DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS

QUESTIONS FOR A MULTI-STAKEHOLDER DIALOGUE ON RESPONSIBLE INVESTMENT IN WEAK GOVERNANCE ZONES

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Preamble

The responses presented here comes from a larger context of the role being played by private corporations and particularly, the extractive industry in the political economics of most of the developing and under developed countries today, and their impacts on the social, legal, economic, political, cultural and ecological resources of these nation states. Experience of communities and civil society representing the concerns of communities abused and exploited by the extractive industries reveals that even in democratically strong and vibrant countries, elected governments are being weakened by the power and interference of trans-national and extractive industries to the extent of blatantly violating legislative, judicial and executive laws and orders while overtly influencing 'economic reforms', actively lobbying for constitutional amendments where protective safeguards towards communities, indigenous people, labour and national resources are detrimental to their businesses. Besides, not only being socially and environmentally irresponsible, disrespecting international standards and guidelines, particularly with regard to free and prior informed consent of indigenous peoples, the extractive industries are lobbying with international bodies and nation states to accept voluntary codes of conduct and self- regulatory corporate social responsibility in lieu of legally binding accountability. It is highly questionable, then, whether companies will act in the interest of a host country and its citizens' right to life and dignity in weak and unstable governance zones when the human rights of societies in strong governance zones are highly threatened by corporate bodies and international financial institutions.

Investor roles and home and host government responsibilities

1. Do companies have a role in helping to support reform of economic and political institutions in host societies?

   No, companies should not have a role in the policies and political reforms of host countries as their interests are not primarily that of welfare and justice of the majority society but mainly the extraction and commercialisation of the resources for business purposes. In normally 'healthy' democratic countries, they are tampering with the constitutional laws and are lobbying for investor friendly economic reforms which are not necessarily geared towards public good or economic growth of the majority. In weak governance and conflict zone countries, they will find it easier to manipulate political powers to bring swift economic reforms which enable them to quickly conduct their operations at the cost of social and environmental destruction.

2. If companies have such a role,

- Is this role different in weak governance zones than it would be elsewhere?

  Yes it will be worse in weak governance zones and heighten the conflicts by their interference and involvement.

- How are they to tell the difference between positive contributions to the reform process and inappropriate involvement in local politics (which Recommendations II.11 of the Guidelines asks them to avoid)?

  The difference is reflected in the nature of reforms that are brought in as a result of companies' involvement in the reform process. If socially just constitutions have been tampered with in the name of economic progress by bringing in free trade zones, privatization of national resources, de-regulation of laws which protect the interests of labour, indigenous communities, local communities, women and other marginalized communities, disinvestments and retrenchment in public sector companies in the midst of public protests and opposition, use of armies and military power to bring down public protest against companies interfering in the political and economic processes in host countries, harassment of civil society groups, illegal detention of communities, workers, NGO's, creating an environment of terror and human rights abuse, direct and indirect displacement of communities from their lands and ancestral properties often leading to migration, starvation, loss of livelihoods, pollution of environment with companies escaping accountability due to weak legislative, judicial and executive governance, increase in public corruption, suppression of independent functioning of media and communication systems are all indicators of the negative and inappropriate involvement of companies in host country activities and policies.

- How are they to distinguish between their own roles and those of host governments, international organizations and home governments (e.g. their diplomatic services, ODA programmes, etc)?

  If companies take on the role of the State, if they are influencing policies under puppet governments, if they are playing the role of taking political sides by supporting one party against the other, providing armed support, they are dangerously stepping out of their roles in order to ensure their business stability. This is totally unacceptable. Similarly, International financial institutions must not influence political and economic reforms of host countries on behalf of companies or industry lobbies in the name of economic progress, as is happening in most countries where IFC's are involved. They must first study these economic and political situations before they finance governments or companies in these zones because the State is a puppet both to companies and to IFC's in such zones. Companies must not align themselves either with IFC's or their home governments in imposing economic sanctions, supporting rival governments or countries with arms, military or other incentives if economic and political reforms of their convenience are not implemented by the host governments. If they find that either the host governments or rebel groups do not allow them to operate within their role, they should withdraw their operations from these zones rather than directly or indirectly aid conflict.

Investor roles in weak governance host societies

3. Investors in the DRC responded to threatened or actual abuse of political power by cultivating political ties so as to establish a kind of "home made" investment protection. How do efforts of this type affect the development of the rule of law in weak governance host societies?

   These kind of efforts totally destroy rule of law, more so in weak governance countries as citizens do not have a democratic means of public expression, media is stifled and human rights violations go unquestioned.

4. The DRC case study suggests that investors in weak governance host countries have to be well informed about the local political situation and about each other's activities.

   - What should a company do if it obtains information about wrongdoing by private actors or public officials? Should companies be encouraged to bear witness to wrongdoing? Under what circumstances should companies consider that they have whistle-blowing responsibilities?

     The main aim of the companies is to do profitable business, so they would rather use informal methods of communication between governments and rival groups to the extent that it is useful for their business. Ideally, any individual or institution has the responsibility of reporting wrongdoing, not only companies. However, the risks involved in conflict zones, deter either from doing so. It would be ethical for companies to withdraw their operations rather than be passive or active support to conflict.

   - Should their responses be different in weak governance zones than they would be in other investment environments? If so, how?

   - If companies have a responsibility to make their knowledge about wrongdoing public, how can they protect themselves against retaliation by host country actors?

     Normally conflicts and weak governance are a result of political and economic conflicts over resource ownership, utilization and benefits. In strong governance, a democratic framework provides the checks and balances. However, in weak governance zones the absence of these checks raises the need for companies to review their operations which also revolve around resource extraction and utilization and will certainly entail involvement in conflicts, to a large extent. Hence, their responses certainly have to be different in weak governance zones.

   Operating in these situations entails a substantial risk for companies but if they are able to link with global industry networks or international bodies for safety of host country citizens, then the target of the conflicts groups may not be centred on individual companies located in these zones. But it is rare to expect companies to respond in such a manner.

5. The DRC case study shows that oil and mining companies provided "monetisation" services that converted the DRC's natural resource assets into (mainly) financial assets that accrued to state-owned enterprises or to the Treasury at a time when few financial and fiscal controls were in place.

   - Does companies' provision of these services influence the nature of their responsibilities in weak governance host countries? If so, how?

     Firstly, it is unacceptable that a country's natural resources, (an asset is purely a commercial connotation while definition of resources extends across social, economic, cultural, ecological, *aesthetic, values of the resources) which are public property and ecological wealth of the nation, should be converted into fiscal assets. Companies or international financial institutions should not take advantage of the financial vulnerability of a country to convert them into assets. Secondly, we find that the converted assets are mainly exhausted for repayment of loans and financial deficits of the host countries and not for economic reinvestment to generate income and revenues for the country. Thirdly, the transactions, particularly in weak governance zones, are with politically corrupt governments, so natural resources are converted into financial misutilisation and not for public good. Companies must not be involved in such incentive drives or negotiations.*

- How can these companies avoid giving the appearance that they are aiding and abetting people who might be in a position to take advantage of the weak financial and fiscal controls in the host country?

  In such conflict situations, it is very difficult for companies to avoid appearances of involvement with the wrong people or groups, as they are directly dealing with corrupt and weak governments where laws are not in place. In such situations, the media and the public also have no access to correct and truthful information to take the right decisions about the companies. If companies still wish to operate in such circumstances, they have to agree to utmost transparency and public scrutiny of not only host country citizens, but also international bodies, human rights organisations and civil society groups outside these countries, as the host country citizens do not have democratic rights.

6. Is there any special role that financial companies can play (besides their important and often legally required contribution to helping combat money laundering) in improving the institutional framework in weak governance host countries?

   These financial companies should have strict guidelines which are on lines with international standards and instruments like the OECD guidelines. They should also insist on companies adhering to these guidelines under strict negotiations of right to withdrawal if companies stray from these guidelines.

Corporate governance – creating shareholder value with integrity:

7. The Disclosure chapter of the guidelines encourages companies to apply high standards of financial and non-financial disclosure. Do companies have an extra duty of transparency when investing in non-transparent host countries or are their responsibilities in this area the same in all host countries?

   Yes, they do have an extra duty of transparency to international bodies, civil society groups, share-holders and host country citizens.

8. OECD societies have valid reasons – grounded in the public interest – for holding large, publicly-listed companies to higher transparency standards than smaller and/or unlisted companies. The case study of publicly listed junior mining companies with DRC investments suggests that the juniors have smaller, less open boards than large companies, are less likely to report on company policies, management practices and performance in non-financial areas. The small unlisted mining companies in the case study are found to be less transparent than both large and small publicly listed companies in the financial and non financial areas.

   - Should junior and small unlisted companies be encouraged to use their boards to assign high strategic priority to the ethical management of their investments in weak governance zones? If so, how could this be done (e.g. add board members, create a special committee with access to relevant expertise)?

Junior and senior companies alike must follow strict international standards and guidelines. Companies must be obliged to conform to these principles although they are lobbying for removal or dilution of these guidelines in the name of investor friendly economic progress to combat the instability of host countries. They can access international guidelines, standards and ethical codes being adopted internationally. Host and home countries must monitor the activities of these companies. Human rights cannot be compromised in the name of small business enterprises.

- Recommendation II.8 of the Guidelines asks companies "to develop and apply….management systems that foster a relationship of confidence….." with the societies in which they operate. The Disclosure chapter encourages them to communicate information on "systems for managing risks and complying with laws, an on statements or codes of business conduct". How do these recommendations apply to small unlisted companies and to junior companies in weak governance zones? Should they be encouraged to adopt internal compliance and external non-financial reporting practices that the case study shows to be common among larger extractive industry companies?

- Chapter I of the Guidelines acknowledges that small and medium sized companies may not have the same capacity to observe the Guidelines as larger enterprises. Is asking the juniors and the small unlisted companies to open up their boards, adopt advanced compliance programmes and engage in extensive non-financial reporting equivalent to asking these companies to act like large publicly listed companies? If so, is this reasonable?

We agree with RAID that all companies alike must observe the Guidelines.

Doing business with weak governance state owned enterprises (SOEs)

9. The case study shows that many OECD based companies had joint ventures and other business relations with SOE's in the DRC and suggests that these SOEs' governance rules were weak. OECD and non-OECD experience shows that weak governance SOEs can be a mechanism for lowering public wealth through waste or questionable business practices. Through their joint venture arrangements, OECD based companies provide services and revenues to SOEs.

- Are companies' responsibilities the same when they enter into joint ventures with weak governance SOEs as their responsibilities with stronger governance SOEs?

Yes, they have greater responsibility as the SOE's are either dysfunctional or corrupt and are willing to hand over valuable national resources and public assets to the private partner in order to maintain the joint venture. Sale of strong profit making SOEs to private companies in the extractive sector is taking place in strong governance countries, so in weak zones, these transactions create a greater public loss to the national economy when there is no scope for public scrutiny.

- What SOE characteristics should an investor look at when considering whether or not to enter into partnerships with weak governance SOEs and when deciding how such partnerships should be managed?

We are increasingly finding that companies are trying to take advantage of weak governments in order to purchase SOEs and through devaluation of the SOE profits and assets. It is difficult to believe that private mining and oil companies, particularly in DRC and other weak *governance zones, will follow strict self regulatory principles or even follow OECD principles when entering into joint ventures to operate in weak governance zones. The case study reveals this issue clearly.*

- Guidelines Chapter X asks companies to conform "transfer pricing practices to the arm's length principle." Should companies be encouraged to apply this principle when structuring transactions with SOEs, even when it is not required by law or is not a common business practice in the host country?

  They have to strictly follow international standards and OECD guidelines.

10. Many of the larger multinational enterprises in the DRC mining sector tend to be non-operating shareholders in mixed public/ private companies. In this respect their positions and interests are similar to those of the DRC citizens. In addition, large publicly listed companies tend to have significant expertise in corporate governance, involving elaborate and transparent governance practices. The current DRC government has identified SOE reform as a policy priority.

- Should such companies be encouraged to seek to protect the interests of host country citizens (as shareholders in these partially state-owned companies) or are their responsibilities limited to protecting the interests of their own shareholders?

  Mining companies are not ready to take responsibility for losses and exploitation of host country citizens in strong governance countries, so we are not confident that they will perform this role of protecting the citizens of weak governance countries.

- Recommendation II.6 of the Guidelines asks companies to "uphold good corporate governance principles", while Recommendation II.3 asks them to "encourage local capacity building through close cooperation with the local community, including business interests". Should large companies be encouraged to share their governance expertise with their SOE partners?

  Yes it is expected that they first clean up their questionable practices and set the highest standards based on international guidelines and follow them strictly to set an example to their SOE counterparts.

Corporate tax payments into weak governance fiscal systems

11. Do companies that make large tax and royalty payments to weak governance fiscal systems have a role in supporting reform of these systems?

    We are not confident that companies who pay large tax and royalty to weak governments will support reform which is likely to protect public good and not short term private business interests because these royalties are paid in lieu of relaxation of rules and laws detrimental to their business. It is rare to find companies which have the larger economic progress of the host country before their own business interests.

12. If it is agreed that companies have such roles, then:

- How do these relate to those of other actors, notably host governments and international financial institutions (whose mission is *inter alia* to promote public sector reform)?

  We find that the role being played by IFI's in public sector reforms in many countries are promoting the interests of private industries rather than the public good of the citizens, even where there are strong protests and opposition to these reforms. We also see a strong nexus *between the IFI's and the extractive industry in influencing these reforms. When IFI's posing as development agencies are acting against the societies' interests in host countries, it is difficult to expect companies to play a socially fair economic reforms role.*

- How can companies most effectively go about supporting reform? Should companies refrain from signing contracts with governments that prohibit them from publishing their payments to host country treasuries? Are there countervailing concerns about business confidentiality that cannot be met trough appropriate contracting?

  Any utilization of public resources requires utmost accountability and public accountability is paramount to a healthy economic progress. Companies which find governments not willing to disclose payments should refrain from doing business in those countries.

13. Do the questions set forth in Annex Table 2 – which are based on the OECD Best Practices for Budget Transparency – provide a good basis for identifying weak fiscal systems and areas where reform is needed?

Eradicating bribery of public officials

14. Chapter VI of the Guidelines asks companies to promote employee awareness of and compliance with company policies against bribery and extortion and to adopt management control systems that discourage bribery and corrupt practices. Do participants agree that these recommendations are particularly relevant for investors in weak governance zones, where bribery and corruption is common?

    We completely agree with RAID on this matter that companies should comply with the OECD guidelines on bribery, as this will fuel conflicts and war in already weak governments.

15. Recommendation VI.2 of the Guidelines asks companies to 'ensure that remuneration of agents is appropriate and for legitimate services only". When a company's agent or other business partner is found to have bribed public officials, is it sufficient for the company to severe its relationship with the agent or should it be encouraged to take additional remedial actions? If so, what kinds of actions would be appropriate?

    The company should not be allowed to operate in the host country by its home government until it has stopped the practice of bribes and other such negotiations along with its agent.

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