of conduct have become an important tool for companies to demonstrate support for particular social principles. However, experience from other industries indicates that codes developed by companies or industry associations in isolation often lack legitimacy vis-à-vis outside observers. Governments could play a role in bringing together industry actors and NGOs to work out codes that various parties find acceptable (e.g. the negotiations to establish the "Voluntary Principles on Security and Human Rights").

Collective action by oil companies may also benefit from the "sponsorship" of a respected international body, such as the UN or the World Bank. Governments and the oil industry should recognise the value of multilateral institutions such as the United Nations or the World Bank in helping to manage collective action problems and reputational risk. Government and private sector partnerships with multilateral institutions must reflect the international norms and law that these institutions embody.

One approach to stimulate companies to provide more information or to implement other desired policies would be to make these provisions or policies a requirement for receiving certain services provided by or regulated by government. There has been discussion in some countries about expanding criteria for environmental conditionality, already in place in some OECD countries, to include stricter requirements regarding transparency and accountability of payments. There has already been some work to co-ordinate action in this area among OECD governments. As an issue for multilateral negotiation, the transparency of payments by international oil companies to foreign governments may lend itself to the existing negotiating framework, along the lines of the OECD anti-bribery convention. Similarly, stock market listings are in many cases regulated by states, giving governments scope for imposing conditions in this area. A major criticism of conditions on stock market listings is that they could inadvertently punish the financial centres that impose them. However, this collective action problem could be solved by co-ordinated action to introduce harmonised legislation in the world's major financial centres. Governments should consider the development of mechanisms of positive conditionality in support of stricter requirements regarding transparency and accountability of payments.

1 Oil, States and Armed Conflict

The statistical impact of primary commodity export dependence
According to research carried out by Paul Collier and Anke Hoeffler, the most "dangerous" level of primary commodity export dependence is about 26% of GDP, at which point the risk of a civil conflict occurring in the "ordinary" country within the proceeding five years becomes 23%, as opposed to only 0.5% for an identical country without primary commodity exports. (Collier, June 2000, p. 6)

Some 70% of world oil production currently takes place outside OECD countries, and over 40% outside either the OECD or the Middle East. The heavy presence of the international oil and gas industry in developing countries is due to the natural distribution of resources, as well as the fact that most OECD countries already have been heavily explored and most of the large deposits there already discovered and developed. The implication is that most large new finds will be in the developing world.

A number of recent high profile events have highlighted the link between the petroleum industry and conflict in developing countries. These include the 1995 execution of Ken Saro-Wiwa and other Ogoni activists in Nigeria, the continuing violent displacement of minorities in Sudan and Burma, the ongoing civil war in Angola, and guerrilla activity around oil installations in Colombia.

Investments by major oil companies can contribute significantly to the GDP and government revenues of oil-rich developing countries. However, large investments in natural resource exploitation and export also tend to give rise to a number of negative dynamics in the economy, government and society of the host country. Even if unintended, these dynamics can be very powerful, with consequences for social stability.

According to the World Bank project on "The Economics of Civil Wars, Crime and Violence", the largest risk factor associated with civil conflict was found to be significant reliance on primary commodity exports (see box). This chapter examines some of the dynamics that may be behind this finding.

1.1 Governance

It is not unusual for taxes and other payments related to resource extraction and export by international oil companies to account for well over half of government revenues in an oil-rich developing country. For example, oil has accounted for about 80% of the Nigerian government's budget, while in Angola its contribution has fluctuated between 70 – 90%.

Access to large and relatively easy petroleum revenues can give governments a false sense of economic security that undermines the need for responsible economic and fiscal management, not least for the pursuit of policies to combat "Dutch disease" (see box). As pointed out by Terry Lynn Karl in *The Paradox of Plenty*, the access to easy oil wealth can undermine efforts to mobilise resources in other sectors of the economy. This is because the relative ease of collecting large revenues from oil production makes the more difficult collection of relatively small revenues in other sectors hardly seem worth the effort.[1]

According to Karl, states that are already well developed in terms of legitimacy and administrative competency before the onset of oil wealth (e.g., Norway and to some extent Indonesia) have a better chance of avoiding the worst effects of "Dutch disease" and the corrupting influences of oil wealth.[2] Unfortunately, most oil-rich developing countries have not been in this category.

Since oil revenues usually eliminate the need to borrow money from the International Monetary Fund (IMF), the government is also likely to avoid the more basic reforms and technical assistance prescribed by that institution as conditions for its loans. One of the basic reforms often avoided is increased transparency of government accounts.

Governments typically receive oil wealth via several different routes, including bonuses, royalty payments and income tax. Bonuses are lump sum payments made at different stages of the project. For example, a signing bonus (often in the tens of millions of dollars) is typically made at the beginning of a project, though rarely in OECD countries. Additional payments may be made according to a time schedule, or upon the achievement of certain milestones, such as a particular production level. Bonus figures are rarely made public. This can make it difficult to confirm that the full amount has passed through the state treasury or has been accounted for in a government's budget.

[1] Once the government no longer has a need to collect revenue in the non-oil sectors, it also may have less incentive to invest in them. It is interesting to note that spending on social services such as health and education did not increase remarkably following oil booms in Nigeria, Iran, Algeria and Angola. Moreover, these expenditure items have tended to suffer disproportionately during oil price busts, when repayment of government debt has had to take up a signficant portion of government revenues.

[2] Karl, p. 213.

"Dutch disease"

A number of economic effects can take place in an economy where significant investments have been made in natural resources intended for export. Collectively, they are usually referred to as "Dutch disease", after the economic problems faced by the Netherlands following the development of that country's large gas fields in the 1960s and '70s. The typically large investments involved in petroleum development, followed by increased government spending of petroleum revenues, tend to drive up prices for services and inputs in the economy, undermining the competitiveness of other export-oriented businesses. They also lead to an appreciation of the local currency, which penalises non-commodity exporters, as well as manufacturers of goods competing against imported products.

Given the increased dependence on the exported natural resource, the economy also becomes subject to severe cycles of boom and bust related to the changing world price of that commodity. Historically, most governments of oil-rich developing countries have been unable to resist significant spending increases in boom periods, often supplemented by borrowing on the security of future revenues. Since it becomes politically difficult to curtail a high level of spending, such governments typically have developed heavy debt problems, especially once oil prices have fallen.

Short of not investing, or forcing the government to institute tough economic countermeasures, there may not be much an oil company actually can do to help a developing country's economy avoid "Dutch disease". Avoidance depends on a considerable political and administrative effort on the part of the government to adopt appropriate economic policies. Such policies could include programmes to diversify or maintain diversity in the economy, e.g., tax and other incentives to non-oil traded goods sectors, and the promotion of private investment in such sectors; careful budget and public investment planning to account for volatility in oil revenues; and improved revenue collection, especially in the non-oil sectors. Implementation of such policies in the face of a natural resource boom has proven a political and administrative challenge even for economically advanced countries such as the Netherlands and Norway.

Royalty payments are calculated in different ways, but are generally figured as a percentage of oil production. They are paid by the oil company in oil (in which case the company may assist the government in marketing the oil) or in the monetary equivalent of that oil. The government may instruct the company to make royalty payments into foreign accounts. A variation of this is that the government's oil is used as collateral for commercial loans. For example, western banks have set up two trust funds for the Angolan government to facilitate foreign loan repayments. It is arguable that payments by oil companies into offshore accounts for loan repayment or other purposes contradict good governance practices, as they may circumvent the national budget, which such payments appear to do in many cases.

Corporate income tax is generally the most straightforward and transparent payment by a company, in that it usually goes directly into the government's budget. However, the amount of income tax imposed depends on the government's rules

Fiscal Governance Case Study: Angola

It is relatively rare to gain insights into the finances of a petrol state. However, the World Bank and IMF were recently presented with just such an opportunity.

Despite Angola's oil wealth, the government has had to borrow heavily on international markets, preferring to avoid IMF financing, presumably due to the governance conditions attached to such loans. A significant amount of future oil revenue has been used as collateral. This debt burden, compounded by mismanagement, corruption, the civil war and low oil prices, apparently eventually gave the Angolan government an incentive to work with the World Bank and IMF.

In April 2000 the IMF and the Angolan government agreed on a Staff Monitoring Agreement, which set financial, fiscal and reform targets that the government must achieve in order to qualify for loans under the Enhanced Structural Adjustment Facility. This Agreement included an "Oil Diagnostic" programme to monitor the government's oil revenues between July-December 2000, by comparing export, tax and other earnings from oil activities with deposits into the Central Bank of Angola. The programme's limited scope means that it was not able to investigate discrepancies found, nor monitor how income was spent. The programme also had to rely on the information that the Angolan government and the international oil companies were willing to supply.

Co-operation has been limited, and it remains to be seen whether the government will continue even this limited co-operation in a context of higher oil prices. Nonetheless, information emerging from the programme suggests that some US$ 1.4 billion, or about one third of state income, appears to be unaccounted for in the year 2000. (Reuters, 12 December 2001, reported by Global Witness press release of 13 December 2001).

for calculating income and on how it decides to receive its oil rent. For example, if the government prefers to receive most of its money offshore, it could decide to take most of its payment in the form of royalties, compensating the company with fairly lenient tax rules regarding the deductions (of business expenses, etc.), effectively reducing the amount of income the government receives in the form of income tax payable via the budget.

In many cases, a combination of these payment methods is used. Together they can be used to obscure the direction and volume of oil revenue flows. A large influx of easy oil revenue into a non-transparent system invites corruption, in turn creating incentives to further limit transparency and accountability. Under such conditions, much oil wealth allegedly has disappeared into off-budgetary accounts. For example, according to Le Billon, Angolan military expenditures "paid from public budget allocation, oil-collateral short term commercial loans passed directly through Sonangol (the state oil company) and signature bonuses…not only served security interests but provided considerable corruption opportunities".[3]

A number of NGOs, such as Global Witness and Transparency International, have criticised oil companies for reinforcing the trend towards non-transparency. By refusing to publish details of their payments to host governments, oil companies help to conceal payments to accounts that never show up in official government budgets. There is undoubtedly strong pressure from host governments to continue such practices. For example, when BP announced its intention to make public its various payments to the Angolan government, the Dos Santos regime reportedly threatened the company with the loss of its concessions.[4]

1.2 The Security Rationale

As noted above, oil-rich developing countries tend to become increasingly dependent upon oil revenues for their income. As a result, the governments tend to become very concerned about any threat to what can be effectively their main source of power. In the short term, they will be concerned about any cut in the flow of oil. For example, the Nigerian authorities require oil companies to inform them immediately of any difficulties that could substantially affect oil production or transportation, whether such impediment is technical or related to sabotage.

In the longer term, oil-dependent governments are concerned about the willingness of international oil companies to remain in the country. Chevron left Sudan

[3] Le Billon (2001a).

[4] IPA (April 2001), p. 8.

in 1990 after attacks on its personnel and facilities by rebel groups. The Sudanese government understandably has been eager to avoid a similar departure by other foreign companies. This desire may have contributed to the government's brutal treatment of non-Arab minorities associated with the rebels in the country's oil producing South (Ironically, Sudan's overzealous attempt to provide security could make it *more* difficult for some companies to remain in the country, since security abuses by the government make the companies less secure vis-à-vis their NGO critics.)

In some cases, security concerns, real or fabricated, can be convenient for a government if they help to justify increased spending on security that the government wishes to pursue anyway, e.g., to protect itself from groups laying claim to the country's oil wealth or protesting at a lack of practical benefit from that wealth. A war or important security threat also provides a convenient domestic political explanation for the lack of material benefits enjoyed by the population, particularly for regimes under which oil wealth has been siphoned off to the accounts of political elites. Security threats also could justify repressive measures that would not be tolerated during peace time.

Whether or not the dynamics suggested above are fully or even partly responsible for government violence towards its population in a particular case, large oil revenues at least provide the means for a government disposed toward violence to carry out such activities.

The military government of Sudan, for example, which has been conducting a campaign of forced dislocation against ethnic minorities living in its oil producing south, has at times been rather open about the link between oil revenues and military capability. For example, the government's military spokesman, General Mohamed Yassin, has been reported as saying, "Sudan will be capable of producing all the weapons it needs thanks to the growing oil industry".[6] An official Canadian government assessment mission to Sudan similarly commented that it is "difficult to imagine a cease-fire while oil extracting continues, and almost impossible to do so if revenue keeps flowing to…the government of Sudan as currently arranged."[7] Similar comments have been made by observers about the role of oil revenues in supporting the civil war in Angola.[8]

[6] *Al-Share Al-Siyassi* 1 July 2000, as quoted in Christian Aid (2000).

[7] Harker (2000).

[8] See, e.g., *A Crude Awakening*, Global Witness.

1.3 Legitimacy and Civil Conflict

An increased dependence upon oil revenues tends to reduce a government's dependence upon its citizens – corporate or individual – for tax revenues. When a government depends less on its own citizens for its revenue, it also may depend less on them for its legitimacy. In extreme cases, a government might eventually feel it has little need for its people at all, seeing them only as a potentially restive force against which it must protect itself and its access to its main source of revenue. This is arguably the trend in Angola, where Global Witness has commented that the "well being of the population appears no longer to be a matter of priority for Government".[9]

In addition, oil company operations can create tensions or exacerbate existing ones between the central government and oil-producing regions, especially if a disproportionate share of benefits is seen to accrue to the former and a disproportionate share of costs to the latter. According to Ross, common local costs or grievances related to natural resource exploitation include "unfair" expropriation of land, fouling of drinking water, arable land and fishing grounds, and social disruptions from rapid labour migrations. In response to protests against such grievances, the government may station ill-disciplined troops in the region, adding yet another grievance.[10]

Often, a tendency in many states towards the imposition of central control at the expense of the region can generate tensions even before oil wealth enters the picture. This trend can be exacerbated by the existence of large oil revenues, which provide both an incentive and the means for the central government to increase its control. For example, the Muslim Arab-dominated government of Sudan has tightened its grip over the oil-producing South of the country by forcibly removing non-Arab Christian and animist tribes that historically have opposed its rule. Even in Nigeria, which has a federal structure, very little oil revenue is returned to the main producing region, which, after several decades of oil production, remains poorer than the national average. Human Rights Watch notes that the "anger at the inequities attributed to the oil economy [in Nigeria] has led increasing numbers of people from the communities in the oil regions to protest the exploitation of what they see as 'their' oil…without benefit to them or compensation for the damage done to their livelihoods." Such protest usually has met with harsh response from the government, including the highly publicised 1995 execution of Ken Saro-Wiwa and other leaders of the Movement for the Survival of the Ogoni People.[11]

[9] Global Witness (1999).

[10] Ross (May 2001).

[11] Human Rights Watch (1999).

Tensions can also arise if the region feels that the central government's share of oil revenue is "unfairly" large. Whether or not this or other grievances are real or imagined, disagreement over distribution of oil wealth can undermine the legitimacy of the central government. At the same time, the possibility of keeping all revenues in the region provides a strong temptation for local governments or movements to seek secession or for rebel groups to form. Examples of such separatist movements in oil and gas provinces include Cabinda in Angola, Aceh in Indonesia and Biafra in Nigeria. Indeed, some central governments may be reluctant to provide significant revenue flow to the oil-producing region precisely because they wish to reduce the opportunity for such aspirations to tap into new resources.

1.4 Sustaining Armed Rebellion

Collier concludes that grievances alone are not likely to transform a political dispute into an armed conflict. The deciding factor is the ability of the rebel group to sustain itself financially. He found this to be significantly dependent upon the feasibility of natural resource predation (especially after the end of the Cold War and the evaporation of ideologically motivated funding for rebel groups). Collier states that most rebellions "either have the objective of natural resource predation or are critically dependent upon natural resource predation in order to pursue other objectives".[12]

Oil extraction activities present a convenient and tempting target for predation by rebel groups for two main reasons: the extremely large revenues they generate, and the vulnerability of their location-specific and often remote extraction and transportation infrastructure.

Armed groups can seek revenues from oil companies in a number of ways, e.g., in the form of protection money and of ransoms for kidnapped employees. Such transactions have been relatively common in Colombia, where armed groups have frequently reinforced their threats by attacks upon oil transportation infrastructure. Kidnappings of oil workers also have occurred with some frequency in Nigeria.

Armed groups may also seek to replace the government eventually as the main beneficiary of "legitimate" oil revenues, either by removing it or by leading a secession of an oil-rich region (see also the discussion of the exacerbation of regional tensions, above.) According to Human Rights Watch, the struggle for the control

[12] Collier (June 2000), p. 20. See also World Bank Project on the Economics of Civil Wars, Crime and Violence (http://www.worldbank.org/research/conflict/).

of oil revenues among different factions of the elite has been a factor in the succession of military governments in Nigeria.[13] According to Amnesty International, the drive for territorial control over the oilfields in Sudan is "central to the war between the government and armed opposition forces, as well as the ongoing conflict between the various militia factions." Many key opposition leaders have stated at one time or another that one of their main military objective has been to control oil rich areas.[14] Christian Aid points out that although the long-running civil war in Sudan was not originally caused by oil, oil-related revenues and the goal of eventually controlling them has raised the conflict into a "new league".[15]

Armed struggle for both "legitimate" and "illegitimate"[16] oil revenues is probably more likely to occur where the opposition does not feel it has recourse to democratic means of attaining power. Unfortunately, the dynamics of significant oil wealth appear to reinforce rather than diminish the undemocratic character of politically weak regimes.

Like "Dutch disease" and the other negative phenomena mentioned earlier, armed rebel groups are not something international oil companies wish to promote in their host countries. Like these other effects, however, their occurrence can be related to oil company investment in countries where the state is already politically and administratively weak.

[13] Human Rights Watch (1999).

[14] Amnesty International (May 2000), p. 8.

[15] Christian Aid (2000).

[16] Collier refers to rebel predation as "just illegal taxation", while noting that taxes going only to a political elite might be called "legal predation". Collier (June 2000), p. 9.

2 Armed Conflict and the Company

The direct effects of conflict on oil companies are similar to those on other industries, e.g., threats to personnel, installations and supply lines, with the related costs of protecting each of these aspects of the business. However, once conflict erupts in a particular region, it is often significantly more expensive for oil companies to abandon their activities than it is for most other industries (e.g., manufacturers). This is due to the large and long-term nature of oil company investments, including in production, support infrastructure and pipelines. It is also because natural resources are location-specific, meaning operations cannot simply be moved to another region or country that is less exposed to the conflict. These factors help explain why oil and gas companies are often the last to remain in conflict regions that other investors have fled.

The nature of the oil business, then, implies that oil companies should have a greater interest in preventing conflict than many other industries. However, oil companies know that protection of their facilities will be a priority for the host government, since such facilities supply an important part of government revenues. Similarly, because armed opposition groups may hope to eventually profit from "legitimate" oil revenues once they come to power (as opposed to "illegitimate" revenues such as protection payments and kidnapping ransoms), in most cases they have been careful not to inflict damage or demands beyond a threshold that would make oil company activities uneconomical. In other words, oil companies may assume that their operations will be relatively shielded from conflict, in some cases by both sides. Due to the large revenues and potential revenues that their activities represent, it is usually in no one's interest to permit armed conflict to devastate oil company investments.

Finally, the profit from oil extraction may simply out-weigh the costs of doing business in a conflict zone. Depending on local production costs, which can vary greatly according to geology and other factors, the profits to be made from oil extraction often are great enough to compensate even for regular damage to facilities. For example, expected profits from oil extraction in Colombia evidently have been judged sufficient to compensate for rebel activities that effectively have become a "cost of doing business". In a survey of managers overseeing company operations in regions of armed conflict Jonathan Berman notes, "though few MNC managers would admit as much, terroristic (sic) conflict is a widely tolerated risk".[17] Some may even see their ability to operate in these environments as their comparative advantage, not least because reduced conflict could bring more competition from less experienced rivals.

One of the most important negative effects of conflict on an oil company does not occur in the countries where conflict is taking place, but in the product and capital markets of the developed world. This is the threat to company reputation, which in turn can have negative impacts on profits, share prices and the ability to raise capital. Oil companies with easily identifiable brand names at the service station pump are vulnerable to the sort of boycott campaigns that already have threatened companies in other industries, such as clothing and footwear. For example, Shell was threatened with boycotts in response to the heavy-handed measures the Nigerian government took against the activists that protested the company's activities. Another example is the way Talisman Energy's share price fell in response to a Canadian government investigation into the link between Talisman's activities and the violence perpetrated by the Sudan government against those living near the company's concession. In this way, companies may be increasingly susceptible to the growing use of codes of conduct by large institutional investors, such as pension funds. Such investors deal in large blocks of shares and could have a significant impact on share value (see below).

2.1 Collective action problems

Oil companies often provide a large portion of host country budgets and in doing so they join a small group of entities with potential political leverage over such governments. This is why some observers see oil companies as potential agents for positive change.

In practice, such political clout is not always easy to bring to bear. Even if a particular oil company wanted to pressure a government to institute better policies, or, for example, to force it to negotiate more constructively with an armed opposition group, it would have several difficulties. The company could face a loss of competitive advantage if the government decided to punish it and reward one of its competitors that did not make such demands. A related difficulty is the so-called "free-rider" effect, whereby other companies will have little incentive to co-operate with the company that is trying to influence the host government if they feel they could benefit from the outcome without taking the risk of contributing to it.

[17] Berman (2000).

It is conceivable that a coalition of larger companies could form a united front for policy reform *vis-à-vis* one or more host governments. However, these companies could still face non-cooperation from the growing number of technically proficient oil companies from developing countries, principally China and Malaysia, which currently are not under the same pressures from NGOs, customers and shareholders to pursue policies of "corporate social responsibility" (CSR).

Another problem for oil companies is that it probably is easier to calculate the cost of operating under steady conflict than to calculate the benefits of peace-making initiatives, let alone directly connect these benefits to the (likely large) investments and risks that would have to be made by the company in such an effort. As such, it could be difficult to make a conservative accounting case for peace-making, at least one based on in-country costs and benefits. This implies that more work may be needed to demonstrate the business case for conflict prevention.

2.2 Moral and political support to the Regime

Most international oil companies have taken a "neutral" stance on the nature of host-country regimes, noting that companies should not get involved in politics. For example, Unocal states on its web site that it has a "legal and ethical obligation to remain politically neutral."[18] TotalFinaElf similarly mentions a duty to "abstain from all intervention in the political process of host countries".[19]

A number of NGOs have pointed out that large economic investments provide economic and political comfort to host countries, including *de facto* "recognition" of rogue regimes. This may be especially true in the oil sector, where companies' home governments are often involved in helping to secure contracts, if not possessing an outright stake in the company.[20] Moreover, large economic investments could influence foreign policy by making an oil company's home government less likely to take a strong stand against the domestic policies of the country in which the investment is made. At the very least, as Christian Aid points out, the uncritical presence of large oil companies "fosters impunity and adds credibility" to a rogue government.[21]

[18] http://www.unocal.com/responsibility/humanrights/hr4.htm

[19] *Code of Conduct*, TotalFinaElf, 2000.

[20] e.g., the French government had a 32% stake in Total at the time the Burma contract was signed.

[21] Christian Aid (2000).

International oil companies probably are reluctant to be seen influencing governments at all, due to the negative public perception of corporate interventions in the past. Partly in response to this legacy, many companies have adopted a policy of "non-interference in political affairs" in the countries where they operate. However, many critics have asked, to what extent can a company or industry that provides most of the financial support to a government oppressing its own people really claim political neutrality? A policy of "non-interference" may also be a convenient excuse to do nothing.

In Burma, where Unocal and TotalFinaElf are engaged in a project to develop and export gas, the democratic opposition has told the oil companies that such investments will only aid and strengthen the military government, which continues to hold power in violation of the results of the country's 1990 elections. In response to accusations of supporting the military regime, Thierry Desmarest, former president of Total and later head of TotalFinaElf, pointed out that, because the Burmese state-owned oil company must repay the money it borrowed to purchase its share in the project, the government was not likely to see any major revenues until after 2002 or 2003. "Who can say what regime will be in place at that time!" Total's president remarked to a National Assembly committee in 1999.[22]

Desmarest's remark obscures the point that the government is able to use future revenues as credit, including for the purchase of arms.[23] Moreover, credit for arms and other purchases is likely to make it possible for the regime to *ensure* that it remains in place until it begins receiving major revenues from the project. Further, the prospect of attaining such large revenues in the medium term probably gives the regime a disincentive to risk losing or diluting its power through democratic reforms in the short term

[22] Testimony to the National Assembly committee investigating the social and environmental impact of French oil companies abroad, 2 February 1999; TotalFinaElf would seem to have a strong incentive to support the continued survival of the SLORC military government: the opposition NLD has stated that it would not recognise commercial contracts signed by foreign companies with the SLORC regime; FIDH, p. 12

[23] For example, the Burmese government purchased helicopters from Poland in 1994, at which time the Polish president, Lech Walesa, was quoted as saying that payments for the purchase were made by Total. (William Bourdon, secretary general of FIDH, testimony to National Assembly committee investigating the social and evironmental impact of French oil companies abroad, 12 January 1999.)

2.3 Abusive Security

Andrew Mack notes that "government security forces using force to suppress local protesters against the operations of extractive industry corporations is the commonest form of violence associated with the presence of these corporations in developing countries today."[24]

Indeed, NGOs such as Christian Aid and Amnesty International, as well as missions by the UN and the Canadian government, have reported numerous allegations of violent human rights abuses committed by Sudanese government forces and their allied military units in and around the oil producing South of the country. Such abuses apparently have been aimed at depopulating the region of its non-Arab residents, which the central government claims is giving sanctuary to rebel groups that threaten oil company operations. According to Amnesty International, government security force tactics have included destroying crops and livestock, mass executions and torture. Government troops even allegedly cleared the area around the town of Bentiu using helicopter gun-ships and aerial cluster bombs dropped from high altitudes by Antonov aircraft.[25] UN rapporteur Leonardo Franco concluded that "the economic, political and strategic implications of the oil issue have seriously compounded and exacerbated the conflict and led to a deterioration of the overall situation of human rights and the respect for humanitarian law, as well as further diminishing the already slim chances for peace".[26] In 2000, a Canadian government assessment mission noted that at least in Sudan's Ruweng county "it is hard to deny that displacement is now, and has been for some time, because of oil".[27]

Human Rights Watch (HRW) has documented a number of cases of human rights abuses carried out against protesters by government forces in Nigeria's oil producing delta region. These include abuses by the "supernumerary police", which are recruited and trained by the Nigerian police but paid for by the oil companies; the Mobile Police; and the Rivers State Internal Security Task Force. HRW argues that oil company complicity is reinforced in cases where the company has called in or aided the government's security forces. For example,

- In 1990, a Shell manager at Umuechem made a "written and explicit" request for protection of certain facilities by the government's Mobile Police, an incident

[24] Mack (2000).

[25] Amnesty International (May 2000), pp. 2-5.

[26] Leonardo Franco, Special Rapporteur, "Report on the situation of human rights in the Sudan" (A/54/467), 54th Session of the UN General Assembly, 14 October 1999.

[27] Harker Report, pp. 10-14.

which reportedly led to the killing of 80 unarmed civilians and the destruction of hundreds of homes.

- In May 1998, two youths were killed on Chevron's Parabe platform by members of the government's security forces who had been transported to the platform by the company in order to remove 200 protesters.

HRW notes that the cases it reviewed concerned alleged government abuse in response to threats to oil company facilities in Nigeria. According to HRW in none of those cases did the companies involved register a complaint with government security forces, except where report of the abuse had reached the international press.

HRW has drawn attention to the secrecy surrounding security arrangements that many international oil companies have concluded with the host governments. For example, it notes that in Nigeria no company responded to its requests to see relevant sections of memoranda of understanding that companies had signed with the Nigerian government, or even internal company guidelines regarding security. It also notes that (at the time of their 1999 report) no companies published "regular, comprehensive reports of allegations of environmental damage, sabotage, claims for compensation, protest actions or police or military action carried out on or near their facilities."[28] Christian Aid has drawn attention to a similar lack of transparency of security agreements between oil companies and the government in Sudan, noting that "secrecy can only encourage these abuses to take place with impunity".[29]

2.4 Logistical assistance, procurement

A number of oil companies have been accused of providing logistical assistance to government military campaigns against political or ethnic oppositions. For example, several NGOs have noted that the Sudanese government has often used the Hegelig airstrip, which is under the control of the international GNPOC oil consortium. There are alleged cases of Sudanese military planes and helicopters being armed and refuelled at Hegelig, including aircraft that proceeded to attack nearby villages.[30] According to Christian Aid, Talisman Energy originally denied that the government had used the airstrip, then later said its contract with the government allowed the latter to use it for "defensive purposes". Talisman later admitted to

[28] HRW (1999).

[29] Christian Aid (2000).

[30] Harker report, pp. 16-17.

Canadian government investigators that Sudan's government appeared to have exceeded the terms of the contract.[31] Similar stories are told by NGOs about Lundin Oil's Rub Kona airstrip, and about the offensive military use of all-weather roads built by the foreign oil companies in Sudan.

Christian Aid notes that in Colombia some oil companies have entered into arrangements that oblige them to furnish the military with goods and services, including security and communications equipment, engineering services and helicopter and land transport.[32] In Burma, Total has been accused of aiding the military in its fight against rebelling ethnic minorities in the Tenasserim region, through which its gas pipeline passes. Specifically, FIDH, among others, has accused Total of loaning the Burmese military the company's sub-contracted helicopters and pilots. Although denied by Total, such claims were reportedly confirmed by sources within the company.[33] Total has also been accused of allowing its French security consultants to share information with the Burmese military.[34] Part of the problem seems to stem from the difficulty of separating pipeline security operations from the army's military-political objectives in the region.

In some cases host governments even appear to be using oil company security as a convenient cover for waging military campaigns against political or ethnic enemies. In Sudan, Christian Aid has alleged that "the relationship between oil and security has moved far beyond simple defence. A strategy of clearing potential enemies — Nuer and Dinka civilians — from oilfields is seen by the government as a pre-requisite to making way for oil".[35] Such a policy is carried out on the pretext of supplying security for the foreign oil consortiums.

In Burma, the region through which the Yadana gas pipeline passes is populated by Karen and Mons minorities. Contrary to what might be assumed to be normal commercial practice, the pipeline route traversed rather than avoided a political conflict zone.[36] A number of observers have suggested that the government was even eager for the pipeline to traverse this region because it provided an excuse – as

31 Christian Aid, 2001.

32 Christian Aid, 2001.

33 William Bourdon, secretary general of FIDH, testimony to National Assembly committee investigating impact of French oil companies abroad, 12 January 1999.

34 FIDH, p.15.

35 Christian Aid.

36 "Unocal Corporate Activity in Burma", p. 7, Investor Responsibility Research Center; cited in FIDH, p. 24. Before TotalFinaElf's invovlement in the project, Thailand's PTT-EP reportedly approached the World Bank for a loan to finance a feasibility study for the project, but the Bank counselled it to chose a route outside the zone of conflict between the SLORC and the Karens

well as the subsidised means – for penetrating and pacifying this rebel stronghold in the name of providing security for the pipeline. Some NGOs have charged that Total and its partners were aware that the assistance they provided the army for pipeline security purposes (as well as their acquiescence to the government's choice of pipeline route) also benefited the army in its armed political repression of Burma's Karen and Mons minorities.[37]

Some of the most serious accusations levelled against international oil companies have involved direct or indirect assistance in procuring weapons for host country governments, and in some cases for rebel groups. Oil company gifts of small arms for use by government security forces are apparently common. In 1996 British and Nigerian newspapers revealed that Shell had been negotiating to import arms for the Nigerian police. As a result of the revelation, Shell admitted that in the past it had imported side arms on behalf of the police, and had even negotiated for a continuation of such imports. However, it maintained that the last transfers it actually carried out had taken place some 15 years earlier. Moreover, it said it "cannot give an undertaking not to provide weapons in the future, as, due to the deteriorating security situation in Nigeria, we may want to see weapons currently used by the police who protect Shell people and property upgraded".[38] Nevertheless, such arrangements usually are not made public, presumably because of the anticipated negative reaction to these transfers by public opinion in both the host country and home country.

The former Elf has been accused of arms dealing in Congo-Brazaville and Angola. Jacques Monsieur, a Belgian arms dealer who faces investigation in one of the many facets of the so-called "Elf scandal" of the late 1990s, claimed to have proof implicating a number of former Elf officials, including André Tarallo and Jack Sigolet, the ex-head for petroleum pre-financing. In a letter addressed to "A.T." and "J.S." (presumed to be Tarallo and Sigolet) Monsieur threatened to reveal a number of important documents to the French authorities unless he was paid outstanding amounts he claimed Elf still owed for his services. According to *Le Soir* of Belgium, these documents show how Elf "militarily made and defeated" presidents Pascal Lissouba and Denis Sassou Nguesso in Congo-Brazaville, and financed the arms deliveries of Monsieur.[39]

Le Soir and others have pointed out that, by financing the sale of arms to African leaders, Elf in effect got them to "mortgage" their country's oil resources, keeping the country indebted to the oil company regardless of who was in power. According to testimony to the National Assembly by the investigative journalist Antoine

[37] See, e.g., FIDH (1996).

[38] Human Rights Watch (1999).

[39] *Le soir (Belgium)*, 20 March 2001.

Glaser, when Sassou N'Guesso returned to power in Congo, allegedly with the aid of Elf, he discovered that his predecessor had mortgaged Congo's petroleum production up to 2006.[40]

Apparently Elf occasionally aided both sides in military disputes, thus presumably increasing the need for governments in power to buy arms, and to mortgage future oil revenues to do so. For example, a number of sources have accused Elf not only of supplying the arms that helped Sassou N'Guesso overthrow Pascal Lissouba in Congo-Brazzaville in 1997, but of providing the use of Elf-owned infrastructure, notably the boats that transported the Angolan government troops who intervened decisively on N'Guesso's behalf.[41] In a legal complaint registered in a Paris court, the deposed Lissouba quotes the French press and various statements by N'Guesso to support his contention that "Elf Aquitaine aided General Sassou N'Guesso to execute his coup d'Etat in Congo."[42]

Another alleged method of arms funding has been to provide equity shares in oil development projects to arms dealers or middlemen, presumably with the knowledge if not the complicity of the project operator. For example, Global Witness has accused the Angolan government of including "equity partners more normally associated with arms dealing than oil exploration" in several international consortiums. It notes that such partners notably have been included in Block 32 and Block 33, which are operated by TotalFinaElf and Exxon respectively. In its recommendations in the report, *A Crude Awakening*, Global Witness calls upon oil companies to "declare their relationship with equity partner companies [and]…refuse to work with companies involved in the arms trade".[43]

[40] Antoine Glaser, director of the publishing house "*L'Indigo*", testimony to the National Assembly committee investigating the activities of French oil companies abroad, 8 December 1998.

[41] François Xavier Verschave, *La Françafrique* (pp. 313-314), cited in Aubert report, p. 113. Pascal Lissouba was the president of the Republic of Congo (Brazzaville) from 1992 until October 1997, when he was removed by Denis Sassou N'Guesso in a civil war. The latter had previously been president between 1979 and 1992.

[42] Plainte déposée le 20 novembre 1997 au Tribunal de Grand Instance de Paris, cited in Aubert report, p. 113.

[43] Global Witness (1999).

2.5 Abuses by private and company security

There have also been documented cases of violence by oil company security forces or by the private forces hired by the oil companies. For example, HRW reports incidents in Nigeria where witnesses were present when company staff directly threatened (or were present when their security staff threatened) communities with retaliation if production was disrupted. In several incidents Ogoni detainees were allegedly even beaten by company police.[44]

Such cases usually are more clear-cut regarding oil company blame. Hopefully, they will also be the easiest abuses to avoid in future, since the oil companies presumably have more control over their own forces than they do over those of their host governments. Such abuses could be relatively straightforward to deal with via "naming and shaming" campaigns by NGOs. As such, there may not be as much of a need for home country governments to seek policy solutions for this problem as there may be for some of the other dynamics mentioned in this report.

[44] HRW (1999).

3 Policy Options

3.1 Financial transparency

Significant revenues from international oil company operations support the host country government regardless of the nature of the regime. Unfortunately, as the section above attempts to describe, the regime of an oil exporting developing country is more likely than most to be corrupt, due in part to the influence of the large oil revenues themselves. One of the main enabling factors for corruption and diversion of funds to military expenditures in host countries is lack of financial transparency.

Ideally, host country governments could be required to provide a full accounting of the funds they receive from oil industry activities and account for how these are spent. Since the international community has little financial leverage over sovereign host governments, however, this is a difficult proposition.

A second-best option could be to require oil companies to provide a more transparent accounting of all tax, bonus and other payments they make to various host country institutions and agents with respect to each project. This would include payments that do not go through the budget of the host government.

Payments to off-budget accounts are not illegal. However, they can facilitate corruption and the diversion of national wealth to non-constructive purchases: It is assumed that in a number of countries much of the off-budget money goes to purchasing weapons or to paying off high-interest loans that have been used to finance weapons purchases. For example, recent investigations by Global Witness in Angola suggest a highly complicated procurement system for the army under which top Angolan officials receive kickbacks for the purchase of over-priced weapons.[45]

A requirement for oil companies to make a full public accounting of their payments to individual host countries (including to such bodies as "presidential foundations") would make it easier for host country citizenry and other interested observers to achieve a better understanding of the amount of money actually received from the development of their countries' natural resources. At a minimum, this income could be compared to the government's reported expenses, making it more

[45] See, e.g., A Crude Awakening . The Global Witness website also contains a series of articles and press releases on this subject (http://www.oneworld.org/globalwitness).

difficult for large amounts to go unaccounted for. Such transparency could even give the government an incentive to increase the amount of money it spends on public services such as health and education. Although it is unlikely that a full picture of the budget would be possible, unless government expenditures are audited, transparency of inputs is an important start of the total picture.

Below, several possible methods for achieving such policy objectives are examined in the section entitled *Policy Instruments*.

3.2 Transparency in security arrangements

In many cases of alleged armed conflict, foreign oil companies benefiting from the use of force by government troops have either denied knowledge of abuses, or insisted that the actions of the government were not instigated or approved by the company. In addition, the security agreement between a government and an oil company is usually secret, making it difficult to say whether the government acted within or outside the parameters of the agreement. The extent to which companies could be said to be complicit in security related human rights abuses or atrocities resulting from armed conflict would be more easily understood if security agreements were made public.

Even if such government-company security agreements specifically state that particular actions by security forces are not appropriate, companies arguably could be considered complicit in abuses if their personnel become aware of them (i.e., violations of their security agreements) and do little or nothing to address and/or condemn them. Given the large number of credible cases of security-related violence that NGOs have been able to document, one is left with the strong impression that many oil companies do not view this as their responsibility or have not been very persistent in monitoring the security situation relevant for their operations.

There are clear incentives for this behaviour, such as a desire to maintain deniability and to avoid confrontations with host governments. However, given the increased scrutiny of oil company operations by NGOs and others, it would seem to be in many companies' long-term best interests to pay more attention to such issues. Moreover, as Amnesty International has pointed out in Sudan, "oil companies cannot ignore the link between the oil and the fighting, not least because of the direct impact it has on the security of their staff."[46]

Increasing concern about these issues led to the formulation of the "Voluntary Principles on Security and Human Rights", a set of US and UK government-

[46] Amnesty International (May 2000), p. 8.

brokered guidelines designed to govern the use of foreign security forces by companies in the extractive industries.[47] Among other things, the Principles advise companies to ensure that their security services (whether government or privately provided) "exercise restraint and caution in a manner consistent with applicable international guidelines regarding the local use of force, including the UN Principles on the Use of Force and Firearms by Law Enforcement Officials and the UN Code of Conduct for Law Enforcement Officials, as well as with emerging best practices developed by Companies, civil society, and governments." The Principles also strongly recommend that companies perform systematic risk assessments to "examine patterns of violence in areas of Company operations for educational, predictive and preventative purposes." The guidelines for such assessments recommend that, among other things, companies seek to identify the root causes of local conflicts and examine the human rights record of public security forces.

The need for companies to conduct security assessments is echoed by other observers. For example, Mack suggests that companies produce "conflict impact statements" in co-operation with NGOs or international institutions such as the UN or World Bank as a "specialised form of political risk assessment".[48] Similarly, a conference sponsored by the Council on Economic Priorities and the Prince of Wales Business Leaders' Forum states that companies "need to understand the nature of the [security] problem by carrying out conflict analysis and social impact statements". It also notes that "companies have very high health and safety standards. They could, and should, apply the same standards to security."[49]

It is difficult to imagine that most oil companies do not already carry out such assessments, at least internally. However, the value of the Voluntary Principles may be that they force a company to state publicly that it is examining such issues, thus making it more difficult for the company to maintain deniability should abuses occur.

[47] A copy of the agreement is available on the State Department website at http://www.state.gov/www/global/human_rights.

[48] Mack (2000).

[49] "Bussiness and Peace" Conference Final Report, May 2000, UK DFID, UK FCO, Prince of Wales Business Leaders Forum and the Council on Economic Priorities (http://www.dfid.gov.uk/public/what/pdf/chad_business.pdf)

4 Policy instruments

While the section above recommends several general policies to address conflict in host countries, the following section looks at the feasibility of various instruments for implementing them.

4.1 Leave it to the market

One possibility is to leave it to NGOs and consumers to continue their monitoring and pressure campaigns against the oil companies. NGO and consumer pressure probably will be most effective for modifying those actions that are directly under an oil company's control, such as behaviour of the company's own security forces, and decisions about whether to enter or remain in a particular country. Companies would seem to have a significant market incentive to respond to or avoid NGO criticism, because negative publicity can damage their image with consumers and shareholders. Ultimately, oil company managers realise that the NGOs can organise consumer boycott campaigns, and that shareholders can vote in new management if the company loses too much money by mishandling challenges to the company's reputation.

The main drawback with NGO pressure at present is that it does not seem to be applied evenly to all "guilty" companies. It would appear that, given limited funds, NGOs understandably have targeted those companies they perceive to be most likely to respond to their criticism. A favourite tactic has been to compare a company's actions to its stated commitments, e.g., its code of conduct. Given such targeted NGO tactics, a lesson for oil companies would seem to be to avoid calling attention to themselves via significant commitments to such initiatives as codes of conduct. It is the impression of the author that this has been the conclusion drawn by a number of major western oil companies.

Another problem is that the western companies most sensitive to public pressure may be among the best behaved internationally. If one of these companies withdraws from a difficult country, or is replaced with another company by an irritated host government, the replacement company may have an even worse record, while being less susceptible to NGO pressure.

Uneven pressure by NGOs is especially evident when it comes to large, technically proficient *non*-OECD oil companies that offer increasingly credible competition to the majors in developing countries. Many of these currently face comparatively little pressure from their customers and shareholders to address corporate social responsibility (CSR) issues, thus giving NGOs little leverage to affect them commercially. The situation is somewhat similar for many of the smaller OECD-based oil companies that do not have their own service station networks, although the case of Canada's Talisman in Sudan indicates that such companies can still face significant public and shareholder pressure.

A variation of consumer and NGO pressure is investor influence and activism. In part due to effective awareness raising campaigns by NGOs, the share market is responding to a demand for opportunities to invest in "socially responsible" companies. This phenomenon has been boosted by the adoption of codes of conduct by many large institutional investors. A notable development in the US was a set of guidelines issued in 1988 by the US Department of Labor that requires corporate pension plan trustees to pay close attention to the "ultimate value of the plan's holdings". These guidelines reportedly have caused many funds managers to incorporate corporate social responsibility (CSR) criteria into their investment policies and proxy voting policies as a way of ensuring due diligence.[50]

The threat to reputation of being dumped by a prestigious socially responsible investment (SRI) fund or index could eventually serve as a significant consideration in company policy making. The potential impact on companies' share prices could also grow as SRI funds' share of the investment market increases. Already a large number of investment funds and indexes have been set up by money managers and financial services companies to assist SRI investors. For example, Dow Jones maintains a series of "Sustainability Indexes", while FTSE has introduced a series called "FTSE4Good", both of which vet companies for inclusion.[51]

4.2 Facilitate voluntary codes of conduct

Voluntary codes of conduct have become an important tool for companies to demonstrate support for particular social principles. Many oil companies have adopted their own codes. However, experience from other industries indicates that codes

[50] Meg Vorhes, "Is There an American View of Global Corporate Social Responsibility?: The Views of U.S. Institutional Investors", presentation to conference "The Role of Governments in Promoting Corporate Citizenship", Washington DC, 11-12 June 2001 (http://www.npal.org/OECD/Documents/voorhesspeech.htm)

[51] See http://www.sustainability-index.com and http://www.ftse4good.com/frm_home.asp

developed by companies or industry associations in isolation often lack legitimacy vis-à-vis outside observers. For example, the timber industry faced considerable criticism in the early 1990s when it tried to develop its own code to compete with those developed by a number of NGOs.[52] Government therefore may be able to play a

Case study: Voluntary Principles on Security and Human Rights

One of the best examples of a government-brokered code of conduct is the "Voluntary Principles on Security and Human Rights" (mentioned above under "Transparency in security arrangements"), which cover the use of security forces in the extractive industries. The initiative brought together the US State Department and UK Foreign Office to broker a set of common standards with the participation of interested US and UK oil and mining companies, labour unions and NGOs. Oil industry participants included Chevron, Texaco, Conoco, Shell and BP, while NGO participants included Human Rights Watch, Amnesty International, the Lawyers' Committee for Human Rights and International Alert.

The agreement, which was negotiated over one year, was announced in December 2000.[53] It covers the use of both public security services (e.g., local police and military) and private security firms.

According to Freeman, the State Department and the Foreign and Commonwealth Office became involved in the negotiations because both governments "shared an economic and political stake in ensuring that those companies continued to operate in countries such as Nigeria, Indonesia, and Colombia", and because they believed that encouraging CSR could help "rebuild the fractured post-Seattle political consensus for globalization".[54]

The US State Department has noted that the agreement on security issues is "only the beginning", and that the negotiating process already begun provides "an important foundation for further dialogue between industry and civil society" on other CSR-related issues.[55]

[52] See "The NGO-Industrial Complex", *Foreign Policy*, July/August 2001.

[53] A copy of the agreement is available on the US State Department website at http://www.state.gov/www/global/human_rights.

[54] Bennet Freeman, "Drilling for Common Ground", *Foreign Policy*, July/August 2001.

[55] Remarks by Assistant Secretary of State for Democracy, Human Rights and Labor Harold Hongju Koh, 20 December 2000 (http://www.state.gov/www/policy_remarks/2000/) .

role in bringing together industry actors and NGOs to work out codes that both sides find acceptable.

Although voluntary codes are sometimes criticised as a method for industry to pre-empt regulation, it is important to keep in mind that the costs of more formal regulation can be high. Proponents have pointed out that voluntary codes can form the basis of future regulation, while in the meantime providing an opportunity for innovation. The participation of government can help to ensure that the content of voluntary codes reflect the legitimate concerns of a variety of stakeholders and not just those of the relevant industry.

Nevertheless, it is necessary to be realistic about what voluntary codes can achieve. If there is no formal independent monitoring built into the code, much depends upon the vigilance of NGOs and others to monitor industry adherence. Widely accepted voluntary codes at least provide NGOs with convenient standards by which to judge industry participants, including, as appropriate, those companies that have not even endorsed them.

4.3 Positive Conditionality

One approach to stimulate companies to provide more information or to implement other desired policies is to make these provisions or policies a requirement for receiving certain services provided by or regulated by government.

Political risk insurance

Many OECD governments provide political risk and other types of insurance for projects abroad, e.g., OPIC and the Ex-Im Bank in the US, Coface in France, SACE in Italy and the MIGA programme at the World Bank. Although many major oil companies are self-insured, political risk insurance is fairly common in the oil and gas industry for operations in countries deemed “high risk”.

A number of government schemes already require projects to meet certain environmental criteria. There has been discussion in some countries about expanding criteria to include social provisions, as well as stricter requirements regarding transparency and accountability of payments in order to reduce the opportunities for corruption. There has even been some work to co-ordinate action in this area among OECD governments. For example, export credit insurance agencies of OECD countries are now supposed to demand written statements from companies that they will not bribe foreign officials. The OECD may provide an appropriate platform for further co-ordinated work in this area.

Presently, social criteria usually are applied to countries rather than companies or projects. For example, for a time the UK government denied export credit cover for all projects in Angola. While the country approach may be useful in modifying host-government's behaviour, it does little to modify company policies in countries where companies already have invested.

Selective purchasing

A number of State and municipal governments in the US have passed "selective purchasing" legislation that sets social and other criteria for companies receiving local government contracts. Such legislation first began to be introduced in the 1980s to persuade companies to divest from South Africa. In the 1990s the primary target was the military regime in Burma, typified by the 1996 selective purchasing legislation instituted by the Commonwealth of Massachusetts that forbids companies that do business in Burma from receiving new contracts with the state. The Massachusetts law has been cited specifically by several companies, including Motorola, Hewlett-Packard and Apple, as the reason they withdrew from Burma.[56] Some 15 other US localities have passed similar legislation.[57]

Instead of merely forbidding investment in certain countries, however, such government purchasing rules could require companies to have particular policies, e.g., on transparency of payments and security agreements in the case of oil companies. Of course, this policy tool will have limited effect on oil companies without the prospect of large government supply contracts.

Stock market listing

Although stock market listings generally are not a government-provided service, they usually are regulated by the state (e.g., by the Securities and Exchange Commission in the US). This gives government some scope for imposing conditions. Such conditions for oil companies could include, e.g., transparency of payments and security arrangements vis-à-vis host governments. So far, however, debate on this issue has focussed on what are effectively sanctions against operating in certain countries (see box below).

[56] See "The Massachusetts Selective Purchasing Legislation", United States Institute of Peace (http://www.usip.org/oc/vd/vdr/vburma/vburma_two.html)

[57] US municipal and county governments that have passed selective purchasing legislation include New York City (NY), Madison (WI), Ann Arbor (MI), Boulder (CO), Takoma Park (MD), Carrboro (NC), Chapel Hill (NC), Portland (OR), Alameda County (CA), Berkeley (CA), Los Angeles (CA), Oakland (CA), Santa Monica (CA), San Francisco (CA).

Case study: The US "Sudan Peace Act"

A debate over the imposition of non-financial criteria for stock listings took place in the US in response to pressure from a wide coalition of religious and human rights groups opposed to investments in Sudan. (The US has maintained economic sanctions against Sudan since November 1997, due to the latter's alleged sponsorship of terrorism and poor human rights record.) An initial target was an IPO for Petro-China, an affiliate of state-owned China National Petroleum Corporation, which is involved in Sudan. Concern over China's Tibet policy also became an issue.

The US Congress proposed a bill called the "Sudan Peace Act", which would have prohibited any company engaged in oil or gas development in Sudan from raising capital or from trading its securities in the US. It also would have required all companies listed in the US to disclose any business dealings with Sudan to the SEC. The Senate, apparently concerned about relations with the Chinese government, proposed a weaker version of the bill. (In 2000 the Senate also had defeated similar attempts to include capital market restrictions on a bill regarding Chinese weapons proliferation.)

The US Treasury Department and financial services companies lobbied heavily against the bill, arguing that it would set a precedent for restrictions that would ultimately cause US capital markets to lose out to overseas rivals. In an apparent compromise, the SEC declared in March 2001 that it would require companies simply to disclose operations in any countries under US sanctions.

Conditions on access to global capital markets potentially could limit access to this important revenue source for state-owned companies of "rogue" regimes, e.g., Burma's MOGE. Depending on the nature of the conditions, they could also potentially affect the behaviour of international companies operating in developing countries. A major criticism of such conditions is that they could punish the financial centres that impose them. This collective action problem potentially could be solved by co-ordinated action to introduce harmonised legislation in the world's major financial centres (see below).

National regulations under international agreements

Depending on the laws of a particular country, home governments theoretically could impose requirements unilaterally on oil companies based within their jurisdiction. For example, in 1977 the US passed the Foreign Corrupt Practices Act, which among other things, made it punishable in the US for American companies to bribe foreign officials.

The main problem with unilateral regulations is that they can place affected companies at a competitive disadvantage to firms not subject to the same restrictions. In recognition of this, the US Government pressed other industrialised country governments to pass similar anti-bribery legislation. The vehicle it chose for doing this was a negotiating process at the Organisation for Economic Co-operation and Development (OECD). Negotiations among OECD member states (plus Argentina, Brazil, Bulgaria, Chile and the Slovak Republic) led to the 1997 "Convention on Combating Bribery of Foreign Public Officials in International Business Transactions". This convention committed signatory countries to adopt implementing legislation similar to the original US law, thus going some way to levelling the playing field in this area.

A similar approach could be pursued with respect to some of the negative dynamics associated with oil company activities in developing countries. Such action could involve building on the existing OECD convention mentioned above. Transparency of payments by international oil companies to foreign governments is a topic that may lend itself well to the existing negotiating framework. The co-ordinated stock market rules mentioned in the previous section could be one method for achieving this.

4.4 Oil company co-operation with international organisations

Oil companies acting alone to encourage host governments to be more transparent or to spend more money on health and education and less on the military almost certainly will face competitive disadvantages compared to oil companies that do not try to influence host governments. Even providing that a significant number of companies were able to overcome their collective action problems, oil companies seeking to positively influence governments still could face suspicions about their motives, and perhaps even charges of anti-competitive practices. Collective action by oil companies therefore may benefit from the sponsorship of a respected international body, such as the UN or the World Bank. Moreover, such an international organisation presumably would be more credible and experienced than oil companies in giving broad policy advice to developing countries.

One possible model for such arrangements is the current project to develop oil fields in southern Chad for export via a new pipeline to Cameroon's Atlantic Coast.

A number of companies reportedly had been looking at this project for several decades, but had been put off by the severe, long-term political difficulties and economic mismanagement in Chad. ExxonMobil finally agreed to invest on the condition that the Chad government sign an agreement with the World Bank and IMF that arranged for a large portion of the government's oil revenues to go to health and education as well as to vital infrastructure needed by the project.

However, it is unclear that such a model would work beyond cases where the expected economic benefits of oil exploitation are outweighed by an extremely difficult local political situation and/or significant economic mismanagement. In most cases, oil resources of this size (estimated at around 1 billion barrels) would be enough to compensate a company for most political or management difficulties. In such cases, the host government usually would have several potential suitors, and thus could reject those that included a significant amount of conditions, e.g., requirements to meet World Bank conditions.

On the other hand, increasing pressure from NGOs, shareholders and others could eventually lower the threshold of political difficulties that oil companies are willing to accept in host countries. Such a situation could make oil companies and host countries more interested in joining forces with the UN, World Bank or similar international bodies in more instances.[58]

In any case, oil companies are sure to have noticed the value of public relations "shield" which the World Bank provided for the Chad project, when, despite elaborate monitoring arrangements, the government of Chad openly used its first income from the project to purchase weapons. As one commentator noted, "although the [World Bank's] loans covered a mere 5 percent of the cost, the Bank provided invaluable political benefits by diverting the ire of the NGOs from Exxon to itself".[59]

[58] "Reluctant Missionaries", Marina Ottaway, *Foreign Policy*, July/August 2001.

[59] Ibid.

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The Fafo Institute in Oslo conducts policy-related research at the international level, concentrating primarily on countries undergoing substantial structural change. Fafo's Programme for International Co-operation and Conflict Resolution (PICCR) is an umbrella programme for initiatives related to the policies and practices of international responses to armed conflict. In partnership with other non-governmental organisations, governments, and multilateral institutions, PICCR is actively engaged in efforts to understand and promote sustainable conflict resolution, effective multilateral co-operation and efficient international organisation. PICCR is involved in research and dialogue activities that encourage and support principles of multilateralism and international co-operation in general. Since its inception in 1998, PICCR has implemented a series of policy fora and research projects related to peace operations and international responses to civil wars. The honourary Chair of PICCR is Terje Rød-Larsen.

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