Allocation of Resources to Communities from Mining and Oil and Gas Operations

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The modern mining and oil and gas industries have overcome some tremendous challenges. For example, these industries once had very troubling safety records, and unacceptable numbers of employees killed or injured on the job. Dealing with this problem seemed an almost insurmountable challenge.

While there are still corners of the world where performance has improved little over the past, and while few of us regard *any* level of death or injury as 'acceptable,' the progress has been truly impressive. In the leading companies, industry, government regulators, labor organizations, and independent watchdogs have together made a significant difference. A 'safety culture' is embedded in organizations. People no longer look at safety as the job of specialists in safety departments, but accept that everyone in the organization has responsibility for improving safety performance. At its best, change is neither 'top down' nor 'bottom up,' but both; a shared consciousness of the importance of safety permeates organizations.

As this once seemingly impossible challenge was being confronted with increasing success, the extractive industries were hit with another extraordinarily difficult challenge: the awakening to the need for a much higher level of environmental performance. On this issue, the industry is somewhere in mid-stream. While in the places that have focused hardest on environment there has been dramatic improvement in mine reclamation planning, smelter and refinery emissions, spill prevention and containment, and water quality, there are still some problems on which we are very far from declaring victory.

We are still less than clear how to manage the carbon footprint of oil, gas and coal use, conservation of biological diversity in areas of oil and gas production, or what to do about the

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[1] I want to express my thanks to my former assistant Meadow Didier for her insight and research on some of the subjects that are discussed in this paper.

legacy of abandoned unreclaimed sites. But it is both possible and necessary to imagine that industry, again in cooperation with others, will somehow solve these problems.

But even before we have the environmental issue fully under control, the industries have again been hit hard by a new challenge, and one they are just starting to understand how to manage: the "community problem." This is probably where we seem to have the farthest to go, and the least idea what to do. This is symbolized by the fact that we have not yet fully developed a shared vocabulary to talk about the problem. We talk about the "social license to operate" or "community development" or "community consent," and use a lot of other words as well.

Industry has a clear idea of what it wants: the ability to develop projects without obstacles risk and delays, and to be appreciated as a positive contributor to the communities in which we work. But we have very little idea in many cases how to achieve that, or of what the other actors want. This is the great visible challenge of the future, and is one we still in most cases do not know how to approach with confidence of success. If we are just guessing at what local communities want, and we have no rigorous way of measuring what we are in fact delivering, or whether that corresponds to what communities want, we are simply wandering in the dark. Any progress will be an accident.

If this paper does no more than help us – all of us concerned with this problem – think through our objectives, and get a little clearer about how we might achieve them, it will be an effort well spent. If it can help us focus on what words we use to talk about the problem, and what we mean by them, that is also useful.

If on some level we see the problem as lack of community acceptance, then the subject of this paper is one of the key parts of gaining that acceptance – finding a way that real, solid social and economic benefits reach to the communities most directly affected by industry operations. As almost everyone who has tried it is aware, this is a problem that cannot be solved simply by spending money. And those who spend money in any case want to have clear ways of measuring whether it is well and prudently spent; without clear objectives and a way of measuring progress we have no idea whether we are spending too much or not enough on community issues.

While money is required, the money is usually the least of the problem. The difficult challenge is achieving much better local governance, so that spending the money achieves the benefits. We will therefore spend a good deal of this paper talking about the context in which money reaches local communities, whether it reaches them (a) by direct taxes imposed by local government; (b) by national government sharing tax revenues locally; or (c) through company sponsored foundations or community development funds.

INTRODUCTION

At its most vivid and destructive, the issue is easy to see: oil operations in Chad,[2] the Niger Delta,[3] or Aceh Province of Indonesia,[4] sunk in a sea of violence that is bad for the business of the companies involved, bad for the image and reputation of the industry as a whole, and above all, bad for the people on the ground.

Most people who have looked at the problem of violence acknowledge that the civil war in Democratic Republic of Congo has been the bloodiest single event since the end of World War II. The estimate is over 5.4 million war-related deaths between August 1998 and April 2007.[5] Most agree that the struggle to control revenues from copper, coltan,[6] gold, and diamonds played a key role both in starting the war and in making it so terribly long and bloody.[7]

In *Resource Wars: The New Landscape of Global Conflict*,[8] Michael Klare argues that the root causes of <u>all</u> the world's major wars since the end of the Cold War are conflicts over valuable or scarce resources, from oil to diamonds, from timber to water. In a later book, *Blood and Oil*, he reaffirms this thesis and emphasizes the role oil plays in igniting and sustaining violent conflict.

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[2] See Polgreen and Dugger, *Chad's Oil Riches, Meant for Poor, Are Diverted*, **New York Times**, February 18, 2006.

[3] C. Ukeje, A.,**Oil and Violent Conflicts in the Niger Delta** (University of Michigan Press 2003).

[4] See Centre for Study of Global Governance forthcoming report, New and Old Oil Wars. http://www.lse.ac.uk/Depts/global/2oilconflict.htm

[5] "Mortality in the Democratic Republic of Congo: An ongoing crisis". International Rescue Committee. 2007. http://www.theirc.org/resources/2007/2006-7_congomortalitysurvey.pdf

[6] Coltan is used in cell phones, among other things, and its production has boomed as cell phone use has increased. The Democratic Republic of Congo has a considerable part of world reserves.

[7] See the Global Witness report *Rush and Ruin*, and the Human Rights Watch report *The Curse of Gold.* A good summary can be found in the article "A Glittering Demon: Mining, Poverty, and Politics in the Democratic Republic of Congo", by Michael Dilbert. These can all be found at www.globalpolicy.org/security/natres/mineindex.htm

[8] Klare, Michael T. *Resource Wars: The New Landscape of Global Conflict.* Metropolitan Books, New York. 2001.

In his recent Foreign Affairs essay "Blood Barrels,"[9] prominent political scientist Michael Ross agrees with Klare, arguing that oil, more than any other resource, 'breeds' conflict both *within* oil-producing countries and *among* them. According to Ross, "oil alone cannot create conflict, but it both exacerbates latent tensions and gives governments and their more militant opponents the means to fight them out,"[10] which, at least in the poorest developing countries, leads almost always to bloody conflict.

These are not the scribblings of fringe players, but the considered opinions of established, main line scholars. As respected a figure as Paul Collier, in The Bottom Billion, identifies dependence on natural resource exports as one of the key indicators of potential for violence in the poorest countries.[11]

One of the most important points to be made is that in the great majority of these cases of conflict, a national government has issued a concession, and has given the holder of the concession all the permits and approvals required under national law. But scrupulous compliance with national law and the terms of contracts is not enough to buy peace, when minority nationalities, indigenous peoples, traditional local communities or others feel that their interests are being sacrificed on the altar of development, and that they have insufficient say over processes that impact them dramatically.

Further, even where national governments very much want projects to go forward so that they can start receiving the mineral revenues they want and need, most governments are increasingly reluctant to "solve" the problem through use of police and military force. They are increasingly putting the onus on companies to achieve a social license, or an understanding with local communities that allows projects to proceed and national government to receive revenues without paying the political price that use of force implies.

This tendency toward insistence on consensual solutions has a variety of roots worth exploring elsewhere. They include the spread of democratic government, which virtually all lawyers applaud. They include the spread of the Internet, which makes it easier and easier for disaffected communities to tell their side of the story quickly all over the world. They also include growth of a vibrant civil society, which is with each year better at performing its 'watchdog' role. And they also include the emerging body of international standards: voluntary resettlement, community consent, and serious efforts at consultation are all consistent with the

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[9] Ross, Michael. "Blood Barrels: Why Oil Wealth Fuels Conflict". *Foreign Affairs*. May/June 2008. Pages 35 – 37.

[10] Ibid, Page 36.

[11] P. Collier, **The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It**, (Oxford University Press 2007).

letter and spirit of the Equator Principles, the Global Reporting Initiative, and other international principles; a "whiff of the grapeshot"[12] is not.

It would be a mistake to think that we are here only talking about the most extreme situations where community disaffection has led to armed confrontation. The problem of conflict does not need to reach the level of bloody violence to create enormous business and legal issues for natural resource companies and their lawyers. Even relatively peaceful resistance by communities can create serious issues of cost, delay, or viability for projects that are very important to the company's future.

At Esquel in Argentina,[13] Tambo Grande in Peru,[14] the Mount Emmons Molybdenum Project in Colorado,[15] Rosia Montana in Romania,[16] or the Marlin Project in Guatemala,[17] projects – which in most cases have many if not all the necessary legal concessions or their equivalent – have been delayed, sometimes for years,[18] or stopped entirely by local opposition.

The challenge of learning how to avoid these conflicts, or manage them for successful outcomes, may be the greatest of the many daunting challenges facing resource industries in

[12] "Napoleon, then a brigadier general during the later stages of the French Revolution, famously dispersed a Royalist mob on the streets of Paris with a "whiff of grapeshot" on 5 October 1795." http://en.wikipedia.org/wiki/Grapeshot

[13] One source for information about the highly controversial events at Esquel is Business for Social Responsibility, Minera El Desquite Report, available on the PDAC website at http://www.pdac.ca/pdac/advocacy/csr/bsr-esquel-report.pdf

[14] There is a less than objective YouTube video about the events at Tambo Grande, http://www.youtube.com/watch?v=QhLy9he4O24

[15] For thirty years, local citizen opposition has stalled efforts to develop one of the world's major molybdenum deposits. See Blevins, *CRESTED BUTTE: Coalitions build to again keep mining off beloved peak,* Denver Post, December 9, 2007.

[16] See http://en.wikipedia.org/wiki/Ro%C5%9Fia_Montan%C4%83. There is a selection of less than objective videos about this project.

[17] See the reports of the Compliance Advisor/Ombudsman of the International Finance Corporation at http://www.cao-ombudsman.org/html-english/complaint_marlin.htm

[18] March 2009 marks the 30th anniversary of the first attempt to secure community approval to mine Mount Emmons. Gunnison Country Times, Thursday March 19, 2009. It is hard to remember at this point how many different companies have taken on this challenge without success, or how many millions have been spent in the process.. The latest to try is Thompson Creek Metals, http://www.thompsoncreekmetals.com/s/Home.asp

the coming decades. These conflicts have complex roots, and resolving them will take changed approaches on a number of levels.

One of the messages is that compliance with national laws is not enough. Compliance with national law is just a starting point. It is necessary, but is not sufficient to deliver a project that can be developed. This is a statement with enormous consequences for countries, companies and lawyers.

If all that lawyers can do is counsel scrupulous adherence to national law, and they cannot offer any insight into how to deal with community resistance to project development, they will find themselves increasingly marginalized from the difficult issues because their advice will not solve the fundamental business issues facing their clients.

I. COMMUNITIES ACCEPTING MINING AND OIL AND GAS?

The question of what changes in company approach and what kinds of changes in legal thinking are necessary to reduce the risk of expensive, damaging and demoralizing confrontations is a complex one, mostly beyond the scope of this paper, which will offer no more than these thoughts.

The problem may be quite different in the communities with considerable wealth and those with considerable poverty.

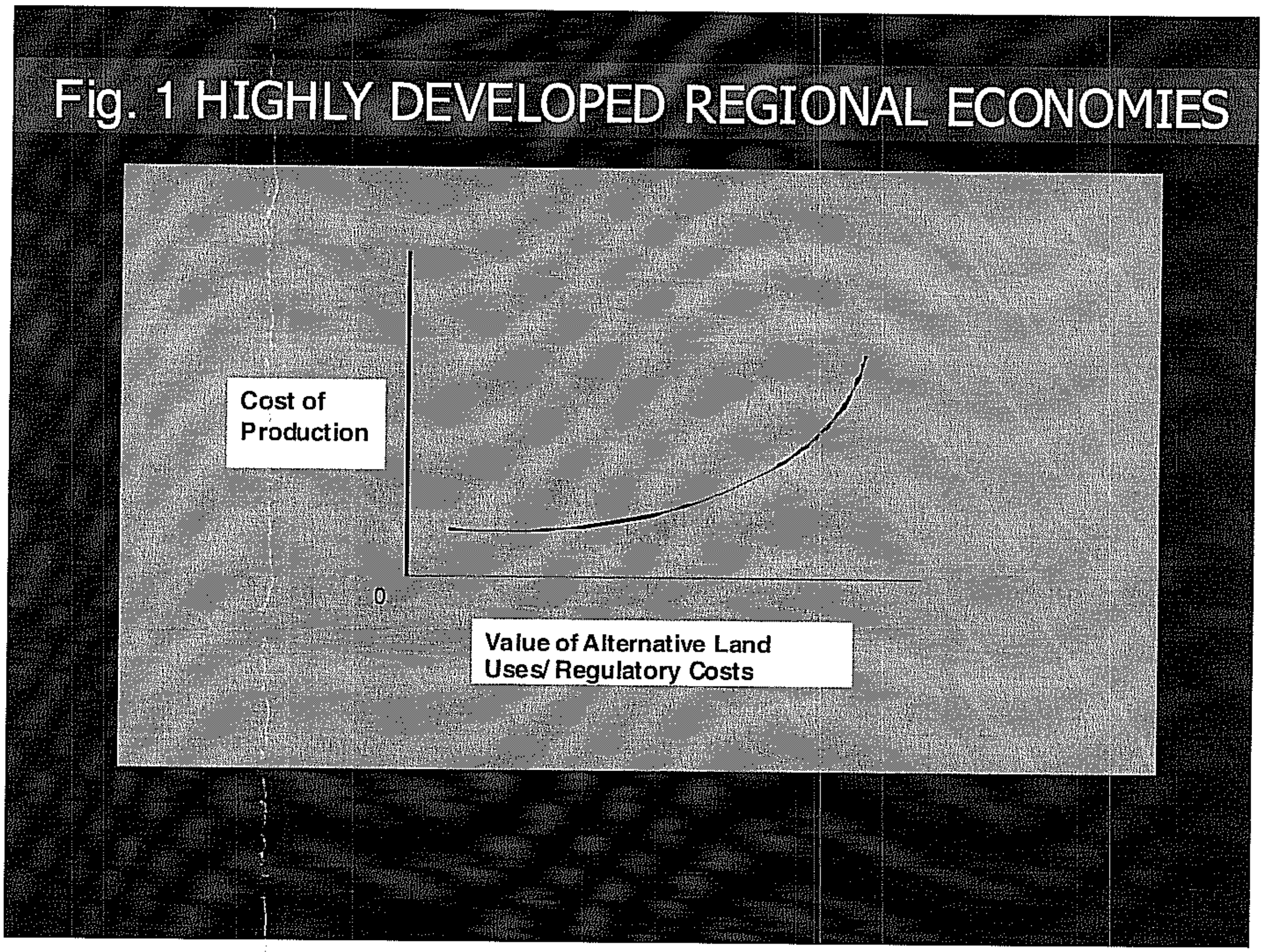
At the wealthy end, competing land uses have too high an economic value. The cost of acquiring land, dealing with the concerns of those dependent upon the other economic activities, and trying to get anything done is far too high.

Aspen, Colorado, was once a major silver mining center. It produced a considerable quantity of silver from a long list of famous mines. There is undoubtedly still interesting mineralization in and around Aspen. But no one is looking very carefully at it for very good reasons: if you found a deposit, you would be surrounded by hundreds of very wealthy owners of vacation homes who might not want a mine in their viewsheds, a considerable 'political risk.' Mine workers would have an enormous commute to anywhere they could afford to live. And while you can probably get very secure title to land, you might have to pay in excess of $2000 per square foot (over $23,000 per square meter) for a land position.[19] It is hard to see how exploring for silver

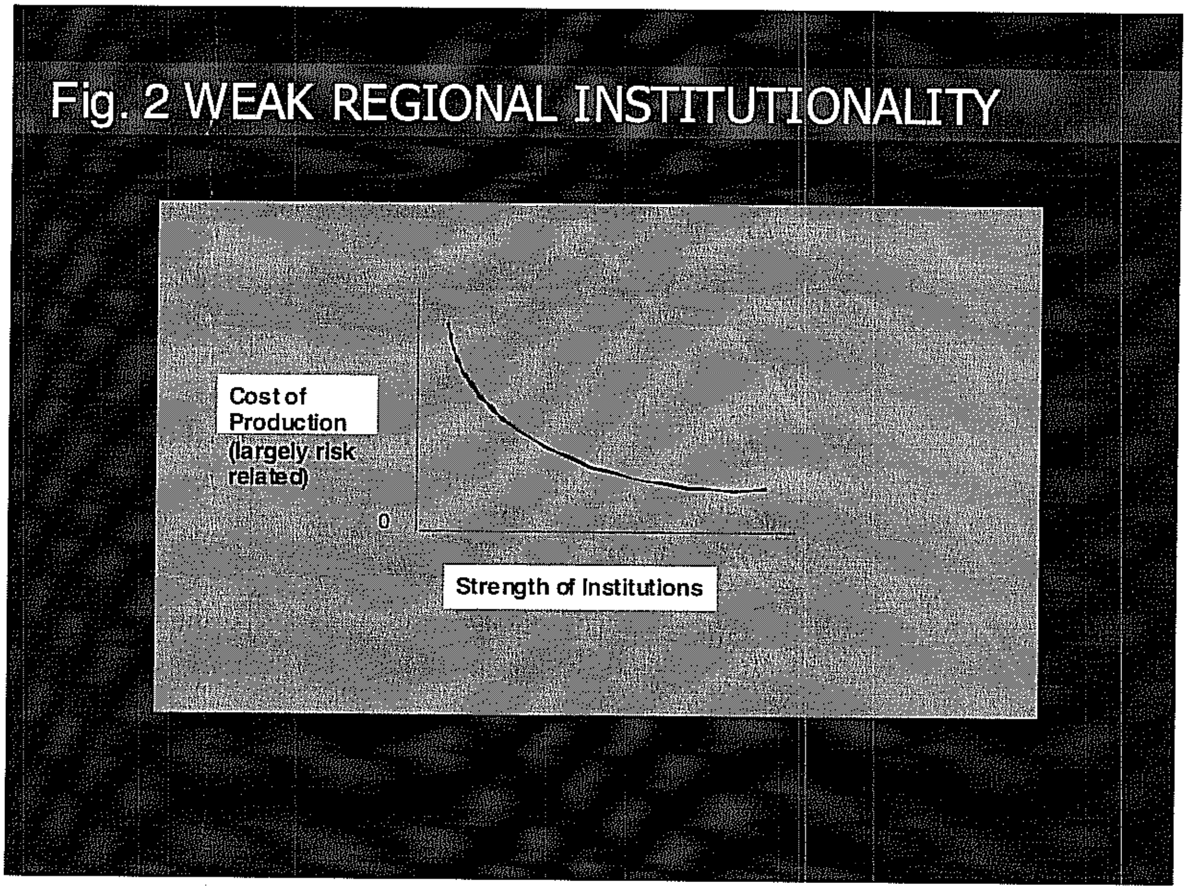
[19] "Aspen broke the $1,000 per square foot mark six to eight years ago, local land brokers say, but these days $2,000 per square foot is becoming common and last autumn saw the sale of a Shady Lane property selling for more than $3,000 per square foot, according to Robert Ritchie, a broker at Coates, Reid & Waldron." See C. Benedetti, Aspen Daily News, April 12, 207, reprinted at http://www.aspenlandandhomes.com/blog/?p=7

in Aspen is a sensible commercial enterprise. Mining cannot afford to compete with other land uses.

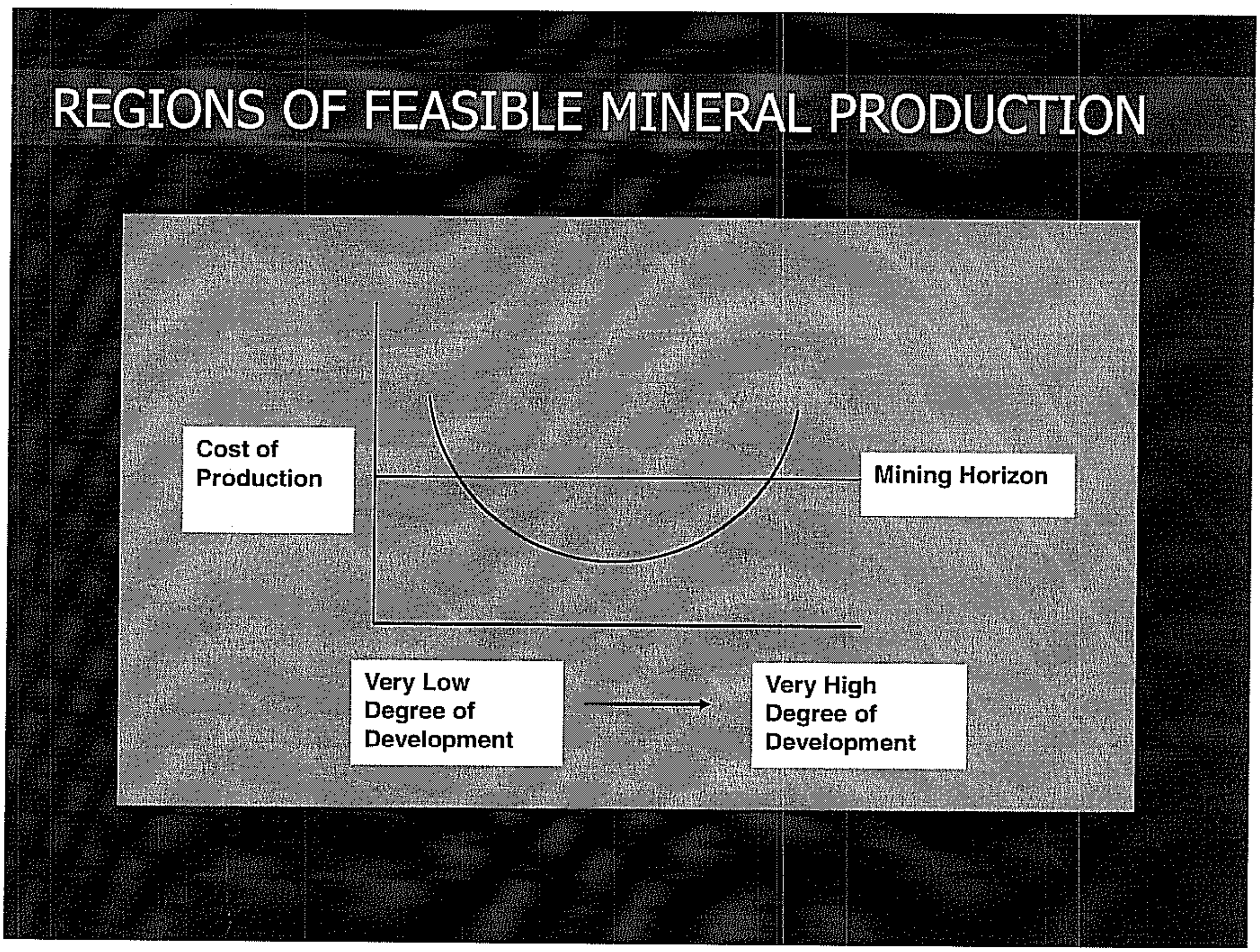
We do not have to go to this extreme to recognize that there are a considerable number of places where it is simply too expensive to produce minerals. Where deposits are under urban areas with thousands of inhabitants, or beach front real estate, projects are often with good reason put in the 'too hard' bin.



There is another and quite different version of the 'too hard' bin. These are places where land may be very inexpensive, but title is so unsure it is of little value. Regions may be so poor that there is almost no infrastructure. The cost of mining is extremely high because almost everything – roads, railroads, ports, electrical supply, and more – has to be built if a project is to go forward. This is problematic enough. But even worse, these problems tend to exist in areas with very weak institutions, very little political stability, and extreme political risk.



This explains to a large extent why mineral investment is going where it is going – to the world's "middle class" countries. These are places that have reasonably effective national governments, functioning legal systems, and the right combination of security of title and modest land prices.



While the question of how to mine successfully in rich regions of rich countries is very interesting, the topic at hand requires that we set that aside and focus on the other end of the scale, where the barrier is lack of development.

If someone could find a way to solve some of these problems – to develop infrastructure, encourage greater political stability, and to strengthen the rule of law, it would make projects viable that are now simply too hard to do. This would have tremendous commercial benefits for the holders of mineral rights and significant benefits for the host communities, where these things are desperately wanted. It would also help us find the answer to the question of how we meet growing world demand for commodities from a shrinking available land base,

This is at the very heart of the business case for sustainable development. But moving from this exciting general idea – that stronger institutions and better infrastructure benefit both companies and the communities in which they operate --to the specifics of what changes are needed to achieve it is far from easy. The devil is indeed in the details.

In general, the needed changes go under the heading of 'improved local governance.' One element of this is revenue sharing at the local level, because without increased resources, improved local governance is very hard to achieve. But revenue sharing is only one of the ingredients of improved local governance.

To set the context for this paper, perhaps it is worth dwelling on what a few of these other ingredients may be. They may give us some discomfort as lawyers, because they challenge some very fundamental assumptions about what "law" is, the role of lawyers, and ultimately how we see the world.

The basic point is that while complying with national law is important, it is not sufficient to deliver a successful project. There are at least two additional sets of legal or quasi-legal requirements that are vital to the success of projects, in addition to national law.[20] One of them is the emerging body of international standards and requirements.[21] The other is complying with expectations of local communities.

Neither of these is exactly law, if we define law as a requirement imposed by a sovereign. The World Bank Group, which developed the Equator Principles,[22] may not be a sovereign, but is not an organization to be ignored by companies that want to develop large natural resource projects. It may have attributes of sovereignty, as anyone who has ever tried to sue it has discovered.[23] This is just one example: with every passing day the consequences of not knowing about, or not following, the growing body of international requirements become more significant. And whether or not these are "law" in a traditional sense, lawyers are spending more and more time dealing with them, and clients are more and more insistent that they do.

At the local level, there is a different set of problems, but the same underlying idea. There are rules, imposed by groups or organizations that are not 'sovereigns,' but which have increasing importance for all of us. Indigenous peoples have many if not all attributes of sovereignty. Operating in their territory, or affecting places they value without following the rules they

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[20] This three level model of requirements for project development is explored in much more depth in L. Danielson, *Sustainable Development in the Natural Resource Industries: New Perspectives, New Rules and New Opportunities* (Proceedings of the 50th Annual Rocky Mountain Mineral Law Institute at 14-1 (2004).

[21] Examples of these include the Equator Principles, note 22 below, the Global Reporting Initiative, http://www.globalreporting.org/Home, the Extractive Industries Transparency Initiative, http://eitransparency.org/, and the Voluntary Principles on Security and Human Rights, http://www.voluntaryprinciples.org/. There is a growing body of such requirements, and the consequences of proceeding without heeding them are becoming ever more serious.

[22] See http://www.equator-principles.com/index.shtml

[23] See as just one of many examples, *Mendaro v. World Bank*, 717 F.2d 610, 615 (D.C. Cir. 1983).

observe can have dramatic consequences. But the same may be true of many communities that are neither indigenous nor tribal.

For example, there are very complex rules developed and observed by the 'informal sector' that exists in many parts of the world.[24] There are countries (and regions) where most people live in the informal sector, and the 'extralegal' rules may be more important than formal law:

> "Outside the West, extralegal social contracts prevail for a good reason: They have managed much better than formal law to build on the actual consensus between people about how their assets ought to be governed."[25]

No less a figure than Hernando DeSoto argues that the incorporation of the rules developed in the formal sector into the legal system is a necessary part of the problem of development.[26] In this view our task as lawyers is not to repudiate and attempt to overcome destroy these 'competing' sets of rules, but *to seek symbiosis and harmonization with them,*[27] as we seek social consensus in our societies.

Understanding this question of rules and fairness to the informal or traditional sector is a key to giving better legal advice. Examples include:

- A mine where a major waste dump is so close to an established village that there are dangers to local inhabitants from rock falling off the dump. The village has a graveyard, and a church, and inhabitants who have been living there for generations. But the existence of the village is not disclosed in the Environmental Impact Statement because of a legal opinion that the land titles of the villagers are not valid.

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[24] "Formal law is increasingly losing its legitimacy as people continue to create property beyond its reach. ...[T]he extralegal sector [has] grown larger not only in Peru but also in other developing and former communist nations." H. DeSoto, **The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else,** (2000) at p. 178.

[25] Soto p.181

[26] See **The Other Path: The Economic Answer to Terrorism** (2002).

[27] The struggle to harmonize ancient Aymara rules for water use with modern Chilean water codes is an example. A rejection of thousands of years of traditional practice because it conflicts with modern legislation is seen be the Aymara as an imposition. While there may be need for these traditions to accommodate to modern circumstances, there may also be a need for the majority culture to accommodate to the traditions. See Madaleno, Aymara Indians in Chile: Water Use in Ancestral Cultures at Odds with Water Rights in Modern Times, CONFERENCE ON INTERNATIONAL AGRICULTURAL RESEARCH FOR DEVELOPMENT, http://www.tropentag.de/2004/abstracts/full/33.pdf

- The Grasberg Mine in Indonesia has had considerable issues with local communities which are at least in some part a result of following Indonesian law, which did not recognize the land titles of the tribes who had historically occupied the project area.[28]

- A hydroelectric project in southern Chile, where families were resettled without all required assistance because they lacked legal title, even if this was the only home some of them had ever had, and findings of respected investigators were suppressed by the International Finance Corporation.[29]

The point here is simply that in each of these cases, and more, *advice that clients do not have to worry about the issue because the law does not recognize the rights of the other party is not of value to the client.* Indeed, it is dangerous, and has helped cause great problems and costs for clients where they have taken it.

This is not the place to explore all the elements of this "extralegal law." But the point is that in part of the world, in the so-called 'developed' countries, there is a much easier accommodation between local communities and national law because there are functioning local governments that can deal with some of the more problematic tasks. In other parts of the world, often in poor rural areas of developing countries, local government is simply absent, or lacks the ability to deal with the tremendous challenge and social change inherent in development of a big resource project.

Why do we need effective local governance so badly where there is a major natural resource development? That resource development is going to bring dramatic change, which can easily outstrip the ability of local people to cope with it. That leads to a failure to capture project benefits, or even making local people worse off, and fear of loss of control, which in turn lead to opposition to project development.

We may not have a definitive list of all the local governance functions that are necessary for success, but some of the more obvious ones are:

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28 Indonesian law does recognize traditional *adat* land titles, but only if there are fixed villages and land is cleared for agriculture.

29 See AAAS, Censorship, Denial of Informed Participation, and Human Rights Abuses Associated with Dam Development in Chile, http://www.aaas.org/spp/sfrl/per/per13.htm

(A) Serving as the community's negotiator to ensure that development protects the community's interests: the concept of consent;

(B) Providing some form or system of dispute resolution;

(C) Managing the delivery of services; and

(D) Managing the process of development.

A. Serving as the Community's Voice in Decisionmaking

If the community does not have a voice in major decisions that affect its own future, it is likely to resist those changes. But where local government is weak, or lacks capacity, or national legislation does not give the community a role it regards as sufficient, the question is who speaks for the community and who expresses its consent.

Even where national legislation gives little role to consultation processes, they are still important. They are important first because refusal to consult causes conflict. Second, they are important because they are required if not by national law, by the growing body of international standards and practice.

If (1) it is imperative that a project have local consent, but (2) there is no effective government system through which that consent can be developed, it is hardly clear how to find the right mechanism, and how that mechanism relates to the recognized legal system.

This is a subject that deserves being explored at length, but suffice it to say here that:

- A central point of contention of indigenous and tribal peoples with respect to any development that affects their traditional land or resources is *free, prior and informed consent*.[30] The juridical basis for this idea is I.L.O Convention 169, Convention Concerning Indigenous and Tribal Peoples in Independent Countries.[31]

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[30] Among the enormous literature on this subject is the May 25, 2007 Declaration by the United Nations Permanent Forum on Indigenous Issues, http://www.un.org/News/Press/docs/2007/hr4926.doc.htm. See also L. Mehta and M. Stankovitch, Operationalisation of Free Prior Informed Consent, for the World Commission on Dams, http://www.dams.org/docs/kbase/contrib/soc209.pdf

[31] http://www.ilo.org/ilolex/cgi-lex/convde.pl?C169

- A long running dispute over the development of the Jabiluka uranium deposit in the Northern Territory of Australia by Energy Resources of Australia (majority owned by Rio Tinto) had led to a complete standstill in discussions between the company and the aboriginal Mirrar people. Development of the project was proving impossible, and the company was deeply concerned about reputational damage. While it remains to be seen where discussions will ultimately lead, the impasse was broken by the signing, in 2005, of an agreement in which Rio Tinto and ERA agreed "to secure Mirarr consent prior to any future mining development of uranium deposits at Jabiluka."[32]

- IFC's Performance Standard 5: Land Acquisition and Involuntary Resettlement, made widely applicable through its incorporation into the Equator Principles, states a strong preference for obtaining consent: "Clients are encouraged to acquire land rights through negotiated settlements wherever possible, even if they have the legal means to gain access to the land without the seller's consent."[33]

- Shell, long a major operator in Ogoniland, in the Niger Delta, found that its negotiations with local Ogoni organizations broke down after they "accused Shell of trying to resume oil and gas production without Ogoni consent after a government-backed peace process failed to reconcile the two parties."[34]

- Newmont's attempts to explore and develop the Cerro Quilish deposit near its Yanacocha Mine in Peru foundered on community opposition:

> "In 2004, after two weeks of protesting by community members from the region, Newmont decided not to proceed with the 3.7 Million ounce development. Larry Kurlander (former Newmont Executive VP) states,
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> "There is a Social License, that in my opinion, it is far more important than a Government License. It is renewable every day!

[32] See 'Jabiluka Conflict Concluded,' http://www.riotinto.com/ourapproach/217_features_4252.asp

[33] http://www.ifc.org/ifcext/sustainability.nsf/AttachmentsByTitle/pol_PerformanceStandards2006_PS5/$FILE/PS_5_LandAcqInvolResettlement.pdf

[34] Reuters, *Nigeria to Give Shell Ogoni Oilwells to Another Firm*, June 4, 2008. http://shellnews.net/PDFs/ReutersNigeriaNews4June2008.pdf

> Without building a trust with the people that live there and work there and have lived there for centuries, you are going to have trouble and indeed they [Newmont] have."[35]

A World Resources Institute study concludes that:

> "Securing community consent to explore and develop these deposits is a long-term imperative for Yanacocha, as its continued viability ultimately depends upon its ability to replenish depleted assets."[36]

It is profoundly unsettling to those of us trained and oriented to see the legal right to mine as something obtained under the provisions of national mining legislation to have to face the idea that some kind of 'consent' of communities, gained in some manner not set out in the law, and measured by undefined standards most people cannot begin to articulate, is necessary.

Yet if our clients ask us as lawyers how to deal with situations like these, and all we can do is tell them that they have a perfectly valid legal right to mine, they are going to look for someone else to help them.

B. Providing Dispute Resolution

Where there are viable functioning court systems, these are of course the recourse we look to first as lawyers to resolve the inevitable disputes that arise in the development of large natural resource projects. But what do we as lawyers recommend where there is no functioning court system? This is often the case in remote rural areas of developing countries – precisely where many oil, gas and mining projects are being developed.

The idea that a major project can be developed without any problems or occasional disputes with local people seems unrealistic. What are the options when a truck kills someone's livestock, or compensation is due for a more serious injury? Lack of a viable local remedy is

[35] University of British Columbia, *Social License to Operate: An Industry Survey*, http://www.mining.ubc.ca/files/SLO%20CIM%20LW.pdf

[36] Minera Yanacocha Gold Mine Project, Peru, http://www.sarpn.org.za/documents/d0002569/10-WRI_Community_dev_May2007.pdf

undoubtedly one of the reasons for the proliferation of litigation against corporations in their home country courts. We are not naïve enough to think that having a better court system in Myanmar would have avoided the Unocal litigation in its entirety,[37] or prevented the litigation in the U.S. of claims against Newmont over the Choropampa mercury incident, better local mechanisms are necessary if we are to move away from such outcomes.

So how do we react where there are no effective local dispute resolution mechanisms?

- Rejoice? Most lawyers are wise enough not to rejoice at the fact that people who have suffered injury have nowhere to go with their claims. We realize that people with no redress within the system are likely to seek redress outside the system. Lack of effective redress of grievances has been identified as a key component in the mix that leads to the kind of violent and conflictive outcomes we discussed at the outset. We see it as in our clients' interests to let people with grievances against our clients have a peaceful and orderly way to adjust those problems.

- Shrug? Most of us feel that we need to do something more for our clients than to tell them that if there is no effective court system we have no idea what to do.

- Get Creative and Start Solving the Problem? Many of us are starting to realize that there is a growing movement to create mechanisms to solve these problems, and an enormous arena for us as lawyers to show our creativity in the process. Some of the relevant developments are set out below.

MMSD was a global, multi-year exercise in research and stakeholder engagement, focused on the role of mining and minerals in sustainable development worldwide. Its final report, BREAKING NEW GROUND,[38] represented a broad base line view of what needed to be done to

[37] The suit, filed on behalf of 15 Myanmar villagers in Los Angeles County Superior Court in 1996, was when it settled in 2005, the furthest along of about three dozen cases that charge corporations in U.S. courts for alleged crimes that took place in other countries in violation of international treaties. See Lifscher, Unocal Settles Human Rights Lawsuit over Alleged Abuses at Myanmar Pipeline, *Los Angeles Times*, Mar. 22, 2005. Global Policy Forum, **http://www.globalpolicy.org/intljustice/atca/2005/0322unocalsettle.htm**

[38] See www.iied.org/mmsd/

reduce conflict in the mining and minerals sector. One of its recommendations was for the establishment of grievance and dispute resolution systems at mining projects worldwide.[39]

It recommended company based grievance mechanisms:

> *"Companies should have a serious interest in endorsing fair, reasonable ways (through a form of mediation/conciliation system) for people with grievances to get the attention of management, and to seek some kind of solution. Lack of such a mechanism drives people with grievances to other measures, many of which can present much higher levels of risk for all."*[40]

It also recommended shared dispute resolution mechanisms:

> *"When problems, disputes, and controversies arise, government should usually be turned to first. But where there is restricted access to justice, especially at the community level, or when existing mechanisms are inadequate or not trusted, it may be necessary to design dispute resolution mechanisms at the community level. The question of how to resolve disputes should be discussed and agreed at the earliest stage of negotiations... "*[41]

At about this same time, the World Bank became concerned about the impacts of its involvement in the oil, gas and mining sectors, and the many complaints about the negative impacts of such projects. The Bank was urged that supporting such projects was inconsistent with the Bank's mission. It therefore commissioned an independent Extractive Industries Review, which also conducted a broad consultation that included industry, civil society, and government. The EIR, in its final report STRIKING A BETTER BALANCE,[42] published in 2003, also recommended the establishment of grievance mechanisms for oil, gas and mining projects. As will be seen below, the Bank is getting quite active in developing this concept.

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[39] *Breaking New Ground* is available at http://www.iied.org/pubs/pdfs/9084IIED.pdf, the particular recommendation is found at page 400.

[40] *Breaking New Ground.* Mining, Minerals, and Sustainable Development. Earthscan Publications, 2002. Chapter 14Page 359. Electronic versions can be found at the site above.

[41] Ibid, 400 - 401.

[42] For a list of all publications of the EIR and the Bank's response to these publications, see: http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTOGMC/0,,contentMDK:20306686~isCURL:Y~menuPK:592071~pagePK:48956~piPK:216618~theSitePK:336930,00.html

The perceived rationale for developing grievance mechanisms is not always the same. For companies it may be risk reduction or promotion of sustainable development. For others, it is protecting human rights, or preventing conflict. These may be different ways of expressing rather similar ideas.

The International Council of Mining and Minerals (ICMM)[43] has developed a Community Development Toolkit,[44] which has a substantial section on Conflict Management, as part of its Resource Endowment Initiative. This includes a Complaints and Grievance Procedure Tool.

In addition to the Resource Endowment Initiative, ICMM has been working with John Ruggie, the Special Representative to the UN Secretary General (SRSG) on Human Rights and Business. In December 2007 ICMM made a series of recommendations[45] to the SRSG regarding effective voluntary approaches to business and human rights, citing their experiences with member companies as examples. These recommendations were part of Ruggie's multi-stakeholder consultations in preparation for making his own report to the UN Human Rights Council.[46] ICMM recommendations were well-received by the SRSG, and in turn the ICMM approved the final report.[47]

One of the companies highlighted in the ICMM submission was Anglo American, a 'cutting-edge' example in human rights and community-company partnership areas. Anglo American has clearly internalized these ideas, at least at the corporate level, as is evidenced by not only

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[43] www.icmm.com

[44] http://www.icmm.com/page/629/library/documents/community-development-toolkit-

[45] This is ICMM's third such submission to John Ruggie.

[46] John Ruggie's report to the Council was entitled *Promotion and Protection of All Human Rights, Civil, Political, Economic, Social And Cultural Rights, Including the Right to Development: Protect, Respect and Remedy: a Framework for Business and Human Rights*. The need for better alternative dispute mechanisms, or "Access to Remedies," was one of the three core pillars of human-rights-centered business practices that made up the framework of his report (the other two being the Nation State's duty to protect against abuses and the corporate duty to respect all human rights). In his discussion of this pillar, he outlines available mechanisms, their weaknesses, and ways to make them stronger. The report can be found here: www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf

[47] In the ICMM website's official support of the report, titles "ICMM welcomes Ruggie Report", that 'welcome' is most clearly extended to the "focus on grievance mechanisms at the corporate level". To read the entire response, see: www.icmm.com/page/8331/icmm-welcomes-ruggie-report

the creation of its Socio Economic Assessment Toolkit (SEAT),[48] but also its commitment to put the toolkit into use. Their insistence on encouraging managers and partners to use SEAT by setting up intensive training workshops (the use of which is not mandatory) has not gone unrewarded: the North American NGO Business for Social Responsibility conducted an interactive study of SEAT to determine its impact,[49] and their conclusions were highly positive.[50] In part based on BSR's recommendations and in part their own observations, Anglo American recently revised SEAT, adding various new tools to the new Version 2. One of their new tools is a Complaints and Grievance procedure, which is not yet available to the public.[51]

International Alert[52] is a London-based international NGO that specializes in peace building. As their motto[53] expresses, their focus is on building sustainable peace, mostly through capacity building.

One of their projects centers around creating 'conflict sensitivity' in the private sector, particularly for multinational companies. Through this program they have produced several guides for avoiding resource-based conflict. Often working in collaboration with other large international NGOs such as Human Rights Watch and Global Witness, the documents from this program focus on helping companies understand, mitigate, and overcome the risks and problems they face in conflict-prone zones.

The most pertinent of these documents is a toolkit for the extractive industries titled *Conflict-Sensitive Business Practice: Guidance for Extractive Industries*.[54] The nearly 200 page guide was

[48] http://www.angloamerican.co.uk/aa/development/society/engagement/seat/

[49] It must be noted that the study was commissioned by Anglo American, and conducted by visits to four Anglo projects (in Chile and South Africa) and nearly 75 interviews with academics, local and national government representatives, host communities, partners and industry groups.

[50] The BSR report can be found here: www.bsr.org/ClientFiles/BAS/Media/PR_SEAT%20-%20FINAL%2011-6-07.pdf

[51] Version 2 has significantly more information about grievance mechanisms and dispute resolution than does Version 1, but unfortunately only Version 1 is available to the public at this writing. www.angloamerican.co.uk/aa/development/society/engagement/seat/seat_toolbox2.pdf

[52] www.international-alert.org

[53] IA motto: *Understanding Conflict. Building Peace.*

[54]The report can be downloaded at: http://www.international-alert.org/peace_and_economy/peace_and_economy_projects.php

written and researched in collaboration with the International Institute for Sustainable Development[55] and the UN Global Compact.[56] It is designed to provide "practical solutions to the real problems faced by extractive industries and host societies"[57] by detailing tools for measuring and avoiding conflict possibilities. It includes detailed macro-level and project-level Conflict Risk and Impact Assessment tools along with guidelines for dealing with nine special conflict areas.[58] Each guideline includes a summary of the issue, the business case for peace, common assumptions about and responses to the problem, key conflict issues, and options and alternative responses. A large part of the proffered solution in all nine conflict areas and both assessment tools is the development of a community-company partnership. The partnership includes a grievance mechanism.

International Alert is attempting to put its ideas in practice with specific companies, and it is also attempting to create a version of the toolkit for communities.[59]

The International Institute for Environment and Development and the Foundation for International Environmental Law and Development are currently collaborating on a project of considerable potential interest. They are doing a survey of approximately 150 corporations in the extractive industries. They have selected the companies because they are members of the Global Compact.[60] The survey focuses on dispute resolution mechanisms at the local level.

The Canadian Department of Foreign Affairs and International Trade has just finished leading a series of Government of Canada Roundtables[61] to discuss ways Canadian mining companies could lead international best practice on corporate social responsibility. Any and all interested parties were invited to the four roundtables, which were open to the public. After hearing from civil society, industry, labor organizations, academics, and government officials, the Advisory

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[55] www.iisd.org

[56] www.unglobalcompact.org

[57] http://www.international-alert.org/peace_and_economy/peace_and_economy_projects.php

[58] The nine areas are Stakeholder Engagement, Resettlement, Compensation, Indigenous Peoples, Social Investment, Dealing with Armed Groups, Security Arrangements, Human Rights, and Corruption and Transparency

[59] The current toolkit was built for companies with company input.

[60] www.unglobalcompact.org

[61] http://geo.international.gc.ca/cip-pic/current_discussions/csr-roundtables-en.aspx

Group summarized the discussion and outcomes and made a series of recommendations for the Canadian government.[62]

While keeping in mind that "the recommendations contained in this report are intended to be read as a comprehensive package, each element building on the others,"[63] two recommendations are important here. The first is for an independent ombudsman office that would hear complaints relating to the mining operations in developing countries, and the second, a follow-up recommendation to the first, is for a Compliance Review Committee whose job it would be to work with the Ombudsman office and determine the appropriate response for companies found to be non-compliant.

The Harvard Kennedy School of Government[64] has recently begun a new project, called "Corporations and Human Rights: Accountability Mechanisms for Resolving Complaints and Disputes." This project, launched in January of 2007, is part of the School's larger Corporate Social Responsibility Initiative and was developed to "examine the strengths and weaknesses of existing complaints or dispute resolution mechanisms in the area of business and human rights and to formulate principles for effective, human rights-compatible grievance mechanisms."[65]

While the project has relied mostly on pulling information and research from other academics and experts, it has also done some limited field work, in Argentina and South Africa. Over the course of this research, Rees and her colleagues have published a number of documents summarizing their findings. Three such documents, *Mapping Grievance Mechanisms in the Business & Human Rights Arena*; *Grievance Mechanisms for Business and Human Rights: Strengths, Weaknesses, and Gaps*, and *Principles for Effective Human Rights-Based Grievance Mechanisms*, were all discussed in multi-stakeholder workshops.[66]

Since those workshops, the suggestions and collaborations were taken in to consideration and several more documents were produced: *Overview of a Selection of Existing Accountability Mechanisms for Handling Complaints and Disputes*; and *Rights-Compatible Grievance Mechanisms: A Guidance Tool for Companies and Their Stakeholders.*[67]

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[62] The report, which includes a list of participants, presentations, and written documents, can be found at the above website.

[63] Ibid, page i

[64] http://www.hks.harvard.edu/m-rcbg/CSRI/

[65] http://www.hks.harvard.edu/m-rcbg/CSRI/prog_ga.html#account

[66] http://www.hks.harvard.edu/m-rcbg/CSRI/pub_reports.html

[67] Ibid.

IFC's Performance Standard 1 requires (paragraph 23) the creation, in most instances, of a project grievance mechanism, which:

> "should address concerns promptly, using an understandable and transparent process that is culturally appropriate and readily accessible to all segments of the affected communities, and at no cost and without retribution. The mechanism should not impede access to judicial or administrative remedies."[68]

This is a tall order, but it is something that we as lawyers should have a special insight in delivering. It can and should be achieved with our support, not despite us.

This is clearly where the World Bank Group is headed. The Compliance Advisor/Ombudsman of the International Finance Corporation briefed the World Bank Annual Meeting in October of 2008 on the importance of establishing project-level grievance mechanisms and participatory monitoring programs as powerful tools for dispute resolution.[69]

The CAO has published an excellent tool, "A Guide to Designing and Implementing Grievance Mechanisms,"[70] to aid in complying with IFC's Performance Standard 1.

Again, the questions include the role of lawyers in these developments. On one hand, we are trained to look to and respect formal court systems. On the other hand, we are increasingly called on to understand, use, and develop other mechanisms, from mediation to arbitration of international investor disputes before ICSID.[71] It would seem that our skills can be useful in designing and using the kinds of mechanisms being talked about here, and our clients deserve our best effort to make them work.

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68 http://www.ifc.org/ifcext/sustainability.nsf/AttachmentsByTitle/pol_PerformanceStandards2006_full/$FILE/IFC+Performance+Standards.pdf

69 http://www.cao-ombudsman.org/Annualmeetings_2008.htm

70 http://www.cao-ombudsman.org/html-english/documents/GM_final_11.June.2008_000.pdf

71 International Centre for the Settlement of Investment Disputes, http://icsid.worldbank.org/ICSID/Index.jsp

C. Delivery of Services and Infrastructure

This is one of the really obvious issues. In rural areas with a high incidence of poverty, there is a tremendous unmet need for basic services, from potable water and sanitation to public health, education, transportation, electrification, and other infrastructure.

The contrast between having all these things 'inside the wire' of a company encampment, while having few if any of them in local villages 'outside the wire' is a major source of friction. And there are few greater opportunities than this situation for graphic media images of the kind companies would much prefer to avoid.

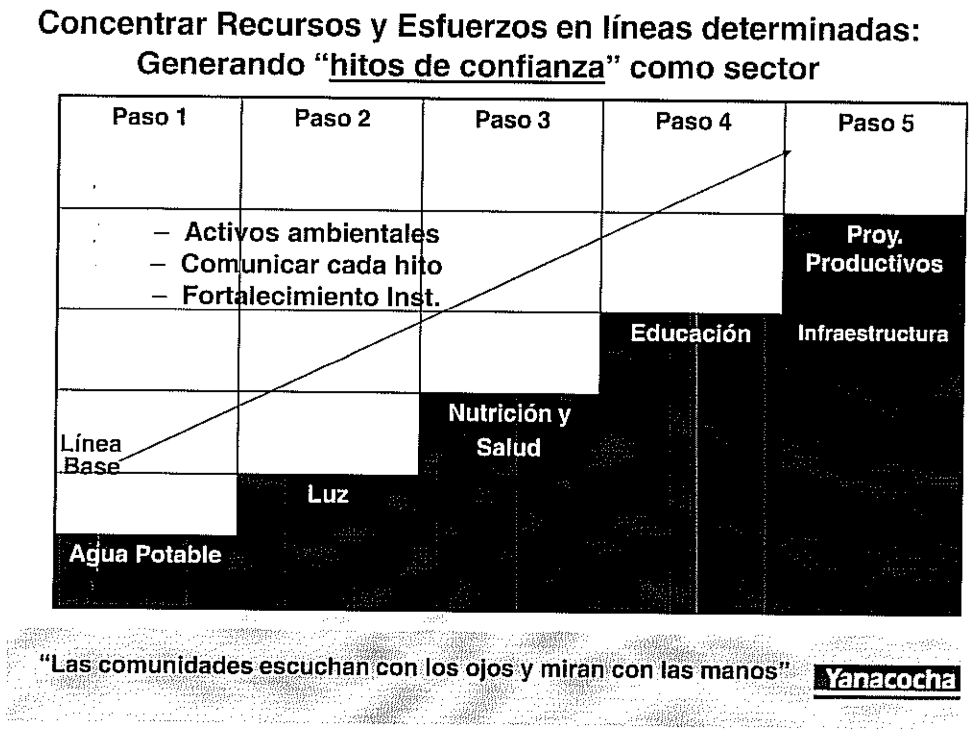
A classic example of this is a village adjacent to a large copper mine that is pledged to be a partner in local development. The mine produces copper, much of which is destined to become electrical cable. And it has a major power line that passes right next to the village. The villagers can hear the hum from the ionization around the charged cable. *But no one in the village has electricity.*

Local people *want* electricity. They also want schools for their children, clean water to drink, and access to decent medical care. If resource development can bring these things, they are likely to support resource development.

But providing these things is not simple. There are all kinds of decisions to be made about how, and when, and what are the priorities. Is clean water first, or is a school? If we can build a school, where will the teacher come from? Which part of the village does the road run through? Which families will get the first electrical connections?

All of these are decisions that really need to be made by local people in conjunction with other actors. Running local schools or water treatment plants is not part of the core competence of most oil and gas companies. These are precisely the kinds of things that communities in rich countries manage for themselves. And so long as someone outside the community is making all these decisions, we are not succeeding on the path of development.

One vision of that path, offered by Minera Yanacocha, is shown in the following diagram:



Suggested steps in the local development process, courtesy of Ricardo Morel Bossio, Minera Yanacocha.

There is probably no more universal 'lesson learned' from decades of development efforts than that the 'engineering approach to development,'providing the equipment and hardware, without adequate engagement of the local community:

1. Will not result in a system people will use and maintain themselves; and

2. Will lead to conflict within the community with those who perceive that others are doing better by the process than they are.

Bluntly, when the sewer system does not work, or the lights go out, or there is no school teacher, local people should look to a politically accountable official for results, and should vote that person out of office if he or she cannot deliver the service. That is what mayors and district counselors are for, to lose elections when they are unpopular. Where a company takes the responsibility for delivering these services without having any kind of political accountability for the results, the community frustration over the inevitable problems lands on the company, rather than where it belongs, on government officials. The only thing more problematic than having the company design build and operate all the infrastructure is having no infrastructure at all.

There may be situations in which local government is simply so far from having capacity to deal with these issues that the choice is between company leadership and doing nothing. But even in these cases, the goals have to be (1) getting local people into decision making roles; and (2) making them accountable to their communities for the results of their decisions.

D. Managing the Development Process

The process of development is very complex and it requires ongoing management. There is no way that a company can develop an agreement with a local community – even a very good agreement – and expect it to work throughout the project life without any fine tuning and mid-course corrections.

> "Companies should develop plans for continuous engagement during the operational life – from exploration through to closure. This plan should be discussed with the community to ensure that the mechanisms it proposes are considered appropriate.
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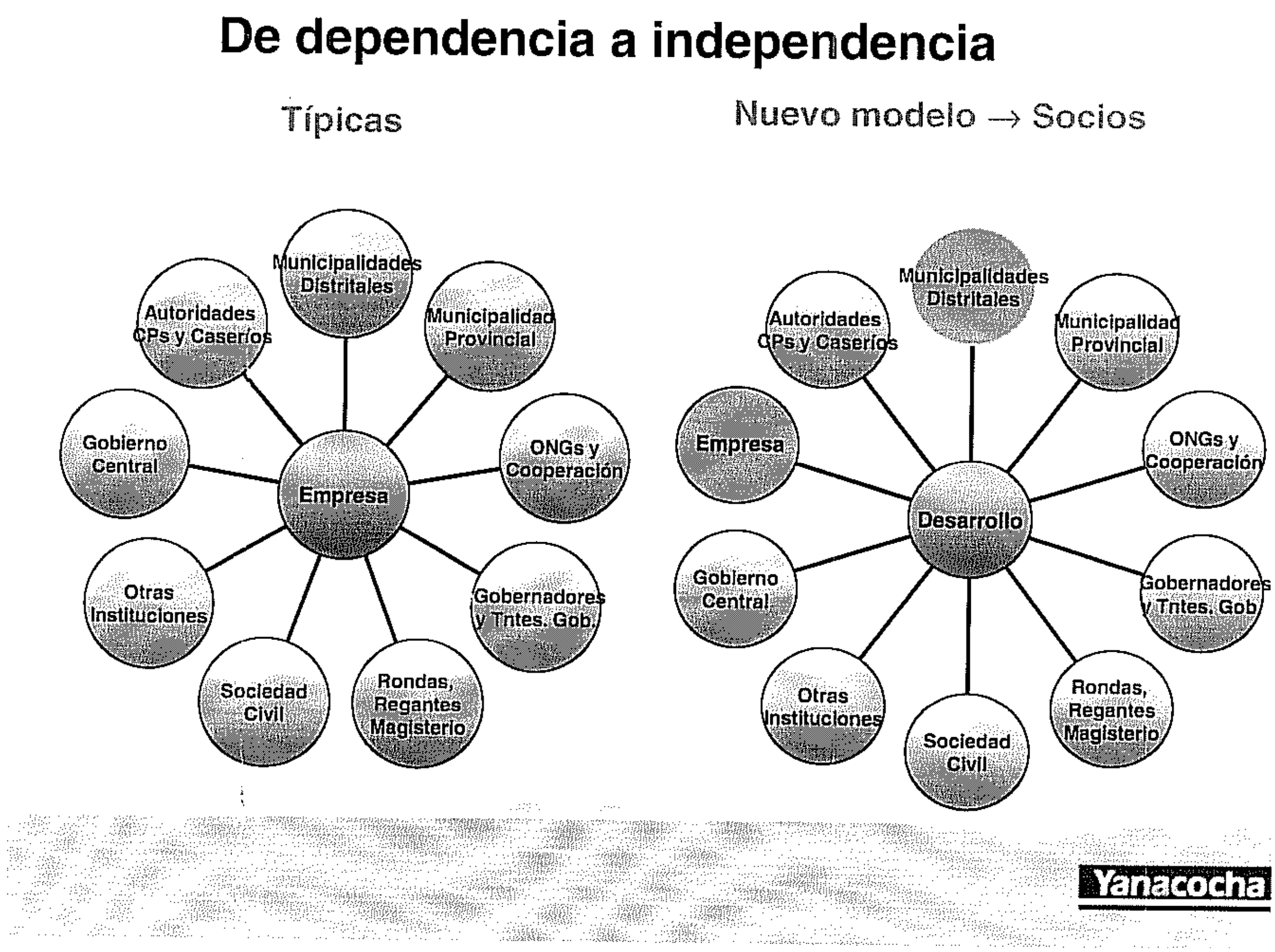
>
> While a company may facilitate and promote the process, the leadership role belongs to local government to the extent it has the capacity and willingness. Otherwise an NGO or development organization could step into this role. The process could also become, for example, part of the forum for discussion between local and national government over revenue sharing and responsibility for services."[72]

[72] BREAKING NEW GROUND, the report of the Mining Minerals and Sustainable Development Project, at 400. http://www.iied.org/pubs/pdfs/G00908.pdf

The way that Minera Yanacocha sees this issue is instructive:



Courtesy of Ricardo Morel Bossio, Minera Yanacocha.

II. A RATIONALE FOR SHARING REVENUE LOCALLY

In many countries, resource developers pay taxes or provide other financial benefits to the national government. Some portion of these revenues could be used to generate development benefits in the regions where the resources are being produced. But often, little or nothing is actually reaching the local or regional level.

There of course are voices that suggest there is no particular reason that it should: 'under the Constitution, all minerals belong to the nation as a whole' is one refrain. In this view, communities around the area from which the resource is being extracted have no particular claim to the revenues from extraction, as the central government has total ownership and control of all natural resources.[73] The national authority is therefore free to do what it will with the revenue, including spending it on a project high on its list of priorities but far from the region where production occurs.

The arguments against this national-government-takes-all approach are several:

- Natural resource development in 'remote' rural areas of developing countries that have (a) traditional cultures; (b) largely subsistence economies; (c) largely intact ecosystems; and (d) weak institutions of governance creates enormous and dramatic changes. The only way that these changes will not overwhelm the system of governance and break out into potentially violent conflict is if governance is strengthened. *And governance cannot be strengthened without more resources.*

- People in the communities surrounding development sites may suffer from a variety of development related problems: environmental upsets leading to loss of subsistence resources, rapid price inflation for commodities they acquire in markets, housing shortages, rapid increase in HIV/AIDS infection rates and other communicable diseases, and many others. They are thus likely to lose ground, *and actually become worse off.* Without some addition of outside resources, they will resist the changes that are causing the deterioration in their living conditions.

- On the positive side, natural resource development can lead to successful local development. But it appears that the successful cases are successful in part because local government has the resources to be an effective partner in development, (e.g., company builds the school, government provides teachers). This opportunity is lost if local government has no resources.

- Very poor people who are desperate for improvement in their standard of living will not sit idly by while they see tremendous wealth being extracted from what they regard as 'their' resources, unless they get a share of that wealth.

We have suggested a set of views that cannot at this stage be rigorously 'proved,' but which are shared in one or another formulation by many knowledgeable students of development and conflict in regions where natural resources are produced:

[73] A longer discussion of this debate can be found in Chapter 17 "The Assignment of Revenue from Natural Resources", in *Handbook of Fiscal Federalism*, by Ehtisham Ahmad and Giorgio Brosio, (2006).

- The best indicator of the potential for conflict may very well be the absence of an agreed-upon revenue sharing formula between national government and the provincial or local authorities.

- Getting some share of the revenue to the local level is not likely to solve the problem unless that revenue is used to strengthen governance and deliver real development benefits – electrical service, potable water, decent housing, health care, education – that matter to local people. The issue is not therefore simply whether the money is being sent to local authorities, but whether they have the capacity to spend it to deliver things that matter to people.

- This of course implies that the resources are not siphoned off into corruption. There needs to be an effective way of restraining corruption, or there will be no benefits that matter to the average person.

- And it also requires some accountability: local officials have to be responsible to the communities they represent for delivering results.

We are well aware that even a very thoughtful approach to the specific problem we address may not be adequate to prevent violence when its causes appear at multiple levels. On the other hand, we think the same can equally be said of any other way forward.

One authority has put it this way:

> "In the raging debates over who should control what resources, the interests of the oil producing communities and the occupiers of the land where the operations take place have been relegated to the background, as the controversy has been mainly between the Federal and the State Governments. It has been argued that an increase in the amount of revenue accruing to the states will not automatically result in better conditions of living for the persons who are most directly affected by the operations, and who are not considered in the equation when discussing the issues of revenue allocation."[74]

BREAKING NEW GROUND, a broadly agreed statement of principles in mining, declares that:

> "One of the most contentious issues [surrounding mining projects] is how to share mining revenues between the central government and local

[74] Ameh, Madaki O. "Ownership And Control Of Mineral Resources". www.dundee.ac.uk/cepmlp/car/html/CAR10_ARTICLE37.PDF

> governments and communities... Few countries with mineral development have been able to resolve this issue satisfactorily. Failure can have serious consequences for government and companies, potentially creating tension or even conflict with local communities."[75]

This is true not just for mining projects, but for projects in any of the extractive industries. The debate about who gets how much of the pie is very long and heated, and there is no simple answer in any situation. However, it is equally clear that this is not a debate that can be avoided, as those who have sufficient governance to mediate these tensions effectively avoid violence, while the rest do not.

Our hypothesis is that where resource revenues result in visible development benefits to the populations most affected by development, production of natural resources is much less likely to be accompanied by conflict ad opposition. Conversely, where the intense disruption caused by resource extraction is not accompanied by visible benefits, the process is much more likely to have a negative outcome.

There are a number of independent pieces of evidence that suggest the ability to deliver real development benefits at a local or regional level is at least one of the keys to avoiding violent conflict:

- The experience of Peru is suggestive. While in the 1980s there was legislation that destined a share of mining tax revenues to the provinces, in the Fujimori years this *canon minero* was often not paid. At the same time, there was tremendous rural violence, some of it centered on mining. In recent years, Peru has had a tremendous diminution of violence, while the flow of revenues to the provinces is accelerating. We do not suggest that these are the only variables involved. *Nor are we saying anything about which is the cause and which is the effect.* But it does seem worth investigating the extent to which the flow of funds to the provinces has fortified the peace process, and vice versa.

- Confidential studies in two countries – Ghana and Peru – purportedly show a very clear connection between the level of development benefits reaching individual communities and their attitudes toward extractive industries.

- It seems *a priori* logical that people who are clearly 'getting ahead' and obtaining the kinds of benefits that mean something to them are not going to want to jeopardize

[75] Page 182.

these benefits by violence. Similarly, it seems *a priori* logical that people who are actually losing in the race to develop – perhaps because their subsistence livelihoods have been destroyed, and have not been replaced by something else – will tend to resist.

- The experience of Indonesia is also suggestive – in the Suharto years there was almost no sharing of oil, gas or mineral revenues with the regions. And many of the regions – East Timor, Aceh, West Papua and others -- could only be kept in the Indonesian state by force. In the post-Suharto era, the Indonesian government has sought a more consensual and less violent relationship with the provinces. And a key feature of that has been a greater willingness of Jakarta at least to talk about sharing revenues, accompanied by some actual flows of resources.

- In many of the natural resource conflicts we have looked at, the parties to the conflict *say* that sharing of resources with the affected regions is part of what they are fighting about.[76] There is some logic to taking them at their word – that they are in fact fighting over what they say they are fighting over. In Ogoniland,[77] in Aceh,[78] in West Papua,[79] and in other places local people point to the refusal of the central government to share a reasonable portion of the revenues as a central issue in their current conflict. Military officials generally do not say that these demands are unreasonable, simply that they have 'to protect private property,' or 'protect the rights of investors.'

- While in environments where the governance is much stronger – the United States, Australia, South Africa – these tensions do not break out into violence, the tensions are clearly there, and serious. Whether it is the State of Louisiana arguing with the federal

[76] In Bougainville, Aceh, and West Papua, for example, the quest for independence or at the very least autonomy is an important part of the mix, and (i) the regional interests may want revenues precisely to become independent, and (ii) the central authorities want to deny them the revenues for that same reason.

[77] Okonta, Ike. "The Prophecy of Saro-Wiwa". *The Guardian*. London, UK. November 11, 2006. http://www.guardian.co.uk/commentisfree/2006/nov/11/comment.oil

[78] Wong, Douglas. "Yusuf, Former Rebel Leader, Wins Aceh Governor Race". Bloomberg, December 12, 2006. http://www.indonesia-ottawa.org/information/details.php?type=news_copy&id=3225

[79] Kosich, Dorothy. "Papuan Province Wants More Freeport-McMoRan Tax Revenue". *MineWeb*. October 8, 2008. http://www.mineweb.com/mineweb/view/mineweb/en/page34?oid=70463&sn=Detail

government over offshore oil revenues,[80] or the coal mining regions of Germany arguing with the central government,[81] the tensions are quite real.

A. *Resource Allocation*

In every resource-rich country, the policies (and the implementation of those policies) are always evolving. Even in the rich countries, there is an ebb and flow, sometimes in favor of the central authority, and sometimes in favor of the regions.[82]

Further, it should be obvious that simply writing checks to regional entities will not solve the problem. While receiving funds may please local elites, this will not long keep the masses content if elites cannot spend the funds responsibly. If there is a dramatic decline in living standards, tremendous disruption of traditional ways, and little or no corresponding benefit to the population, conflict will erupt even if a few regional 'leaders' are enriched.

What may stand in the way of converting resource revenues to visible benefits at the local level? The two most obvious answers are (a) corruption; and (b) lack of capacity. The question is not a simple accounting question of how much money is flowing to the regions. There are three principal variables, all of them classic governance issues:

- Is some share of the natural resource rent flowing to the local or regional institutions?
- Is corruption adequately controlled so that some of that revenue is being spent on public purposes, as opposed to being diverted for private gain?
- Do the people spending the money have adequate capacity to plan and prioritize, so that the spending is likely to have concrete benefits?

If we evaluate the state of advance in various countries, we are likely to find at one extreme cases where (i) almost none of the resource revenue reaches the producing region; (ii)

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[80] Allen, Greg. "Louisiana Demands More Off-Shore Oil Revenues". *National Public Radio.* February 14, 2006. http://www.npr.org/templates/story/story.php?storyId=5205346

[81] Deuse, Klaus. "Germany Debates the Future of Coal Mining". *DW-World.DE.* December 16, 2006. http://www.dw-world.de/dw/article/0,2144,2270512,00.htm

[82] A prime example of this is Canada's recent work between the governmental agency, Natural Resources Canada, and the Assembly of First Nations, Canada's largest organization of native peoples. For more information on this debate, see http://www.afn.ca/article.asp?id=3718

corruption is rampant; and (iii) local authorities have very little capacity to set priorities or spend resources effectively even if they did reach the regions.

At the other extreme there are cases where (i) a considerable amount of revenue reaches the region; (ii) corruption is managed within some limits; and (iii) the local authorities are able to manage, target and spend resources adequately to ensure that benefits will be seen by the average citizen.

We therefore conceptualize the process as passing through five stages, shown below. In our model, countries in Stage I and II should have a higher incidence of conflict than countries in Stage V.

STAGE	EXPLANATION Fig. 2	EXAMPLE
I	There is no awareness of or agreement about the desirability of sharing revenues. The reasoning is that "We are all citizens, and the resource belongs to us all." High endemic corruption and very low levels of capacity at lower levels of government stand in the way of development. Poor civil society monitoring of revenue flows and limited transparency compound the problem.	Democratic Republic of Congo
II	The desirability of sharing benefits is acknowledged, but nothing is done. In this stage, even if the right of the local communities to control the resources in their immediate vicinity is acknowledged, corruption, loopholes, and defects in legislation mean the national government effectively keeps all revenues and mineral rights for itself.[83]	Equatorial Guinea[84]
III	There are legal or policy provisions for sharing revenues, but the revenues actually flow only very little or not at all.	Various[85]

[83] BREAKING NEW GROUND, page 345

[84] While the law in Equatorial Guinea claims that oil revenues will be shared out to provincial governments, the President, Theodoro Obiang, has not ensured their mplementation. See http://www.equatorialguinea-monalige.com/e_g.htm and "Property Rights and the Resource Curse". Feb, 2008. http://www.cceia.org/resources/articles_papers_reports/property_rights_and_the_resource_curse/001.html

[85] See Morgandi, Matteo. "Extractive Industries Revenue Distribution at the Sub-National Level: The Experience in Seven Resource-Rich Countries". *Revenue Watch Institute*. June 2008.

	There is some transparency, but not enough for full monitoring of revenue flows.	
IV	Revenues are flowing to local areas but the local capacity to spend them well does not exist. In many cases, the sudden cash flow disrupts the social fabric and culture of the communities much faster and more violently than the extraction itself.	Indonesia [86]
V	Capacity exists to manage, monitor and make officials accountable for how revenues are spent so that the quality of expenditure should increase over time.	Peru

While these stages are somewhat consecutive and progressive, that does not necessarily mean that a country must pass in sequence through all the previous stages to achieve the fifth stage, which is the stage at which we hypothesize the situation will be stable enough to result in a dramatic and visible reduction in the incidence or risk of violence.

III. REVENUE SHARING AND LOCAL GOVERNAN CE

This then gives us the context for the principal subject of this paper. The context is that mining, oil and gas, hydroelectric dams, timber development and other big natural resource projects often occur in areas where government and governance are weak or almost entirely absent.

The point is simply this: where there is robust and effective government, it is capable of solving very difficult problems. Where this governance is lacking, spending money may not produce value for companies, or for local communities. Indeed, it may cause tension.

In every country with natural resource development, there is considerable tension between national government and local or regional interests. Even in Norway, there is tension between the native Samir people and the national government over mineral development. Some of the struggles between Canadian provinces or American states and their national governments have been legendary. But where government is strong, well-resourced and politically effective, it usually serves to adjust these tensions. Good government does not mean an absence of

[86] According to Tom Beanal, a prominent Amungme (a native ethnic group) leader in West Papua, the money flowing into the towns surrounding the mine only causes alcoholism, prostitution, the spread of venereal diseases (including HIV/AIDS) and the loss of community. See Muller, Kal. "Background Texts". www.papuaweb.org/dlib/tema/amungme/muller/background-texts.rtf

tensions. But it means there is a politically acceptable way to sort out the issues within the system. All the talk about 'consent' has to be understood as a way to cope with situations where government is absent, lacks the technical capacity, has inadequate resources, fails to have credibility, or lacks the political legitimacy to solve the problem.

Where government is functioning well, it provides dispute resolution mechanisms in the form of courts. These may have their defects, but in countries with robust and successful government, they are accepted enough of the time, by enough of the people, to resolve a wide variety of disputes within the system and without violence. This is a major achievement.

Sharing of mineral revenues with local communities has to be seen in this same context. Companies are caught among these conflicting realities:

- First, if there are no visible development benefits to local people, this is almost a recipe for rejection of resource development. Resource development in a poor rural community where people are heavily dependent on subsistence use of natural resources puts many people at risk, disturbs traditional relationships, and may in fact make the poor poorer, if it interferes with subsistence livelihoods without providing an alternative in the cash economy. Communities will not consent to this kind of development. If it is imposed on them without their consent, they will look for ways to express their grievances 'within the system.' If there are not any, the result is likely to be unhappy for many of the participants, including the resource company.

- Second, simply shoveling money into the local community may cause more problems than it solves. There are all kinds of pitfalls: paying 'compensation' to heads of household who turn out all to be male, creating gender stresses that tear families apart. Or fomenting the development of a rich elite in a traditionally egalitarian and communitarian culture. Or giving more money and power to one of the competing social or ethnic groups, upsetting the political balance. These are pitfalls that is hard to avoid, but the consequences of falling into them are severe.

- Third, there are national governments that do not want local people to receive more resources, especially where those local people are of a different ethnicity than the group who run the national government.[87] At a minimum, national government may want resources channeled to its political allies, rather than its adversaries, and may be

[87] "If they get money, they will buy guns and try to become independent" is a comment from one anonymous official.

fairly heavy handed in its attempts to assure this outcome. The problem may be at its worst when local people are part of a despised racial or ethnic minority.

- Fourth, oil, gas and mining companies are not designed to be agencies of development. Even professional aid agencies make a lot of mistakes, and there is a whole literature documenting their failures.[88] Why should we expect an oil company, or a gold mining company, with no track record in this area, to outperform professional aid agencies?

This then is the conundrum: a successful relationship with the community requires success in local development. In areas with very weak government capacity, there is no one but the company to deliver on this promise. Yet companies are not designed for this task and are not clear about how to undertake it.

The classic answer to this problem is twofold: to do our best to strengthen government and build its capacity, and in the meantime to create quasi-governmental organizations, usually company foundations, to deliver on the promise of development.

IV. MANAGING MINERAL REVENUES FOR DEVELOPMENT

There was a time when it did not occur to many developers to be concerned about benefiting local communities. When society started to see this as a priority, it was often simply assumed that mineral revenues would make both countries and local communities better off. That time has passed.

At the national level, we have heard enough about mineral revenues as a source of corruption,[89] mineral revenues exacerbating inequality,[90] mineral revenues fomenting armed conflict and human rights abuse, and the "Dutch disease" [91] that we no longer are able to

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[88] Bruce Rich's **Mortgaging the Earth** remains one of the great classics. But there are many more.

[89] Mark Robinson, **Corruption and Development** (Routledge 1998).

[90] "High inequality can contribute to the immiseration or absolute deprivation of portions of the population, even with growth. Absolute deprivation during substantial growth was experienced for instance by Igbo political elites, dominant in Nigeria's Eastern Region, in 1964-65. The East lost oil-tax revenues when the federal government ceased distributing mineral export revenues to regional governments." E.W. Nafziger, *Development, inequality, and war in Africa,* The Economics of Peace and Security Journal at 15 (2006).

[91] Christine Ebrahim-zadeh, *Dutch Disease: Too much wealth managed unwisely, 40 FINANCE AND DEVELOPMENT,* (March 2003). http://www.imf.org/external/pubs/ft/fandd/2003/03/ebra.htm

assume that mineral resource endowments are automatically a source of prosperity for nations. Indeed, to the extent there is a pattern, much of the evidence seems to suggest that countries with heavy dependence on basic natural resource exports grow more slowly than others.[92]

If, at the national level, we cannot assume that resource development leads to growth and poverty reduction, then is also true at the local level. Too often, we just do not know. And this brings up a series of important questions.

A. What is Poverty? What is Success in Development?

1. Measuring What We Mean by "Better Off." It is a truism in business schools that if we are not measuring something, we are not managing for it. A key to deciding whether we are having a beneficial effect on local communities is measuring the changes in them, something that is all too rarely done. Because in general, we have not tried to make such measurements in any systematic way, companies tend to measure and report their performance with indicators such as how much money they have spent on community activities, which may measure company effort but are not measuring development success.[93]

The first step may be to realize that we are not going to be serious and effective about reducing poverty or making communities better off until we start reliably and systematically measuring and reporting on this basis.

Measuring what we mean by 'better off' turns out to be a very complex question. We have found all kinds of problems with GDP per capita, the most traditional measure of welfare. One of the biggest problems is that the poorer people are, the less GDP per capita measures anything.

This has led to development of a series of alternative ways of measuring poverty and success in development[94]:

- The most widely used is the Human Development Index (HDI), which measures the average achievements in a country in three basic dimensions of human development: a long and healthy life, knowledge and a decent standard of living. It is calculated for 177

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[92] Jeffrey D. Sachs, and Joseph E. Stiglitz, **Escaping the Resource Curse** (Martin Humphreys, ed. (Columbia 2007).

[93] I do not mean to be too critical: companies have the same problems as everyone else in trying to measure their impact on the society around them, and by and large they are not research institutions. This is a shared problem that we all need to work on.

[94] UNDP, *Composite indices — HDI and beyond,* HUMAN DEVELOPMENT REPORTS, *http://hdr.undp.org/en/statistics/indices/*

countries and areas for which data is available. Some companies are starting to compile and report these data.[95]

- The Human Poverty Index (HPI-1) measures human deprivation in the same aspects of human development as the HDI . The HPI-2—human poverty index for developed countries -- includes measures of social exclusion.

- The Gender Related Development Index (GDI) is a composite index that measures human development in the same dimensions as the HDI while adjusting for gender inequality in those basic dimensions.

But even these have limitations. Human poverty is now thought of primarily as a deprivation of choices[96] and opportunities for living a life one has reason to value. In this perspective, poor people do not come better off – at least not much better off – by having people give them things. It is only when they, and the communities of which they are a part, start being listened to, and having a voice in decisions that affect them, that the burden of poverty starts to lift. As attractive as this idea is, increasing or decreasing availability of options is not that easy to measure.

2. Whose Opinion is Relevant? If we see development as increasing options, we have almost no way to measure it except by asking the people involved. Yet this is something rarely done.

Nothing seems to be more frequent at the field level than disputes over whether people are seeing an improvement in standard of living. And nothing is more common than frustration on the part company officials when local people 'refuse to admit' that they are better off.

Local complaints about increased poverty and the adverse impacts on natural resource projects are often seen as attempts to get money or undeserved compensation, or resisted on the basis that people are ungrateful for the benefits they have received.

But the truth is that even if I have a doctorate and a local villager can't read or write, he is expert on his own life, and even modest respect for his dignity means that we have to ask him what he thinks, rather than simply measure him as an object of research.

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[95] One example is Freeport in Indonesia. See Institute for Economic and Social Research, Faculty of Economics of the University of Indonesia, ECONOMIC ANALYSIS OF PT FREEPORT INDONESIA, 2007 Update.

[96] See Nobel economist Amartya Sen's classic, DEVELOPMENT AS FREEDOM (Oxford 1999).

3. <u>The Subsistence problem.</u> People survive on some combination of goods that they buy in markets, and goods they receive free from the ecosystem. Even the rich usually breathe 'free' air from the ecosystem, even if it is pumped through air conditioners and fans, which all cost money, and even if 'oxygen bars' are staring to appear in some parts of the world. But the urban dweller, particularly the rich urban dweller, now drinks water purchased in bottles, and receives the great majority of his or her food, shelter and clothing by purchasing them in markets.

By contract, there are still some people who obtain almost all of what they need directly from ecosystems, and receive very little through markets, even barter markets. These people tend to be poor, by most definitions. The people who depend most directly on ecosystem goods are therefore the poor, who have an extremely limited safety net. Changes in ecosystems can easily upset the delicate relationships on which their survival is based.

When the construction crews show up to build the pipeline, or develop the mine, these are the people who feel the impacts most directly. And if the fish disappear from the river, the game is driven from the forest, or all the potatoes in the area are bought up by pipeline workers, these are the people who feel the immediate diminution on their standard of living. They are the ones, therefore, who need some kind of alternative cash income, or a move out of the subsistence economy into a paying job.

More subtly, what if the fish no longer taste the same, or traditional foods are reported no longer to be palatable? This is a very common indicator of ecological changes. The most common response is to start looking for violations of maximum contaminant levels. But measuring the contaminant levels in fish and declaring them to be within WHO standards may tell you whether eating the fish will kill you or make you sick. It does not answer the question of whether they are good to eat. And whether they are good to eat is a question that the person doing the eating is always better qualified to judge than is the expert who is watching the eating.

B. What Do We Use Revenues For?

Natural resource revenues support two quite different kinds of activities. First, they can go to meeting basic needs of people: schools, hospitals, electricity, clean drinking water. Second, they can go to strengthening local institutions and governance.

This second purpose is really at the core of the argument of this paper. If we have a functioning local government, that has managers who are able to hold up the local community's interests through the development process, supported by experts able to cope with basic technical questions, the community is a long way toward being able to achieve basic objectives. If it wants a road, it may very well be able to get one.

But without capable local governance, delivering goods and services is not likely to work. Even if someone builds a road and gives it to the community, they may not be able to keep it open and maintained.

We therefore have to see building of capable local institutions as the priority. As we have seen above, these local institutions are necessary throughout the development process, to act as the community's negotiator, to express community sentiment, to provide dispute resolution mechanisms, and to help fine tune the effort as it moves forward in time.

C. *Why It Is Hard to Base Development on Natural Resource Endowments*

What are the obstacles to using mineral revenues to support development of stronger and more capable local institutions? There may be many obstacles, but I will suggest just three fairly obvious challenges.

1. <u>The Impacts to be Managed Start Before There Are Revenues.</u>

In general, natural resource projects take some years to develop. In general, they do not put much revenue into the hands of government at any level until there is a production stream to generate revenues.

If this is the case, how can we strengthen the capacity of local institutions when they are most needed – in dealing with the tremendous initial shock of the development ?

If we cannot find a way to strengthen governance very early on, before the revenues start flowing, the game may be lost before we fairly start. This was one of the major debates within the World Bank Group over the Chad-Cameroon Pipeline.

In an area with very weak local institutions, many were deeply worried that a massive development project would lead to all of the classic ills: income inequality, exacerbation of ethnic tensions, inability to channel revenues for development, increased corruption and perhaps even armed violence. In this view, only with an initial process of capacity building and institutional strengthening, perhaps lasting some years, it would be 'safe' to unleash such a massive project with any hope that it would meet aspirations for poverty reduction and a better life for local people.

But where, others asked, were the resources to come from to do that?

- Important potential customers for the oil were impatient and did not want to wait for their oil;

- It was asking a great deal of the governments of Chad and Cameroon, two very poor countries, to wait to start getting the oil revenues while foreign institutions trained them on how to spend them;
- The economics of the project looked less attractive if earlier years' investment had to be carried for some period of years until there was a payback stream;
- International aid NGOs did not want to get involved and look as if they were fronting for oil companies' interests; and
- There was no easy source for the considerable sums necessary for such an effort.

The Bank settled this debate by adopting the *pari passu* doctrine: that with diligent and concentrated effort, it would be possible to achieve success developing the local institutions and the pipeline together, on more or less the same schedule.

> "the Bank went to great lengths to promote the pipeline as a model for using revenues from high-risk projects to reduce poverty. It instituted an unprecedented, elaborate system for ensuring that revenues were devoted to social spending."[97]

Sadly for all concerned, this carefully designed system failed:

> In 2006, then-Bank President Paul Wolfowitz abruptly suspended the Bank's lending to Chad after [President] Deby orchestrated an amendment to the country's oil revenue management law that allowed it to redirect funds to security spending to quell increasing unrest in the country. In response, the World Bank suspended its loans to Chad, triggering a freeze of the offshore escrow accounts holding oil revenue payments. Facing a standoff in which the government threatened to halt oil production, the Bank backed off, signing an agreement that allowed the resumption of its lending and granting the government even greater discretion over the revenue than before.[98]

Instead of a model of development,[99] the project has led to a variety of negative consequences:

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[97] "World Bank announces withdrawal from Chad-Cameroon Pipeline after early repayment," Bank Information Center, http://www.bicusa.org/en/Article.3892.aspx

[98] Id.

[99] "The pipeline project is the World Bank's most significant attempt yet to modify the intervening variable of government policy and transform the equation from one of resource extraction + bad governance →poverty

> "the pipeline has been less a tool for development than an incitement to greater instability. Indeed, several of the civil society leaders who have played crucial roles in raising awareness of problems with the pipeline in Chad were forced to flee into exile earlier this year when the Deby government used a threatened rebel attack on N'Djamena to crack down on critics and political opponents."[100]

This may be an extreme case. But the problem – that powerful impacts of project development may come early in the game, before there are revenues to pay for strengthening of local institutions – is very real.

A tremendous initial shock of ecological, cultural and economic change comes before there are any revenues to strengthen the institutions that must moderate these impacts.[101]

If traditional livelihoods are disrupted, or construction workers bring in sexually transmitted diseases, or people are exposed to new vices and cultural stresses, there is usually nothing much there to ameliorate these problems until much later in the development cycle.

If we are going to have greater success in creating benign and widely supported kinds of development on a resource base, we almost have to find some way to get revenues flowing into capacity building and impact mitigation at the local level much earlier in the project cycle. There has been talk of issuing bonds against future revenues to do this, but so far it has been mainly, if not entirely, talk.

2. Revenues Fluctuate and Are Hard to Rely On. Mineral prices are notoriously volatile. The exact extent of this volatility depends on the commodity, but there are commodities that go up and down routinely by a factor of five or six.

This of course heavily impacts mineral companies, who find themselves alternately flush with cash and desperately cutting costs in order to survive. Companies have an understandable reluctance to commit themselves to sizable long term obligations which they have no way to reduce when times are bad.

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exacerbation to one of resource extraction + good governance →poverty reduction. This article finds that these policy interventions are not working well and that the Chad–Cameroon pipeline project is unlikely to lead to poverty alleviation." S. Pegg, Can policy intervention beat the resource curse? Evidence from the Chad–Cameroon pipeline project, AFRICAN AFFAIRS, vol. 105 (Dec. 2005).

[100] Bank Information Center, note 85 above.

[101] This problem is hardly limited to developing countries. See for example the excellent 1973 study

Most companies have tried to hedge this risk by trying to negotiate tax payments of foundation donations that depend on profits. While this is understandable, this does mean that payments into the community are abundant when the local economy is booming because of high mineral prices. When the local economy is in a trough, and the social needs are the greatest, the contribution to the company foundation, or the payment of taxes, is much reduced.

Leading companies are starting to understand that this is a principal source of instability in their agreements: if economic times are very hard, just as mineral revenues to government drop to zero or near zero, the agreement will be politically unsustainable, and will almost necessarily be renegotiated in one way or another.

Some of the most sophisticated countries have tried to manage these fluctuations by creating 'stabilization funds' into which government pays when times are good, and from which it draws when prices are down.[102] This is difficult to manage effectively, and very poor countries, especially countries new to managing mineral revenues, have not generally been able to do this.

Not all projects are equal in this respect. Some of the great Chilean copper mines have stayed in operation for over a century. But there are also projects that have stopped generating revenues for either shareholders of government after rather short periods. And there are others that have gone into and out of production repeatedly, taking dependent communities on a series of ups and downs.

3. The Impacts Continue After the Revenues End. We have long recognized that there are considerable post-closure environmental costs for some kinds of facilities. We are starting to recognize that there are important post-closure social costs as well, which is one reason why closure of mines has been so politically fraught for everyone from the Thatcher government in the U.K. to post-communist regimes in eastern Europe to the Chilean example of the Lota coal mines.

Government has to find some mechanism to ensure that enough revenue is saved, or that stimulation of the private sector is sufficient, to provide the revenues to manage these development problems after the revenue stream stops.

In sum, managing mineral revenues to create a stable and positive form of development is very challenging at the national level. Some countries, such as Finland, or Canada, or Botswana, or

[102] See BREAKING NEW GROUND, the report of the Mining Minerals and Sustainable Development Project at 175-76, http://www.iied.org/pubs/pdfs/G00900.pdf, Chile, Papua New Guinea and Botswana have experimented with this approach.

Chile have had some success. But many countries, especially the poorest, are finding it very hard indeed to meet these challenges.

The process is at least equally challenging at the local or community level, where the positive and negative impacts of development are most concentrated, and the capacity of government is likely to be considerably lower.

V. CONCLUSION

Somehow, it is necessary to get significant revenues to the local level in order to support local development. The alternative is instability, some chaos, conflict, and in the worst cases violence.

Part of that revenue may need to go directly for services – hospitals, public health, education, potable water.

But if part of the resources do not go to local government to build its capacity to set priorities for the community, negotiate with companies, the central government and others, resolve disputes, and manage the process as it goes along, all of the providing of services is likely to go sour.

Companies may be tempted to fill the vacuum where there is no capable local government. But this is a difficult role. For example, company foundations may be in the middle of serious disputes. And the issue really is and must be to transition from company control to local control over foundation decisions. Otherwise we are fostering dependency. While companies may have to help provide technical support for local development organizations that spend company money – accountants, investment advisors, lawyers – ultimately it is local people who need to make the decisions.

And it is elected political leaders who ultimately have to have political accountability for results. Things will not always go right with development. Where the results are not to the liking of local communities, they need to have the ability to replace the people making the decisions. If the people who are making decisions work for an oil company, they will want to replace the oil company.