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Para-economic Expenditures by Oil Companies

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The increasingly vocal debate about corporate accountability – whether in terms of financial probity, transparency or social responsibility – has recently crystallised in a number of national and international legal instruments designed to reduce or eliminate unacceptable business practices, broadly defined as “those that are not allowed at home, and hence should not be practiced away from home”. This note explores one aspect of this subject, namely those ‘murky payments’ that are not explicitly required by law, yet seem “necessary to get the job done”. This paper focuses on defining such payments, and develops and explores a proposal for their exposure and accounting.

Traditionally, public opinion in most countries has taken it for granted that the profitability of the oil business is in large part a function of the oil industry's leverage on governments and its ability to set the terms of trade unfairly to the industry's advantage. However, this negative perception has not really had a great impact on the way that oil companies go about their business, except at a few critical junctures. We appear to be at such a juncture today. Indeed, it is probably fair to say that international oil company managements have not been subjected to so much corporate responsibility pressure since the days of the Rhodesian blockade and the South African oil embargo. This time round, though, the backdrop to the demands that the Augean stables be cleaned has been the wide-spread and growing distrust of the management of major companies amongst shareholders, who have seen the value of their investments deteriorate in the wake of a series of high-profile corporate governance scandals.

Given the colossal economic interests that revolve around oil, it is only natural perhaps that the reaction to the breaches of corporate responsibility (particularly in the area of oil companies' relationships with governmental actors) should be primarily emotive. Unfortunately, this also constitutes a major obstacle to understanding and dealing with the underlying conditions that almost inevitably lead to “murky payments” being made, not only in dysfunctional developing countries but also in the developed world (*vide* the latest in the Elf bribery trials). Indeed, when revising the extant literature on this subject, it is difficult not to be reminded of Carlyle's opinion about the historiography of the French Revolution: "It is unfortunate, though very natural, that the history of this period has so generally been written in hysterics. Exaggeration abounds, execration, wailing; and on the whole, darkness".

One of the reasons why the debate on this topic has not produced much new thinking leading to suggestions for improvement can be traced to the failure to move from the anecdotal plane to the next step: the critical examination of the underlying motives for endemic corruption but also of the reasons why certain industries (armaments, civil engineering and infrastructure, commercial aircraft, petroleum, to name the most prominent) are particularly prone to it. A principal reason for the unsatisfactory state of the debate, however, is the schizoid attitude that many opinion leaders in the West display towards the issue of corruption. Their attitude has two basic dimensions, one practical and one legal, which are complementary but actually seem to pull in opposite directions. We shall examine each one of these dimensions in turn.

At the practical level, the attitude we are talking about attempts to draw a supposedly pragmatic distinction between corporate responsibility issues in stable and democratic countries, on one side, and in the less salubrious places of the globe, on the other. It posits that in countries of the developed world, corruption cannot and should not be condoned or excused under any circumstance. At the same time, it two-facedly holds that the notion that bribery and extortion should not be allowed anywhere anytime is idealistic and not really applicable to countries where laws are not conducive to clean and transparent business, where payments are very often required for a host of services outside projects *per se* and where, crucially, most of the oil in the world available to private companies is now to be found. In these countries, the argument goes, “gifts” (that would be called outright “bribes” in the West) actually function as a palliative for the non-existent rule of law, thereby “oiling” the machinery of government in a way that allows economic activity to take place. Without such “oiling”, trust-based relationships with local elites cannot be built and resource development therefore cannot take place, which would ultimately be to the detriment of both the populations of these countries (whose main hope of progress involves oil being extracted and exported by foreign oil companies), and the oil companies and their shareholders. Ultimately, the argument concludes, however distasteful this sort of activity might appear to some Western eyes, companies would not be discharging their duties to their shareholders if they turned down opportunities just because they involved “oiling” (in its bribery sense), not least because some of their competitors would not necessarily feel themselves bound by similar scruples. And if these “facts of life” make some shareholders and critics queasy, then these people should ponder on the fact that it is not so long since “cowboy” or “crony” capitalism gave rise to the rule of law in most (but by no means all) western market economies and that, with any luck, bribes and grease will gradually wither away as economic progress eliminates the economic gap that they are substituting for.

There are many objections one can pose against this point of view. First of all, even if one grants that grease might serve a function in places where there is only a rudimentary system for the enforcement of property rights, grand corruption can never be anything other than a millstone around a country’s neck (a popular saying of early post-revolutionary Mexican vintage pertinently pointed out that the key reason why the Mexican states were not as productive as they could be was that they were required to produce a rich governor and state legislature every four years). Moreover, it is both sanctimonious and patronising, not least in the way in which it glosses over the frequency with which one encounters large doubtful payments and illegal political contributions in the supposedly “clean” developed countries. It also ignores the fact that Enron’s above-board deregulation-linked campaign contributions, for instance, do not necessarily differ in principle from a decision taken by a Western company to offer a bribe to authorities in order to obtain an oil concession in an underdeveloped

nation Indeed, the main difference is one of degree. The link between payment and the desired outcome is highly attenuated in the West, where the polyarchical nature of politics greatly increases uncertainty because of the many actors who can oppose or hinder any policy initiative. Thus George W. Bush and his Congressional fraction might have delivered to the oil industry on the ANWR issue, but the Refuge has not been opened up to drilling because the US President does not have the final say in such matters.

Quite apart from the above, however, this point of view is also highly objectionable because it stretches pragmatism to the point of complicity. Surely amongst the obligations that managements have towards their shareholders one can include not spending the latter's money in a corrupt way? Thus, recognizing the existence of latter-day cowboy/kleptocratic capitalism is one thing, participating enthusiastically in the game, all the while pretending to occupy the moral high ground, is quite another. And while it may be true that, in every single country in the world, corruption is a symptom of a systemic malady as opposed to a disease in and of itself, it is also true that plenty of the things that oil companies do in the political sphere tend to perpetuate the malady, and hence exacerbate corruption. By the same token, even though there are rigorous sociological and economic explanations as to why the taking and distribution of bribes is part and parcel of the economic process in what Francis Fukuyama called "low trust" societies, the alleged "naturalness" of these practices is easy to overstate. After all, in how many of those countries where bribery is allegedly "the accepted local custom" are the names of bribe-takers a matter of public record?

It is clear, therefore, that there is some bad faith in the argument that oil companies which have identified a good opportunity in a country where corruption is endemic are in effect totally powerless to resist such corollaries as consensus-forming payments, bribery of the political elite and so on. In fact, the bigger and more technologically advanced an oil company is, the more desirable its involvement in a development project will be, and the greater its leeway will be to avoid corrupt payments. Having said that, stock market valuations reward companies doing dodgy deals in developing countries with higher earnings multiples than the staid old decent looking and acting firms, implicitly because most shareholders either subscribe to the pragmatic view of corruption or are simply unaware of its existence. This puts oil companies on the horns of a dilemma. They may find themselves damned if they don't (by analysts, institutional investors and some shareholders, not to mention government officials in the countries in which they operate), and damned if they do (by activists, NGOs, other shareholders and even their home governments). Under these circumstances, managers seeking guidance and enlightenment are not helped a great deal by anti-corruption legislation from advanced countries.

Aside from a certain leeway for minor transgressions (i.e. grease), neither the Foreign Corrupt Practices Act (FCPA) nor the OECD Convention on Combating Bribery of Foreign Government Officials or the OECD Guidelines for Multinational Enterprises admit any fine gradations in the subject of bribery and extortion. Their message is clear: no such payments under whatever guise are allowed anywhere, under any circumstances. Period. Unsurprisingly, business principles advertised by some oil companies faithfully echo the official language, confirming categorically that their managers never engage in such practices. But how can one reconcile the puritanical legal attitude of western actors (and particularly governments) towards corruption with the well known practical dimension described above? The answer is simple: in honesty, one cannot. Given this, it is difficult to avoid the conclusion that the main

effect of this corpus of legislation is to function as a salve on collective consciences and as an incentive for company lawyers to invent subterfuges. In effect, its blanket condemnation of corruption (and the harshness of potential punishments) allows boards to distance themselves from the corruption that may be going on all around them and claim that the operations and accounts of their company are nothing other than clean, all the while resting comfortably in the knowledge that their local managements – formally ordered to steer clear of local corruption – will find by stealth a way to obtain what their company really needs. In other words, the legislation enables oil company managers to deal with anomalies like the fact that the price of pipeline paid in a certain jurisdiction is ten percent higher than the norm for no good reason, but without their having to suffer from an unclean conscience, without their having to take on the responsibility of asking where that surplus money might be going, and even without their having to foot the bill for this creaming (because the companies get this money back through their remuneration formulae).

Since the essence of these anti-corruption rules and guidelines is to forbid rather than to open doubtful cases for objective inspection, it is very difficult for companies to come clean about possible misdemeanours, as they would be setting themselves up for self-incrimination and prosecution. Because of this, only insignificant or token corrupt payments are revealed under current “best” practice by “socially conscious” top managements, in thinly audited Corporate Social Responsibility reports. Everybody suspects that much larger amounts lurk in the nether reaches of the companies’ accounts, or in the accounts of their sleeping partners, safely tucked away under headings like “legal fees”, “advertising”, “local assistance”, “consultancy fees”, to say nothing of paying salaries to nationals who are supposed to be employees and trainees, but who never put in an appearance.

The lack of concordance between Western anti-corruption *praxis*, on the one hand, and law, on the other, is clearly something that needs to be addressed if the problem of corruption is finally to come out from under the legalistic carpet where it has been swept for decades. Increased transparency (rather than more “detect, discipline and punish” initiatives) seems to offer the most promising way out of this *cul de sac*. An example of the power of transparency to galvanise actors into action can be seen in the genesis of George Soros’ “Publish What You Pay” initiative, which is the direct offshoot of just a few reliable numbers about the hidden diversions of official oil company tax payments within several West African governments. When outside studies of government accounts had shown that billions of tax dollars failed to reach their rightful destination in the ministries of finance, the World Bank, various non-governmental organisations and individuals like Soros, started this campaign for oil companies to produce full data of all their payments to governments. To their credit BP did just that in Angola, against the strenuous objections of the Angolan government (regrettably, other major companies have not come out in support of BP, and are hiding behind confidentiality clauses, notwithstanding the well known fact that these big fish can afford higher standards of conduct than little contractors at the bottom of the heap). Similar far-reaching practical initiatives have also been taken in Chad by the World Bank and by ExxonMobil in the Doba oil project, for joint Revenue Management Programmes whose objective is to allow publicly announced tax revenue to be used for the benefit of social rather than military spending (an example perhaps for Iraq?). The *Transparency in Extractive* (both petroleum and mineral) *Industries* initiative sponsored by the British government is another step in the right overall direction.

Regrettably however, compliance with increased transparency is seen as burdensome in some quarters, as witnessed by the hostile reception the *Transparency in Extractive Industries* has had in certain American boardrooms (and, by extension, amongst American politicians). Indeed, were this attitude to remain unchanged, any international transparency drive in the oil industry would probably be stillborn. At first glance, this hostility seems difficult to explain. After all, the main thrust of both the Soros and British government initiatives is that companies should, *first and foremost*, publish all those payments stemming from their *legal* compliance with their host countries' resource laws and regulations (i.e. acreage bonuses, severance, taxes, surface rents, royalties and income taxes). In other words, "publish what you pay" in this context is a way of shifting the onus of accountability for diversion of monies to host countries (and it has little to do with bribery involving oil companies as such). One might suppose that Americans are against this initiative because their FCPA explicitly forbids American companies from making subterranean payments, making it uncomfortable for American companies to admit even the knowledge of subsequent illegal diversion of funds by the host governments. Having said that, a long historical precedent shows that company managements are partial to opacity precisely because it provides the best conditions for corruption to thrive (and companies appreciate the finer points of corruption as a marketing tool of sorts, a double-edged control device over people of influence, and an instrument of non-price competition). In light of the above, American opposition to the aforementioned transparency initiatives leads one to think that, at the moment, there is not a great deal of principled corporate or governmental support in the USA for a worldwide anti-corruption drive, even though it was the American government that pushed through the OECD Convention on Combating Bribery of Foreign Government Officials,

Although company managers might view things differently, transparency initiatives are actually something that is in their firms' best interests to support. Company managements, when confronted with the excesses of the people that they happily do business with, tend to answer with the oldest excuse in the Book: "Am I my brother's keeper?". As well as being ethically unsatisfying, such a stance poses significant dangers to their own organisations. Publicity, for starters, is a force for moderation that influences not only those who find themselves at the receiving end of demands for payments, but also those that demand them. As with price transparency in markets, transparency in these matters should lead to lower costs. Quite apart from this, it has been proven time and again that organisations that enter into contact with systemic corruption and consistently turn a blind eye to it, cannot help but be affected (indeed, infected) by it, sometimes with fatal consequences. Anyone who doubts this should recall, say, the push that the CIA gave to the world heroin trade as a result of its attempts to fight the Vietcong by means of the Montagnard tribes in Vietnam and Laos. Closer to home, it is difficult not to trace Gulf's eventual demise in the early 1980s back to the explosive contents of the report of a review committee set up by the company's board as part of the obligations stemming from a suit brought by the Securities Exchange Commission in the wake of Watergate, and which chronicled fourteen years of large scale illegal activity by Gulf (with millions of dollars being funnelled through secret accounts in the Bahamas, before finding a home with politicians both in Washington and abroad). The recent scandals surrounding the Tenghiz megaproject constitute another case in point, one that led to the cull of a

number of managers who for a long time had headed the second largest oil company in the USA.¹

As said before, the main thrust of the *Transparency in Extractive Industries* initiative is in the direction of payments actually required by law (because these are prone to go AWOL in certain countries). However, it would be very desirable if a similar “publish what you pay” initiative were extended to a different type of payment, which we would call “para-economic”. We would define these payments in the following terms:

- a) they are not required by law;
- b) they *may* or *may not* be booked as legally and normally acceptable expenses;
- c) they make no direct, immediate and transparent contribution to the maintenance of good industry practice (safety and environmental standards and so on) OR to revenues and profits AND they divert resources (not necessarily in an illegal fashion) away from both shareholders and tax authorities towards *outsiders* who are seen as able to exert influence on a company’s social and political milieu;
- d) they are judged *essential* by management for the continued existence and stable growth of an enterprise in a given social and political context.

Para-economic expenditures therefore range all the way from the costs of meeting the demands of international action groups like Green Peace, to non-project specific and voluntary environmental studies, the construction of interpretative centres for natural areas and archaeological sites disturbed or encountered while developing, local community education and non-petroleum related training projects, the sponsoring of local sports teams, payments which should normally be the responsibility of government, all the way down to subsidies for hostile neighbourhoods money paid/extorted to assure the safety of personnel. In other words, para-economic payments span a very wide spectrum in both the developing and fully developed nations of the world. But what is the point of lumping together the perfectly legal with the repugnant and immoral? Is this not a way of dignifying corruption? Is not “para-economic” one of those terms that seek to make respectable what is quintessentially objectionable? We shall answer these questions by referring to a concrete and well-known example: Shell’s disposal of the Brent Spar.

Readers will recall that the pressure on Shell not to dispose of the Spar by sinking it into deep waters eventually materialised in a German consumer boycott and a spate of vandalism causing millions of euros worth of damages to the company’s service stations (again, chiefly in Germany). This convinced the company to take a large (and totally unnecessary, according to scientific data) loss in its British operations by disposing of the Spar on land, in order to stop both the boycott and the sabotage. In other words, Shell caved in to local demands and incurred certain expenditure to obtain a tacit renewal of its licence to operate without aggravation in Germany. So far so legal (and so understandable). But, seen in the light of this case, what can one make of a hypothetical decision to finance community projects for tribes to stop them

¹ The CIA’s involvement in the drug trade is extensively discussed in *Whiteout: The CIA, Drugs and the Press*, by Alexander Cockburn and Jeffrey St. Clair (Verso, London 1998). Gulf’s *mea culpa* appears in John McCloy’s *The Great Oil Spill: The Inside Story of Gulf Oil’s Bribery and Political Chicanery* (Chelsea House Publishers, New York, 1976). The on-going controversy surrounding Tenghiz appeared as meticulously described by Seymour Hersh in the July 9, 2001 of *The New Yorker* magazine (“The Price of Oil. What was Mobil up to in Kazakhstan and Russia?”).

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from damaging pipelines in Nigeria, for instance? This would appear to be a slightly less above-board albeit equally understandable decision. It would also, of course, be one step further down the slippery slope, the next being condoning extortion. There is a difference of degree only between this and paying so that your pipeline is not blown up every fortnight. And if one can justify paying terrorists in this fashion, then it becomes easier in turn to justify sweetening the dictator/despot/president/king of some country or other with nice cash payments.

The Brent Spar example is meant to convey the fact that para-economic payments form a *continuum* that spans everything from harmless (indeed, laudable) payments, at one end, to colossal bribes to kleptocratic rulers, at the other. After all, maintaining good relationships with stakeholders in certain parts of the world will require only modest para-economic payments that will raise no eyebrows and ring no alarm bells (a couple of tickets to a ballgame, say, or the kit for a local team). In more imperfect parts of the world, though, there will be greater demands for anti-economic and unreasonable payments as a way to secure minimally satisfactory working conditions. And the crucial point is that, because there is no outside requirement for companies to justify and rigorously report any para-economic payments (such as the cost of their government relations efforts), managers can easily find themselves going down the slippery slope mentioned above, starting at the clear end then seamlessly transitioning to grey and ending up in the murk. Indeed, in most cases, this process of mental cover-up appears sincere and subconscious, an entirely logical consequence of the fact that the majority of para-economic payments that any one manager will have to approve/review/make in his/her career will have nothing fishy about them, and will also have an endless chain of precedents.

It is not difficult for managers, then, to convince themselves that para-economic payments are part of their normal business prerogatives, of a routine legal and public relations effort to make themselves acceptable to stakeholders (sometimes very loosely defined). But this attitude needs to be challenged. There are reasons to believe that managements in developed countries have become too complacent and malleable in their supposed right to throw company funds at whatever worthy public cause they want to influence or co-opt. Indeed, publishing and itemising all para-economic expenditures looks all the more necessary because some managements seem to have developed very close relationships with certain actors that should really be their sternest objective watchdogs, like non-governmental advocacy organisations and external auditors.

Even if the credibility of big company managements were not at an all-time low, it would appear naive to entrust them exclusively with the truthful identification and the justification of all para-economic expenditures in their realm. Indeed, they should welcome an independent audit to put them beyond reproach on this score. After all, no one thinks that team managers in the Tour de France should be exclusively entrusted with the enforcement of strict anti-doping measures. Thus, the initiative of truthfully analysing, categorising and publishing corporate para-economic expenditures (for subsequent inspection by shareholders, the public at large and the independent watchdog of the press) would benefit enormously from the collaboration of independent actors fulfilling the role that anti-doping authorities have in sports. Amongst the more obvious candidates to fulfil this role are large banks. These banks have not exactly covered themselves with glory of late, and the torrents of bad loans and write-offs now crowding their books bear a direct relationship to the ease with which their management failed to carry out comprehensive due diligence on projects

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to which they loaned money. Some would say that this emphasis on due diligence undeservedly gives many bank managements the benefit of the doubt. Quite a few banks have used their considerable talents to engineer kickbacks to politicians from large development loans brokered by themselves, and even supranational financial organisations have been known to do it (in Suharto's Indonesia, for example), after having succumbed to the lure of the "pragmatic" view of corruption. Be that as it may, it would be a step forward if banks' due diligence tasks were to routinely include an "anti-doping" dimension to them, where the banks could ask for random testing of company balance sheets by agencies of their choosing (not necessarily accounting firms) to make sure that everything is above board and transparent. Gradually, this type of certification could be extended to include underwriting for share issuance, for instance. This will by no means get rid of the problem: anti-doping controls have not got rid of drugs in sports and, if the sorry saga of Enron is a lesson about anything, surely it is that even the watchdogs of probity have a limit in the face of companies prepared to pay what it takes to buy pliability. Nevertheless, these additional safeguards will at least make it more difficult for those who wish to engage in this sort of practice.

In sum, the end of the road for codifying ever stricter "Business principles" and "Guidelines", seems to have been reached. Everyone can concur *in abstracto* that bribes are bad as well as illegal, but this is of little help in dealing with a fluid and fuzzy reality, not least because key actors cannot even agree on key definitions and approaches. It is therefore time to broaden horizons as much as definitions, to take into account the fact that there are many places in the world where oilfields coexist with paramilitary groups that live on extortion, and other places where oil operations will probably not begin unless companies first meet the demands of local acceptance (i.e. obtain a licence to operate from stakeholders), which will inevitably be articulated by influential outsiders, not always in pleasant ways. There is, of course, no reason not to call certain types of para-economic expenditures for what they are: bribes that may look excusable within a local social context but are now all too easily given. By the same token, though, there is no reason to expect that the promulgation of strict guidelines will lead to these practices evaporating. Again, open accounting of all para-economic expenditures appears like a more effective tool for combating incipient corruption than strictures no one really takes at face value (including, and this is a point that deserves to be repeated, the governments that promoted them). The publication of para-economic expenditures could be done in a categorised form, to avoid naming individuals directly, but they should no longer remain totally hidden from public scrutiny, as is now the case. Their magnitude, the tremendous amount of public relations spin applied to justify them, and their influence on costs, will certainly come as a shock to shareholders, and as more than a mild surprise to outsiders. Published league tables would exert powerful pressure towards moderation on all participants. Economics and democracy everywhere would benefit.

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