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in Natural Resources
Geneva, 20–22 November 2006

REPORT OF THE EXPERT MEETING ON FOREIGN DIRECT INVESTMENT IN NATURAL RESOURCES

Held at the Palais des Nations, Geneva,
from 20 to 22 November 2006

CONTENTS

Chapter I

CHAIRPERSON'S SUMMARY

1. In accordance with its agenda, the Expert Meeting on Foreign Direct Investment in Natural Resources discussed the role of transnational corporations (TNCs) in extractive industries and key implications for developing countries. The Meeting focused on economic, social and environmental development challenges related to the extraction of oil, gas and selected metal minerals.

2. In his opening address, the Chairperson of the Expert Meeting stressed the timeliness of revisiting the interface between international investment in resource extraction and development. He noted that the supply and demand of natural resources had resurfaced at the top of the international political agenda. The role of TNCs had undergone significant change in recent decades. For example, many developing-country firms in the extractive industries were emerging as regional or global players. He underlined that, for many African countries, most foreign direct investment (FDI) inflows were related to the extraction of natural resources, but that many unmet expectations concerning the development impacts of such investment remained. The Secretary-General of UNCTAD urged the Meeting to explore what policy measures could be taken at national and international levels to promote greater development benefits. He emphasized the importance of bringing all relevant stakeholders – home and host countries, local communities, trade unions, the private sector and civil society – into the discussion.

3. Several experts stressed the strategic importance of natural resources. In that respect they highlighted the need for adequate policy space for countries to ensure that FDI would contribute to their priorities and national development objectives.

4. Experts considered recent changes taking place in the extractive industries. Over the past few years, investments in these industries had increased dramatically on the back of high commodity prices. The implications for meeting growing energy demand, enhancing security of energy supplies and reducing energy poverty were noted. It had been estimated that investment in oil exploration and production would be 90 per cent higher in 2007 than in 2004. Exploration expenditures had also grown rapidly in metal mining, especially in developing and transition economies. The unprecedented level of FDI flows to Africa in 2005 had been triggered mainly by investments in the oil and gas industry.

5. It was noted that the role of TNCs varied considerably between oil and gas on the one hand and metal mining on the other. In oil and gas, State-owned companies had increasingly gained control over exploration and extraction during the past three decades. For example, national oil companies now controlled some 82 per cent of all known oil reserves. Moreover, while developed-country TNCs were still the main players in terms of FDI in oil and gas, some developing-country State-owned companies – not least from China and India – were also emerging as important outward investors. In metal mining, developed-country TNCs remained dominant, although firms from Latin America, the Russian Federation, China and India were increasingly expanding overseas. Surprisingly, despite various large international acquisitions, the level of concentration had so far changed little in the majority of metal industries.

6. Experts agreed that recent commodity price increases had had a notable influence on investment decisions. The recent commodity boom appeared to be somewhat different from

previous booms since the Second World War in at least three respects. First, the hike in prices had not brought developed economies into recession. Second, the main demand growth now came from developing Asia, and especially from China. It was noted that, since 2004-2005, Asia's demand for oil was higher than that of North America. The high intensity of mineral use in these economies was related to their present stage of development, which required, for example, the construction of infrastructure and heavy industries. Third, although difficult to measure, speculative activity was also likely to have fuelled the recent boom.

7. The commodity boom had also affected policies concerning the entry and operations of TNCs in extractive industries. Several references were made to changes in legislation in important mining economies, often aimed at raising royalties and taxes on resource extraction, renegotiating contracts with TNCs, or increasing State ownership. Surveys of investor perceptions had found that the relative attractiveness of selected mineral-rich countries had declined since 2001. Some experts raised concerns that a forced retreat of TNCs might increase the risk of investment collapsing. For the mining sector, reference was made to growing barriers to entry and more difficult access to land as key challenges in expanding the supply of certain minerals.

8. There was no consensus as to the likely scenario for future prices of oil, gas and metal minerals. Experts agreed that the situation was highly uncertain. There was considerable debate as to whether a structural shift was taking place in the market or not. Some expected higher prices to be sustained as a result of an accentuated degree of depletion, the demand growth from China and India, rising costs of extraction and recovery, and higher barriers to entry, at least for certain metals. Others disagreed on the grounds that mineral reserves continued to grow and that increased demand should eventually be met with increased supply. In this latter scenario, capacity growth would outpace demand growth, causing prices to tumble.

9. Several experts underlined the relevance of energy security in considering the links between TNCs and extractive industries. Several incidents in different parts of the world, including terrorist attacks, natural disasters, electricity blackouts and disruptions in natural gas supply, had contributed to the fact that energy security issues were climbing on the international political agenda. Concerns had been further accentuated by rising energy prices. Measures to cope with energy security included both national strategies (e.g. to diversify a country’s energy sources) and international collaboration, for example in the context of the G8, APEC and the Energy Charter Treaty.

10. The importance of South-South cooperation in the current scenario was highlighted by some experts. New alternatives and examples were given in the area of oil and gas through the framework of ALBA (Bolivarian Alternative for Latin American and the Caribbean), which in a few months had provided concrete results on development issues to Cuba, Venezuela and Bolivia, as well as through Petrocaribe between Venezuela and the Caribbean countries.

11. The usefulness of international investment agreements was discussed. It was noted that bilateral investment treaties offered additional protection to foreign investors; that the Energy Charter Treaty included both investor-State and State-to-State dispute settlement mechanisms; and that most production-sharing agreements also included provisions concerning dispute settlement. However, few if any studies had been undertaken to investigate the impact of international investment agreements on FDI specifically in extractive industries. Some delegations suggested that multilateral solutions were superior to

bilateral ones. Others underlined the importance of considering the benefits for both host countries and investors in order to find the appropriate balance.

12. Much of the discussion was devoted to the potential impacts of TNC involvement in resource extraction and related policy implications. Experts agreed that mining provided opportunities for economic growth and poverty alleviation. However, the social and economic outcome of involving TNCs in extractive industries was governance-dependent. Many mineral-rich countries had failed to realize the economic development potential of the exploitation of their endowments. Several speakers referred to the resource curse, suggesting that countries well endowed with natural resources had grown more slowly than those without such resources. Meanwhile, some experts cautioned that the empirical evidence was mixed, and that statistical results depended on the definition of resources and country samples.

13. From an economic development perspective, key areas of consideration included the size and distribution of budget and export revenues from extractive industries; creation of employment and local linkages; and industrial diversification and infrastructure development. Potential contributions of TNCs were identified to include capital; management and technical skills; business development skills; promotion of higher standards; and good operational practices. To benefit from such contributions, it was important for countries to adopt adequate legal and institutional frameworks and to strike an appropriate balance between the interests of the private sector, the national host-country Government and the local community.

14. Experts noted that the implications of investment in metals mining and in oil and gas differed in important respects. Key differences included the size of the resource rent; market structures; the diversity of the industries; price volatility; and ownership structure. These differences had, among other things, resulted in much higher levels of fiscal takes on net profits in the oil industry, and a proliferation of different “fiscal packages” both between and within countries.

15. In the oil industry, it was typically national oil companies that negotiated with foreign investors on behalf of their Governments. Established oil-producing countries could often take 70-90 per cent of net project profits and still attract foreign investment. Involvement of foreign companies was particularly common when exploration projects were technologically complex or when domestic technological capabilities were lacking. With high oil prices, a number of countries had taken steps to increase State takes. An example was Bolivia, where increased taxes and royalties and the renegotiation of contracts with foreign oil companies had ratcheted up the State’s take from 18 per cent to about 80 per cent.

16. In the metal mining industry, the common approach to regulating the involvement of TNCs in most developing countries had been through the use of mining codes, mining agreements and mining royalties. It was noted that structural conditionality imposed by multilateral financial institutions had sometimes resulted in too little attention being given to the choice and the design of development strategies, as well as reduced space for alternative policies. Case studies showed that reforms of fiscal and regulatory frameworks of extractive industries in order to open these industries to FDI had often been introduced without the safeguards necessary to achieve long-term development objectives. Neither had such reforms contributed to redefining past asymmetrical relations between investors and host Governments. Following extensive liberalization efforts in the 1990s, at a time when mineral prices had been generally depressed, many countries had adopted mining codes, and

negotiated contracts, that were seen by some experts as being too generous vis-à-vis foreign investors.

17. However, recent legislative changes in Latin America and some African countries were seen by some experts as a turning point, with Governments revisiting past mining codes. Key concerns revolved around the fact that Governments had entered into contracts that had resulted in meagre royalties, a lack of transparency and at times poor social relations. One problem highlighted by several speakers related to the inadequate skills and capabilities of mining administrations when engaging in complex negotiations over fiscal terms. This situation was more acute in the case of mining, where negotiations were often handled by ministries rather than by national mining companies. The outcome of some negotiations had set dangerous precedents as future investors might demand similar treatment.

18. Several experts questioned the usefulness of seeking to develop model mining codes. It was recognized that each country should develop codes that reflected, for example, the nature of the minerals it possessed, its stage of development, its institutional set-up and its geographical location. However, it was stressed that countries should seek to make use of the best available practices when designing their codes. Based on a review of experience of different countries, this could lead to both market-oriented models and models involving a relatively high level of state involvement. Some experts stressed the importance of sufficient policy space for countries reflecting the development agenda with a view to achieving sustainable development gains.

19. In light of the cyclical nature of commodity markets, it was argued that countries should design their policies with a long-term perspective in order to ensure long-term sustainable investment. This could involve flexible contracts that were cost and price indexed, which could better align the interests of both countries and companies.

20. Some experts proposed a two-pronged approach, whereby the type of mining licence should depend on the level of risk involved. Under such a system, a host country should impose stricter conditions for licenses for projects that involved relatively low levels of risk. Other speakers warned about tailoring special packages to different levels of risk, partly because it could become burdensome for relatively weak mining administrations and because it was more difficult to generate bidding processes with competing proposals in the mining industry. Establishing the risk level of a project might also be difficult for Governments. An alternative approach was to adopt fixed regimes, but with a progressive element in order to increase government takes at times of high prices.

21. Despite very generous mining codes, most experts argued that Africa was receiving relatively low levels of mining investment given the vast resources of the continent. Important factors behind this observation included the insufficient quantity and quality of geological data. Lack of such data implied greater risks for companies when investing in exploration, and also often led countries to underestimate the value of their mineral deposits. Another factor was the lack of infrastructure, which sometimes made extractive projects too expensive to undertake.

22. Some experts asked how the necessary skills and capabilities could be developed in mining-rich countries' administrations. While the main responsibility for this lay with the countries themselves, there was agreement that technical assistance in this area would be helpful, but also that it was currently very slim, especially assistance from the United Nations system. Some assistance was offered by the Commonwealth Secretariat, and the Norwegian

Government had launched a project aimed at systematically sharing the Norwegian experience with oil-producing nations. Funding for capacity-building in this area was extremely limited. It was suggested that UNCTAD could potentially play a more important role in this context. Fields to consider included policy analysis, technical assistance (e.g. capacity-building in respect of negotiating agreements and designing mining codes) and sharing of experience through its intergovernmental machinery.

23. Experts stressed the need to improve governance in resource-rich countries in order to ensure a fair distribution of revenues between government and firms on the one hand and the contribution to sustainable development and poverty reduction on the other. Good governance could contribute to clear and stable laws and regulations, budget discipline, and dialogue among all stakeholders. Transparency was seen to increase accountability, reduce waste and corruption, improve macroeconomic management and enhance access to finance. Some experts underlined that any discussion on corruption had to consider both parts of the corruption process. Various examples were given in the Meeting of countries that had revised their legal and institutional frameworks with a view to improving governance, as well as the distribution of benefits to the poor.

24. Several developed and developing countries had established stabilization funds or future generation funds as a tool to limit the risk of Dutch Disease and to ensure longer-term benefits from current resource extraction activities. Experts noted that such funds could support fiscal management, especially if there was wide political and public support for the way the funds were managed, clear rules, and the generation of genuine savings. However, it was also argued that the question as to whether it would be appropriate to set up a fund would depend on the specific situation of a country. Important lessons could be learned, for example, from Azerbaijan, Chile, Norway and Timor-Leste, where such funds had been set up.

25. A distinction was made between industrial and artisanal mining. It was argued that small-scale coal mining had had a very negative effect on worker safety. At the same time, it was also recognized that, despite the health and safety problems, many millions of people in the world still depended on small-scale mining. The interface between TNCs and artisanal mining was a complex issue, as the two often competed in a given country. Governments were seen as having a potentially key role as a mediator in such situations.

26. The implications of the rise of South-South FDI were also addressed. Some experts stressed that such flows could sometimes involve greater associated investment in infrastructure, education and local community development. They were seen as a new source of financing, as well as a new form of partnership for low-income economies. At the same time, some speakers noted that some developing-country State-owned enterprises did not yet comply with the same corporate governance regulations as the large traditional TNCs. Only a few national oil companies, such as Statoil, subscribed to principles of payment disclosure. Some concerns were also raised in connection with the impact on local employment of cases where companies used expatriate labour in the host country.

27. In order to ensure sustainable development gains from extraction of natural resources, many experts underlined the necessity of getting all direct stakeholders involved in the process, especially at the local community level. The example of the province of Espinar in Peru was presented. In this case, a process leading to the signing of a framework agreement between a foreign affiliate of a TNC, the provincial government and civil society had started in 2002. The main idea was to promote confidence and to achieve greater local economic

benefits, as well as smaller environmental and social costs, as a result of mining activities. In the process, a number of local community workshops and consultations had taken place with a view to building trust and enhancing the understanding of relevant issues. Moreover, as a result of the agreement, the local community now had considerably higher revenues that could be invested in local development projects, and a number of safeguards had been put in place to minimize the environmental risks. The local community faced a challenge, however, in finding the best uses for the funds created. It was emphasized that training of both government officials and workers was needed to develop the capabilities required to foster development and to enable local communities to be prepared before an investment actually took place. The Meeting took note of various international programmes aimed at strengthening local community capacity, such as the new World Bank facility, CommDev.

28. Experts stressed that mining activities were inherently unsustainable. It was therefore important to ensure that they played a catalytic role in the process of economic development. Due to the limited employment opportunities in mining, which was a highly capital-intensive activity, it was important to identify other industries that could benefit from revenues created through resource extraction. The importance of promoting linkages in order to create greater economic benefits was underlined. Such linkages could involve downstream activities that could add value to resources before they were exported; sidestream activities in the form of industries supplying inputs (goods and services) to the extractive industries; technological linkages; and infrastructural linkages, e.g. related to energy or transportation. It was suggested that countries should seek to develop clear development strategies to enable them to build on their resources in order to catalyze the development of these and other industries. The Spatial Development Initiatives in the African context were noted as important steps in that direction. Some delegations pointed out that strategic development plans were important to enhance the effectiveness of the distribution of State revenue to benefit poorer segments of the population.

29. The link between extractive industries and human rights was discussed. Work by the Special Representative of the Secretary-General on Human Rights and Transnational Corporations had found extractive industries to be overrepresented in cases concerning human rights violations highlighted by civil society. There was often a correlation between such incidents and the presence of low income levels, weak governance and conflicts in the countries concerned. It was noted that some progress was being made, thanks to various international initiatives and to growing awareness among companies and Governments of the need to address this area, but much remained to be done. One of the remaining issues was how to ensure that smaller and medium-size companies as well as State-owned enterprises also lived up to agreed standards and procedures. It was noted that the International Council on Mining and Metals (ICMM) had adopted a set of principles and monitoring procedures. However, these applied only to their 15 member companies, which were all so-called mining “majors”. No similar initiative existed in the oil industry. The role of junior mining companies was identified as a problem.

30. Various international initiatives were referred to. For example, 25 developing countries had endorsed or were actively implementing the Extractive Industries Transparency Initiative (EITI), which aimed to improve transparency and accountability through the publication and verification of company payments and government revenues in oil, gas and mining. Several experts called upon more countries to sign up to the EITI process. The EITI was supported by the ICMM, as well as by a number of civil society organizations. The potential role of banks in the EITI context was debated. A key advantage of the EITI

approach was that the participation of countries was voluntary; when countries did commit to the initiative, the transparency provisions applied to all companies in the country – foreign and domestic, large and small.

31. New environmental and social standards adopted by the International Finance Corporation (IFC) that were applied when it made investments were noted, as were the Equator Principles. The latter were a voluntary set of guidelines for managing environmental and social issues in project financing. To date, more than 40 of the most important institutions financing projects in developing countries had signed up to these principles.

32. The International Labour Organization (ILO) had invited Governments and other international organizations to participate in a project it was about to initiate together with the Centre de Recherches Enterprises et Societés (CRES) on assessing the experience of local content development in the oil sector. The International Trade Union Confederation stressed the need for TNCs investing abroad to adhere to fundamental labour standards, as set out in ILO Conventions and reemphasized by the ILO Declaration on Fundamental Principles and Rights at Work (1998). It also underlined the importance in extractive industries of the right to organize and collective bargaining, which enables workers to get a fair share of the benefits. It further mentioned the significance of international framework agreements concluded between the International Federation of Chemical, Energy, Mine and General Workers' Unions (ICEM) and TNCs and the interest expressed by ICEM in being involved in follow-up work by UNCTAD on FDI in extractive industries.

33. In terms of mitigating the risk that investment and trade could fuel or prolong armed conflict situations in developing countries, reference was made to the Kimberley Process Certification Scheme – a United-Nations-backed intergovernmental instrument involving the official certification of all rough diamond shipments. It now had near universal participation of diamond producing, trading and polishing countries. Since it had been formalized in November 2002, the process had evolved progressively with the addition of provisions on monitoring, compliance/admission and statistics. A question that needed further consideration was to what extent the experiences of the Kimberley Process could be applied effectively in the context of other commodities. It was indicated that UNCTAD could offer an important forum for further discussions in this area.

34. There was broad agreement that civil society had an essential role to play in the process of promoting greater development benefits from resource extraction. NGOs, such as Publish What You Pay and Global Witness, had helped shed light on many issues that had subsequently been picked up in international initiatives. In this context, the role of locally based civil society organizations in developing countries was particularly emphasized.

35. With regard to future orientations, a number of recommendations emerged from the deliberations for Governments, the private sector and the international community as a whole:

- There is a need for more technical assistance for developing countries aimed at improving regulatory frameworks (including mining codes) and institutional capabilities in order to allow them to benefit more from extractive industries;

- Technical assistance is also needed to strengthen the capability of developing countries to negotiate with TNCs, an area in which UNCTAD should play a more active role;

- Further policy analysis should be undertaken on ways to encourage industrialization and diversification based on resource extraction;
- Further policy analysis is also needed on ways to improve mining taxation schemes;
- As part of efforts to enhance their institutional capabilities, developing countries also need to develop their geological survey data in order to strengthen their bargaining positions;
- More countries and companies involved in extractive industries should be encouraged to sign up to the EITI;
- The scope for South-South collaboration in the area of developing development-friendly policies and institutions regulating the involvement of TNCs in extractive industries should be further explored.

Chapter II

ORGANIZATIONAL MATTERS

A. Election of officers

36. At its opening meeting, the Expert Meeting elected the following officers to serve on its bureau:

Chairperson:	Mr. Arcanjo Maria do Nascimento (Angola)
Vice-Chairperson-cum-Rapporteur:	Mr. Morten Svelle

B. Adoption of the agenda and organization of work

37. At the same meeting, the Expert Meeting adopted the provisional agenda circulated in document TD/B/COM.2/EM.20/1. The agenda for the Meeting was thus as follows:

1. Election of officers
2. Adoption of the agenda
3. FDI in natural resources
4. Adoption of the report of the Meeting

C. Documentation

38. For its consideration of the substantive agenda item, the Expert Meeting had before it a note by the UNCTAD secretariat entitled “Transnational corporations, extractive industries and development: implications for policies” (TD/B/COM.2/EM.20/2).

D. Adoption of the report of the Meeting

39. At its closing meeting, the Expert Meeting authorized the Rapporteur to prepare the final report of the Meeting under the authority of the Chairperson.

Annex

ATTENDANCE[1]

1. Experts from the following States members of UNCTAD attended the Meeting:

Algeria
Argentina
Bangladesh
Belgium
Benin
Bolivia
Brazil
Central African Republic
China
Côte d'Ivoire
Cuba
Democratic Republic of the Congo
Dominican Republic
Ecuador
Finland
Germany
Haiti
Holy See
India
Indonesia
Iran (Islamic Republic of)
Italy
Jordan
Madagascar
Mauritania
Moldova
Norway
Oman
Pakistan
Philippines
Russian Federation
Saudi Arabia
Serbia
Spain
Sudan
Syrian Arab Republic
Switzerland
Timor-Leste
Uganda
United Arab Emirates
United Kingdom of Great Britain and Northern Ireland
United States of America
Yemen
Zambia
Zimbabwe

2. The following intergovernmental organizations were represented at the Meeting:

African Union
African, Caribbean and Pacific Group of States
European Commission
South Centre

3. The following United Nations agencies were represented at the Meeting:

Economic Commission for Africa
Office of the High Commissioner for Human Rights

[1] For the list of participants, see TD/B/COM.2/EM.20/INF.1.

4. The following specialized agencies and related organizations were represented at the Meeting:

International Labour Organization
United Nations Industrial Development Organization
World Trade Organization

5. The following non-governmental organizations attended the Meeting:

General Category

BPW International
Engineers of the World
International Confederation of Free Trade Unions
International Co-operation for Development and Solidarity

Special Category

Center for International Environmental Law

6. The following panellists attended the Meeting:

20 November

Mr. James Rosenfield, Senior Advisor, Cambridge Energy Research Associates, United States
Mr. Damian Brett, Mineral Economist, Raw Materials Group, Sweden
Mr. Manfred Lindvall, Vice President, Lundin Mining, Sweden
Mr. Marian Radetzki, Professor, Luleå University of Technology, Sweden
Mr. Klaus Brendow, Senior Advisor, World Energy Council
Mr. Miharu Kanai, Senior Expert, Energy Charter Secretariat
Mr. David Humphreys, Chief Economist, Norilsk Nickel, Russian Federation

21 November

Ms. Bonnie Campbell, Professor, Department of Political Science, Quebec University, Montreal, Canada
Mr. John Groom, Vice-President, Anglo American
Mr. Paul Jourdan, CEO, Mintek, South Africa
Mr. Morten Svelle, Technical Director, Sustainable Economic Development Norad, Norway
Mr. François Ndengwe, Telema
Mr. Bryan Land, Head, Economic and Legal Section, Commonwealth Secretariat
M. Mohamedou Diaby, Secretary-General, Ministry of Mines and Industry, Mauritania
Mr. Fridtjof Berents, Assistant Director General, Norwegian Ministry of Finance
Mr. Daniel Graymore, Private Sector Adviser, Secretariat for the Extractive Industries Transparency Initiative, United Kingdom

22 November

Mr. Clive Armstrong, Lead Economist, World Bank/IFC
Mr. Luis Alvarez, Mayor, Provincial Municipality of Espinar, Peru
Mr. Gerald Pachoud, Special Adviser to the Special Representative of the Secretary-General on Business and Human Rights

Mr. Kim Eling, First Secretary, European Commission Delegation, Geneva
Mr. Liu Qiang, Assistant Research Professor, Energy Research Institute, National Development and Reform Commission, China
Ms. Huaichuan Rui, Lecturer in International Business and Strategy, Brunel University, United Kingdom
Ms. Sarah Wykes, Senior Campaigner, Global Witness
Mr. Matthew Robinson, Energy Research, Accenture

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