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**Natural Resources, Governance, Development and Conflict**  
Discussion Paper

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**I. Private Sector Activity & Armed Conflict**

Over the last decade, armed intra-state conflicts have become increasingly self-financing. Both the end of the Cold War, with its attendant withdrawal of superpower patronage for proxy wars, and the liberalization of the global marketplace compelled actual and aspiring combatants to secure alternative means for war-financing, while also providing them new opportunities to do so. Just as the state's traditional monopoly on warring has been increasingly privatized by non-state actors (private security firms, mercenaries) so too, the means for waging war have become increasingly commercialized, by both state and non-state actors.

In many conflict zones, the political economy of contemporary armed conflict goes well beyond isolated acts of theft, pillage and plunder to include systematic and elaborate operations for resource extraction and cross-border trafficking conducted by armed groups, transnational criminal enterprises, rogue companies, and shadow states, as well as by otherwise legitimate business entities. Not only do these activities pose immediate threats (and also, in some instances, perverse but not insignificant benefits) to the physical and economic survival of civilian populations, they also create additional barriers to conflict resolution, the restoration of good governance, and long-term socioeconomic development.

The ability of armed groups to generate revenues critically depends upon access to global finance, commodity, and arms markets. This means that an extended chain of local and international non-state economic actors, from rogue middlemen to otherwise legitimate corporations and financial institutions, are integral to combatants' capacity to transform ill-gotten gains into military might and, sometimes, personal profit.

Both state collapse and the extensive economic liberalization (phenomena which are not unrelated) over the last decade has weakened national governments' jurisdiction and capacity to regulate international commerce and hence to combat the proliferating "conflict trade". Fundamentally, this is an issue at the intersection of governance, security, and development.

**II. The Role of Multinational Extractive Companies**

The political economy of civil war is characterized by a wide heterogeneity of actors and interests, the management of which presents different sets of challenges for conflict management, prevention, and resolution and requires distinctive policy tools. For example, the involvement of transnational organized crime enterprises in conflict is largely an issue of enforcing existing international norms and conventions. The pernicious effects of the illicit trade in small arms and

the role of private security companies, though not (yet?) covered by formal international conventions, have at least gained a modicum of normative consensus, and are subject to a range of *ad hoc* embargoes, regional moratoriums, and domestic prohibitions.

This memo will focus on one subset of the private sector: the often problematic conduct of multinational extractive industries in conflict zones and the potential of international organizations and governments to adopt policies to reduce the risk that these problematic activities pose for both security and development.

There are several factors which justify this focus:

*1) Extractive Industries are Undeterred by Armed Conflict:*

Unlike manufacturing or other secondary and tertiary industries, extractive companies do not divest or relocate when conflict erupts. Indeed, the site specific nature of natural resources, their strategic importance (especially of oil and gas), the potential profits, and the capital intensive and long-term nature of their production cycles means that extractive companies do not obey the same investment logic as other investors: that is, they are not deterred by an unpredictable or dangerous environments. While there are several instances where instability and violence have contributed to extractives' decisions to divest, the typical pattern for extractive companies is to factor in the costs of extra risks and stay the course.

This pattern has consequences for developmental prospects; as conflict drives away other forms of economic investment and development, the shift to non-tradables exacerbates the country's dependency on primary commodity exports and, thereby, the well-known macro-economic pathologies associated with the resource curse. The consequences for conflict are discussed below.

*2) For Developing Countries, Natural Resources are (Often) the "Only Game in Town":*

Many of the countries most affected by poor governance and conflict are located in parts of the developing world which are yet the key areas of untapped natural resources in high global demand. In the case of estimated petroleum yields, the vast majority of prospective deposits are located in the developing world, notably in Africa and Central Asia. This means that the problems posed by the behavior of extractive companies in zones of weak governance or open conflict are not likely to disappear any time soon. If these activities are to contribute to sustainable development rather than to a regressive cycle of rent-seeking, state hollowing, conflict, and human misery, ensuring their responsible development is critical.

*3) Extractive Industry Conduct is Implicated in Negative Conflict Dynamics*

Even a cursory survey suggests that, despite extractive companies' claims to the contrary, their conduct in unstable countries has several conflict promoting aspects, both before and during the active outbreak of hostilities.

- First, as typified in Angola, the financial deals that EIs engage in with unaccountable governments in weak governance and conflict zones can exacerbate corruption, rent-seeking and off-the-books state allocations (sometimes directly to clandestine military expenses, sometimes to official self-dealing). In turn, this fiscal opacity can contribute to grievances regarding inequitable resource distribution and legitimacy crises that feed rebellion.

- Second, as sadly demonstrated by UNOCAL’s activities in Burma and Talisman’s in Sudan, companies sometimes elect to remain with or enter into joint ventures in resource extraction with state partners with an identifiable history and continuation of violations of human rights and war crimes ( including allegations of slavery in the former case and ethnic cleansing in the latter).
- Third, practically in all conflict settings, multinational extractives, eager to protect their investment, plant, and personnel, engage in a wide variety of dubious practices that some would call “bribery”: for example, payments to local militia or rebel groups after extortion threats, or threats of destruction or disruption of company plant and operations, are commonplace in Indonesia, DRC, Columbia, and many other locations. These payments have often benefited state and non-state armed groups as much as they have guaranteed the continuing, profit-seeking, activities of the companies in question.
- Fourth, and more disturbingly, there have been several cases where extractive companies allegedly have been involved in the market in “booty-futures” or the deliberate financing of rebellions in the hopes that their victory will yield new market opportunities or more favorable concession rights. In the Sudan, oil revenues of US\$1 million per day help to fund the government’s war in the south. In Congo-Brazzaville in 1997, the arms used by President Denis Sassou-Nguesso’s private militia during a bitter four-month war against incumbent president Pascal Lissouba were paid for, in part, by money obtained by the sale of rights to Congo’s future oil production.
- Finally, there have been instances in which otherwise reputable companies have allegedly supplied illicit arms to various combatant groups.

Aside from the direct conflict exacerbating effects of these activities, some have noted the broader, indirect effects of continued operations of extractive multinationals in war zones, including: the perpetuation of corruption and money flight, exacerbation of socio-economic inequalities, and their contribution to the emergence of secondary political and socio-economic grievances that can perpetuate conflict.

#### *4) Extractive Industries’ Have Ambivalent Impact on Civilian Entitlements in Conflict Zones*

As noted by France Stewart, civilian entitlements tend to shift during war to informal and illegal markets. As examined by Michael Ross, Jonathon Goodhand and others, the effects of extractive companies exploitation on civilian entitlements or livelihoods in conflict can be ambivalent. While on the macro level and in the long term, their activities are pernicious to both stability and development, in the immediate term, their activities can offer critical livelihood options for civilians, particularly in areas inaccessible to humanitarian relief or development assistance ( such as poppy farming in the Taliban-controlled areas of Afghanistan in the 1990s and coltan mining in the rebel-controlled areas of eastern DRC from 1997 to 2000).

Much depends on whether the natural resource involved are *lootable* or *non-lootable*. According to Ross, lootable resources (those which, like alluvial diamonds, coltan and timber, narcotic drug cultivation, are labor intensive but have low entry costs) tend to benefit a wide range of civilians, whereas non-lootables (which are capital and technology intensive, such as oil, gas, and deep mineral deposits, with high entry costs) tend not to have welfare benefits to local civilians, and, in conflict zones, few long-term macro-economic benefits.

This suggests that policy interventions will be different for each type of resource, and that regulating non-lootable extractive industry activities (such as oil and gas extraction, by definition a multinational activity), risks less collateral damage on civilian entitlements. This is not to say that efforts to regulate private sector extractive operations in lootable resources should be the sole target of policy interventions, only that it is more complicated.

### III. Key Issues/ Core Policy Concerns

The issue of extractive industry behavior in conflict-affected or otherwise unstable developing countries is relatively new. It is also an issue where consensus about the diagnosis let alone the remedy is nascent, if it exists at all. Humbly, therefore, my following list of key issues cannot be called authoritative, but merely suggestive. Apologies, but many of the critical barriers to effective remedy are a) definitional and b) political. I will address these in the context of the main substantive issues that I think are critical:

#### *1. Defining Company Responsibilities in Conflict Zones : CSR vs. “Do No Harm”*

The key question here concerns expectations about what extractive should or *should not* do in unstable or conflict-ridden countries. To date, there is little by way of conceptual let alone normative consensus among companies, governments, multilateral agencies and NGOs. Indeed, though the distance between advocacy groups and companies has narrowed over the years, there is still a great deal of debate over standards and obligations, with the former setting maximalist agendas and the latter reacting in a defensive pattern, seeking to deflect or limit regulatory interventions on their activities in conflict zones.

Traditionally, the response of advocacy NGOs to allegations of corporate “complicity” in human rights abuse in repressive or unstable host countries has been to urge their full divestment. Implicit in these arguments is that “mere presence” of MNE operations in such settings makes MNEs responsible for the range of ills that may be occurring. While useful in underscoring the reality that no corporate activity in these settings is neutral, this approach has proven unsatisfactory for a number of reasons: it seldom achieves either divestment or broader positive improvements; it may drive out otherwise beneficial economic activities; and it sidesteps more refined analytical and policy inquiry as to what corporations that elect to remain should or should not do in these settings.

The response of many NGOs to the issue of extractive industries in conflict has been to start from existing agendas of Corporate Social Responsibility (CSR), designed largely by and for the labor and environment agenda, and to adapt it to conflict prevention and mitigation. The notion of responsibility implied in these approaches is not always one based on direct company direct effects of company action, but one based on company capacity; the implicit logic is that because extractive multinationals are well endowed with expertise and resources, these capacities obligate them to undertake broader social and economic functions, where governments are weak.

The result has been an expansive list of “should dos” imposed on MNEs. Not surprisingly, this has had little effect on the will or capacity of corporations to effectively deal with conflict issues, and is indicative, I submit, of a misguided or ill-conceived agenda for development in conflict settings. Others, myself included, would argue that this approach, while useful in terms of PR is analytically and instrumentally unhelpful.

There is an alternative approach one that may be called “DO NO HARM”. It is a line of policy inquiry that begins from a notion of responsibility that is based on consequences of action and by asking what is it that extractive companies are doing that exacerbates conflict and that exacerbates negative developmental pathologies.

Approached this way, few would say that building schools or inoculating children (however salutary for development and human welfare) should be their priority in conflict-ridden environments, nor should the performance of these activities be allowed to exonerate companies who yet engage in more problematic, conflict-promoting behaviors. As the list of problematic activities above suggests, they mainly boil down to two critical issues: security and finance. This puts a premium on policies that seek to improve fiscal accountability through transparency and promote human rights and protection through careful security policies.

This approach has the advantage of building from established and well-accepted global norms of anti-corruption and human rights, setting minimal and clear expectations, and has the potential of building a level playing field for private sector activity in weak governance and conflict zones.

## *2. Collective Action and Free Rider Problems.*

While the lack of consensus in diagnoses and remedies is one impediment to improved policy, another is the unfavorable incentive structure for progressive change on the part of extractive companies. Multiple and divergent jurisdictional standards, government protection of comparative advantages in extractive industry performance, and the structure of the extractive sector inhibit collective action and create enduring free rider problems.

Engaged as they are in a high stakes competition for strategic and valuable resources, extractive industries are ill-suited to working together. In cases, where extractive companies have unilaterally taken steps to improve their conduct in conflict zones (e.g. BP's transparency initiative in Angola, Talisman's divestment from Sudan, Elf's withdrawal from Burma), they have risked retaliation by hostile governments and by competitors. In the latter cases, for example, withdrawal (forced by NGO and legal pressure) was immediately followed by their replacement as a joint venture partner in the Sudan and Burma by Indian and Malaysian state-owned companies, respectively. Not only did divestment have no impact on the commerce-conflict nexus, it may have made the situation worse, as these state-owned companies are less susceptible to reputational effects of public pressure, so far virtually the only avenue of remedy.

## *4. Sovereignty concerns*

Efforts to extend good governance to extractive industry operations in weak governance or conflict zones is severely complicated by a range of concerns associated with conventional (Westphalian) state sovereignty doctrines. International conventions give sovereigns the right to manage their country's resource wealth, a norm behind which many unaccountable governments still seek to hide their misconduct. Companies, too, cite sovereignty norms to defend the *status quo*, claiming that their sole obligation in developing countries is to obey the laws of the host government, regardless of the relative weakness of legislation governing their conduct or the absence of effective enforcement, particularly in conflict zones. They also cite sovereignty to reject advocacy efforts for them to undertake service provision properly belonging to governments (development, health, welfare) in cases where the government capacities are weak or non-existent.

## *5. Which Standards Govern Extractive Activities in Weak Governance/Conflict Zones?*

In recent years, there have been a proliferation of company and industry codes, as well as public-private and external standards (proposed by the UN Global Compact, the UN Subcommission on Human Rights, the OECD (Guidelines for Multinationals), the UK Extractive Industry

Transparency Initiative, as well as a plethora of codes proposed by international advocacy NGOs).

Again, there is no consensus over which code or standard should take precedence, whether such codes should be voluntary or mandatory, how they might be reconciled with the above-mentioned issues of sovereign domestic law in conflict zones, and who or which authority is properly mandated to enforce compliance and impose penalties for non-compliance. In the interim, companies justifiably complain of confusion and code-weariness, and of what has led to constantly changing goal posts. There are opportunities for overcoming these impediments, as well as overcoming the impediments posed by sovereignty doctrines and collective action problems. Doing so, however, will require the creation of concerted, coherent international standards, and a clear identification of authoritative jurisdiction.

#### **IV. Policy Responses and Opportunities**

As will be discussed further, like other areas of private economic activity in armed conflict, the negative security and development ramifications of extractive industry behavior in weak governance and conflict zones has not yet been fully addressed. Here, there is a marked lack of normative consensus in the international community. While companies (and their government backers) may justifiably protest that they are not mandated to ensure either good governance in the countries in which they invest/operate or peace and security, many would argue that they *are* responsible for minimizing, if not eliminating, the conflict-promoting aspects of their own activities. For better or worse, as multinationals, whose business opportunities are typically subsidized by home government risk insurance and export credits (a.k.a. taxpayers), they are, can be, and should be held to a higher standard. Given the increased attention by multinationals, NGOs, multilateral agencies, including the IFIs, and governments to the consequences of multinational operations in conflict zones, there is a gathering momentum towards more effective policies to ensure that the activities of this critical sector of the global private sector contribute to both peace and development, before and during conflict.

There are a variety of venues and initiatives which provide opportunities for incremental improvement, including the G8, the OECD (and their various initiatives against corruption, and money-laundering, and for corporate social responsibility), the IFIs (particularly their potential to leverage loan conditionality to the improved extractive industry practices), as well as an opportunity to increase the sensitivity of the MDGs to this policy agenda.

##### 1. Transparency Initiatives

The mismanagement of natural resources can aggravate existing political, social and other grievances and heighten the risk of conflict. Policies that increase the likelihood of revenues being used to alleviate such grievances through spending on poverty reduction, healthcare, education and other public services, rather than being squandered or misappropriated by state officials, may prevent the occurrence of conflict in resource-dependent developing countries. Given the interconnections between resource-dependency, developmental pathologies ( the resource curse and rent-seeking) and conflict, and given the MDG's commitment to poverty reduction , sustainable development, and good governance, a highly promising avenue for policy lies in transparency promotion.

*The Publish What You Pay Campaign*, launched in 2002 by a consortium of NGOs, seeks to promote transparency in the Extractive Sector and asks companies to disclose all and any information about tax payments, royalty fees, revenue-sharing payments and commercial transactions with government and public sector entities on a country-by-country basis. In so doing, the objective is to provide ordinary citizens the information to hold their own government accountable. By bringing about greater accountability through transparency, the propensity for grand-scale corruption by government officials and violent conflict in resource-dependent poor countries is likely to be diminished, while creating pressure for redirecting revenues towards poverty alleviation and improved governance.

*Publish What You Pay* proposes a number of mechanisms for implementing disclosure requirements, including:

- integrating them into security exchange conditions for listing companies;
- adapting the reporting requirements of the IAS (and other standards such as the GAAP in the U.S.) to include the disclosure of tax and other payments made by extractive industries, broken down per country.

One drawback of both mechanisms is their lack of universality: listing requirements would not affect state owned and non-public companies, while the IAS is currently not a global accounting standard, is generally not enforced by developing countries, and would not catch extractive companies and related commercial entities based in these countries, such as Angola's state oil company Sonangol.

Another is that, as initially formulated, the PWYP proposal focused on companies alone and did not address the need for government disclosure, which is essential for full transparency.

Finally, while disclosure is a necessary condition for improved governance, it is not sufficient. There is a need to transform disclosed information into effective accountability, including by providing technical training and capacity building to civil society and government administrators.

The PWYP initiative, backed now by the UK-Sponsored dialogue, Extractive Industry Transparency Initiative, and working through the IFIs, and the G8 has moved to address these concerns, that is: to require governments to provide full disclosure of extractive industry transactions; to explore mechanisms to promote universal standards and coverage (to state-owned and private companies) and to provide supplemental support for capacity building.

*Proposals to promote universal rules and compliance for all extractive companies:*

- Including transparency conditions on extractive companies receiving loan financing from banks and underwriting commitments from insurance companies.
- Making the provision of export credit support (which is the main source of extractive industry financing) conditional upon disclosure by payments to the state by the investors in those projects;
- Using existing frameworks, such as the OECD Anti-Bribery Convention, the OECD Guidelines for Multinationals, the and the Financial Action Task Force (against money-laundering), the International Convention against corruption, the Convention against

Transnational Organized Crime, as a platform for structuring clear rules for transparent financial relationships between multinational corporations and host governments;

*Proposals to Promote Government Disclosure:*

- Make transparency requirements a core feature in all lending and technical assistance programs, as well as national and multilateral poverty reduction strategies.
- Mainstreaming transparency requirements into World Bank and IMF their operations in the more than 50 countries where, according to the World Bank's own measure, natural resources are economically significant;
- Condition development aid on the incorporation of Conflict Impact Assessments into domestic law by governments;
- Integrate transparency capacity development and education into development assistance strategies.

2. Resourcing Development: Social Revenue Sharing

Many of the same mechanisms and strategies could be adapted to address the related problem of inequitable distribution of resources generated by natural resource exploitation, so often a source of social and political grievances that can trigger or exacerbate conflict. The use of social funds and social revenue-sharing schemes have the potential to reduce the macro-level economic distortions and developmental problems caused by resource windfalls as well as contribute to poverty reduction, environmentally and socially sustainable resource exploitation, and economic diversification that benefits a wider range of people.

*The Chad-Cameroon Pipeline*

Although not specifically undertaken to address conflict prevention or poverty reduction, this WB-sponsored public-private initiative between the governments of Chad and Cameroon and an international consortium of oil companies offers potential for further adaptation. The arrangement includes both a revenue-sharing scheme that allocates 80% of the pipelines revenues to a jointly (international and domestic) managed escrow fund which then channels allocations into agreed upon social and economic development projects.

The arrangement has several shortcomings: including a lack of transparency!, limited coverage of Chad's resource endowments, a sunset clause that allows the government to opt out after five years, as well as lack of capacity to make these developmental allocations effective.

However, it may offer important lessons for improved design and for improved strategies and mechanisms for effective and equitable revenue-sharing in resource rich countries that, on their own, may be unable or unwilling to do so.

**V. Unrealized Opportunities for UN Action:**

For UN peace and development agencies, with operations on the ground in weak governance zones or zones of conflict, there is a need for them to better monitor the positive and negative

impacts of private sector actors on peace and sustainable development, and to undertake policies that encourage the former while discouraging the latter.

This entails several areas for improvement:

- 1) UN agencies need a better understanding of the role of private sector actors, both criminal and “legitimate” in the particular settings in which they operate. There are a number of conflict impact assessment tools that have been developed for companies, and which UN agencies would do well in adapting, so as to identify potential problem areas and anticipate remedies.
- 2) Companies have complained that the UN has an “anti-Business” mindset<sup>1</sup>, one which not only precludes more positive collaborations and trust building with affected communities, but which also actually contributes to local tensions. In this regard, companies would welcome greater information sharing and multistakeholder partnerships with various UN agencies in-country. UN missions would do well to establish a local facility to engage with progressive companies and communities to promote conflict prevention and sustainable development, as well as to monitor and report on the pernicious impacts of regressive private sector actors.
- 3) UN development agencies need to look at all the components of sustainable development in a coherent and inclusive fashion. UN development policies should be aimed at including the “actually existing” private sector in development projects, rather than regard them as activities beyond UN mandates. This could be done by establishing an office or representative/specialist dedicated to understanding how private sector activities impact on agency mandates, projects and goals, to identifying problem areas, and to identifying policy responses as well as opportunities for engagement to ensure that private sector actors contribute to peace and development.
- 4) Critical areas in need of concerted policy efforts : natural resource extractive operations and revenue sharing mechanisms. As noted above, these are two primary areas where economic activity is critical to peace and sustainable development, and where current practices have been found wanting.

While there are a variety of emerging policy options for improved multilateral efforts to improve the conduct of extractive industries in conflict zones, as well as zones of weak governance generally, following the above discussion this memo will focus on those most relevant to ensuring that company conduct of business as usual “does no harm” to either security or development dynamics. Only once clear standards have been achieved on this minimum agenda for security and development should we begin to consider the policy options to advance the more expansive agenda of CSR in weak governance and conflict zones

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<sup>1</sup> Indeed, in all of the background papers provided for the DESA Task Force, none mentioned “private sector” and only one mentioned the word “business”, and this was in a quote from an SG report.