

## **Crafting a Strategic Response to the Commodity- Development Conundrum**

A response to “Commodities and Switzerland: Development Policy Challenges and Policy Options” by Werner Thut.

**Alexandra Gillies**

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# POLICY DEBATES

## COMMODITY TRADING POLICY COHERENCE IN A TOP TRADING HUB: SWITZERLAND

### EDITOR'S NOTE

The 'Policy Debate' section of *International Development Policy* offers a platform where academics, policy makers and reflective practitioners engage in critical dialogue on specific development challenges. The initial lead paper is not peer-reviewed. Instead, it is followed by reactions and critical comments from different stakeholders.

The lead paper below, written in December 2012 by Werner Thut (Swiss Agency for Development and Cooperation), is followed by reactions and analysis from Alexandra Gillies (Revenue Watch Institute, New York), Humberto Campodonico (Universidad Nacional Mayor de San Marcos, Lima) and Stéphane Graber (Geneva Trading & Shipping Association). Readers who are interested are invited to contribute to this policy debate on our blog < <http://devpol.hypotheses.org/19> >.

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Initial contribution by Werner Thut, Senior Policy Advisor EU Development Affairs at the Department of Foreign Affairs (FDFA), Swiss Agency for Development and Cooperation (SDC, Analysis & Policy Division < <http://www.sdc.admin.ch> >). This contribution reflects the personal views of the author, and does not necessarily represent the official position of the SDC.

## Commodities and Switzerland: Development Policy Challenges and Policy Options

### Paper's Abstract

Switzerland is one of the world's largest commodity trading hub. The author, senior policy adviser at the Swiss Agency for Development and Cooperation (SDC), reviews experiences and policy options related to commodity trading from a development policy perspective. While this sector has become of strategic importance to Switzerland's economy, it also entails a number of risks. On the other hand, Swiss development cooperation efforts focus on several resource-rich countries, whose mineral and agricultural commodities are traded via Switzerland. How can Switzerland assist these countries to reap the benefits of their natural resource wealth? This paper looks at development policy aspects of commodity trading in relation to Swiss foreign and domestic policy. It examines ongoing policy debates in Switzerland and discusses development policy options.

## 1. Introduction

The topic of commodities – understood as the result of both mining and agricultural activities – is a particularly diverse one, and includes the closely-related and globally-intertwined sub-processes of resource extraction, trade and usage. At each stage of the value chain and beyond, the issue presents development policy challenges. In resource-rich developing countries, there are implications for social, environmental and legal-institutional, as well as export revenue, tax and distributional, policies. In the resource-hungry countries of the Organisation for Economic Cooperation and Development (OECD) and in emerging economies, commodities issues include questions relating to the size of their ecological footprints and to the security of supply. Similarly, another hotly debated aspect is the role of corporations, and their share of revenues, in this industry.

This document focuses on concerns, experiences and possible courses of action relating to commodities that are particularly relevant for Swiss international development cooperation. On the one hand, these courses of action arise from the mandate, potential and experience of Swiss international development cooperation. The Swiss Agency for Development and Cooperation (SDC) and the Economic Development Division of the State Secretariat for Economic Affairs (SECO) are active in many countries rich in mining resources, such as Afghanistan, Bolivia, Chad, Colombia, Ghana, Mongolia, Niger, Peru, South Africa and the Great Lakes region of Africa. In many of Swiss development cooperation's priority countries, mining and agricultural production are incorporated in value chains that are traded via Switzerland. As a result, the question arises as to how Switzerland can assist these countries to fully reap the benefits of their natural resource wealth.

On the other hand, with respect to policy coherence for development, this overview also considers the role played by commodity trading companies that are based in Switzerland and thus subject to Swiss law. Switzerland weighs heavily in the commodity trading industry, with Swiss-based companies or resident subsidiaries accounting for an estimated 15-25 per cent of global trade in (mining and agricultural) commodities. Furthermore, Switzerland is one of the world's most successful centres of financial and other services, providing the commodity trading industry with vital financial and legal services, logistics, insurance, etc.<sup>1</sup> Ultimately, the Swiss regulatory framework, with its structure of corporate and tax legislation, constitutes the overall environment that determines the scope for business operations. It is therefore no coincidence that Switzerland itself has become part of the current discussions at the international level regarding the more problematic aspects of resource extraction and commodity trading. A principal line of inquiry in these discussions focuses on the scale and nature of illicit financial flows (IFFs). From this perspective, questions arise as to the coherence for develop-

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<sup>1</sup> The Boston Consulting Group (BCG) estimates the amount of capital held in Swiss banks at over USD 2 trillion, or 27 per cent of all offshore wealth, quoted in an article published in *The Economist* on February 11, 2012; 'Don't ask, won't tell - Amid a global squeeze on tax evasion, Switzerland is the prime target': <http://www.economist.com/node/21547229> (accessed on April 22, 2013). Offshore wealth is defined by BCG as 'assets booked in a country where the investor has no legal residence or tax domicile'. For more details see BCG Report (Becerra et al., 2001).

ment of some components of Swiss policies, including those relating to trade and international taxation.

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### BOX 1: Switzerland's Commodity Trading Industry in International Media

The announced merger, expected to be completed in 2013, of the commodities trading firm Glencore, situated in Baar, Switzerland, with the mining operator Xstrata, located in neighbouring Zug, will result in the largest merger ever witnessed in the commodities sector. In one stroke, the new company will become, in terms of annual revenue, both the second largest commodities trader and the fourth largest mining operator in the world.<sup>2</sup> Analysts estimate that the combined turnover of all businesses within the new company will amount to USD 210 billion. After Glencore's initial public offer in May 2011, this merger plan further propelled the Swiss-based commodity trading industry into the international spotlight, and not only for global investors, as the development and political dimensions of this industry became the focal point of international discussions and analyses.

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How do development policy aspects of the commodities trade relate to Swiss foreign and domestic policy more generally? As the Swiss Federal Council has prominently stated, the commodities trade is not only a sector of strategic economic importance to Switzerland, but is accompanied by a number of related risks (Federal Department of Foreign Affairs, 2012). Moreover, there are major challenges from the perspective of policy coherence for development, a priority of the Swiss, as well as the international, development debate. In this context, Swiss international development cooperation actively engages in inter-ministerial and domestic debates to argue in favour of a Swiss foreign and domestic policy that actively takes the interests of poor, resource-exporting developing countries into consideration. With this strategic approach, Swiss development policy ultimately contributes to the strengthening of Switzerland as an internationally respected and competitive economic centre, thus promoting sustainable growth over the long term.

This paper<sup>3</sup> addresses commodity production and trade from a development policy standpoint. It reviews current debates and emerging policies in selected countries as well as major international initiatives. Ongoing debates in Switzerland and development policy options for Switzerland are then be examined.

In conclusion, the paper advocates for a balanced approach, wherein Swiss development and foreign economic policies help ensure that (a) foreign investments respect internationally-agreed standards, (b) resource-rich developing countries retain a fair share of profits generated from this trade, and (c) the

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<sup>2</sup> There are different ways of measuring the size of a company. According to an *Al Jazeera* article, Glencore is 'the world's biggest listed trader of commodities by capitalization' ('Glencore: Taking over the world?' <http://www.aljazeera.com/programmes/countingthecost/2011/05/20115299504775782.html>; accessed on April 22, 2013). Similarly, *Foreign Policy* magazine, in a May/June 2012 article, depicts Glencore as the 'world's biggest commodities brokerage firm with a financial valuation higher than Boeing or Ford Motors', Silverstein, K. (2012) 'A Giant Among Giants', [http://www.foreign-policy.com/articles/2012/04/23/a\\_giant\\_among\\_giants?page=0,5](http://www.foreign-policy.com/articles/2012/04/23/a_giant_among_giants?page=0,5) (accessed on April 22, 2013).

<sup>3</sup> The topic of commodities touches upon many other areas of government policy, and most large Western nations have developed fully-fledged resource strategies. Such strategies deal with a large number of issues, including the availability of, and access to, important strategic energy resources and environmental issues. This paper, however, will not seek to address these concerns.

populations of these countries actually benefit from said profits, as they are to be invested in economic and social development, with the ultimate goal of eliminating poverty.

## 2. Commodities Production and Trade from a Development Policy Standpoint

This paper divides the term commodity into the most common three categories: fossil fuels, ores and metals (minerals), and agricultural commodities (soft commodities). Fossil fuels include oil, gas, and coal. Minerals refer to metals such as iron, non-iron metals and precious metals. Agricultural commodities, in turn, refer to grains, luxury foodstuffs (such as coffee or tobacco), sugar, plant/vegetable oils and fibres for textile production.

In the Swiss context, the commodity trade itself is a central feature of any discussion related to global resource use. We have therefore chosen a broad perspective that takes into consideration the entire value-added chain, from production, to trade, to consumption. Only from such a perspective is it possible to analyse the implications of the trade for development policy and identify possible courses of action.

Accordingly, we will first examine the importance of the commodity trade for resource-exporting developing countries, including associated financial flows and the challenges they present. Secondly, the paper will consider the commodity trading industry in Switzerland.

### 2.1. Commodities Production and Trade – Challenges for Exporting Developing Countries

The following figures illustrate the importance of resource extraction and trade for developing countries:<sup>4</sup> the global trade in commodities, including fossil fuels, minerals and agricultural commodities, measured in commercial value, amounts to an estimated USD 3000 billion annually. The fossil fuel sector dwarfs all other extractive sectors, accounting for about 65 per cent of this overall figure. Non-fuel minerals and agricultural commodities account for 20 per cent each.<sup>5</sup> 59 per cent of metals and ores (71 per cent in the case of copper), 63 per cent of coal and 64 per cent of oil consumed in the world originate in developing countries. 60 per cent (and rising) of global mining production comes from politically unstable and extremely unstable countries.

Another dimension of the commodity problematic concerns the trade in agricultural, or soft, commodities. Their renewable nature makes these commodities unique in this analysis. In addition, according to some studies, this sector is characterised by the considerable market power of several large, vertically-integrated trading firms and, correspondingly, a potentially negative impact upon markets. In this context, there is intensive debate as to whether, and to what degree, there exists a connection between the speculative busi-

<sup>4</sup> For the numbers quoted in this chapter, see Le Billon, P. (2011); Berne Declaration (2011a); Federal Ministry of Economy, Family and Youth of the Republic of Austria (2011), pp. 26-27.

<sup>5</sup> Estimates of the total value differ greatly. The cited numbers are drawn from the Bern Declaration 2011 (see footnote 6). According to Le Billon, extractive sectors alone currently generate about USD 3.5 trillion in annual gross revenue, corresponding to around 5 per cent of GDP.

ness practices of certain market actors and the widely fluctuating (though generally rising) prices of agricultural commodities experienced over the last few decades. While evidence is not conclusive, some analyses have found a connection between the business practices of certain private actors in the financial markets and a trend towards speculative trades, large-scale land grabs and even human rights abuses.<sup>6</sup>

Naturally, the economic and political conditions present in resource-exporting countries vary widely. This is particularly true with regard to tax regimes, and therefore to the structure of state revenues, and the nature, breadth, and quality of services each state is able to provide. While the contribution that resource extraction makes to state revenues in resource-rich developing countries can be significant, the contribution from minerals specifically is minimal – with the exception of a few countries like Botswana (over 40 per cent), Chile and Guinea (between 10 per cent and 20 per cent), this contribution is regularly less than 10 per cent of the state revenues. Tanzania's mining sector, for example, has attracted USD 2.5 billion in investment over the last decade, accounting for 40 per cent of exports but only 3.6 per cent of state revenues. Some countries, such as Ghana and Tanzania, have made positive strides on this front, as their governments are reviewing old contractual arrangements with the mining industry in order to correct this unfavourable situation. The opposite, however, is often the case with oil, whose revenues generally contribute a substantial amount to national finances. These amounts, it should be noted, fluctuate considerably (from between 70-90 per cent in the case of the traditional oil-producing countries, to under 10 per cent in the case of new producers).

Natural resources generally hold significant or even transformative potential to spur sustainable economic growth and overcome existing poverty. They can support raising public funds, foreign currency reserves and investments, generate employment and downstream economic activities, and also improve energy security. At the same time, many resource-rich countries do not take full advantage of their natural resources. In fact, there is considerable evidence that natural resource abundance often coexists with pervasive poverty – a phenomenon widely-known as the 'resource curse'.<sup>7</sup> Numerous studies highlight the damage caused to human health, the environment and the forces fuelling expropriation and conflict, while others (including audits) document practices of corruption, illegal extraction and tax evasion.<sup>8</sup> Other studies analyse and rate the local initiatives of international actors with regards to corporate social responsibility and social investment.<sup>9</sup>

<sup>6</sup> Some papers point to a causal relationship between speculative trades and price increases. See for instance, Baffes, J. and T. Haniotis Timmer (2010) and Friends of the Earth (2012).

<sup>7</sup> See for example Collier, P. (2007). For an overview of economic studies, see van der Ploeg, F. (2011).

<sup>8</sup> Bern Declaration (2011b); Bergbau-Lizenzvergabe im Kongo (confidential background paper, also quoted in the TV programme ECO on SFDRS, 05.03.2012; <http://www.sendungen.sf.tv/eco/Sendungen/eco/Archiv/Sendung-vom-05.03.2012> (accessed on April 22, 2013). For the African context, these realities are well documented in the most recent report of International Study Group to Review Africa's Mining Regimes (2011). For more details, see Chapter 3.1 of that report.

<sup>9</sup> For case studies of the specific aspects of these initiatives, see ECDPM, *Extractive Industries and Local Development. Annotated Bibliography*, 2012 (internal document); and World Bank documents in its *Extractive Industries for Development Series* <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTOGMC/0,contentMDK:22278227~menuPK:6456599~pagePK:210058~piPK:210062~theSitePK:336930,00.html> (accessed on April 24, 2013).

With regard to the use of natural resources, most resource-exporting countries in the developing world face a number of specific challenges, among them:

- **Signing bad deals:** Governments often fail to negotiate a fair share of potential revenues for their respective country due to weak capacities or the prevalence of short-sighted interests (including bribery). In these cases, companies pay what is owed, but the amount is far less than what the country would equitably receive under a fair contract.<sup>10</sup>
- **Revenues are collected but misallocated:** Publicly-owned resources are diverted before they are incorporated in budgets of public entities. For example, national oil companies can collect revenues and then spend on behalf of officials, or invest in businesses controlled by political elites. Furthermore, revenues may be transferred to private accounts or spent on corrupt contracts.
- **Underpayment of revenues:** Due to either tax avoidance or tax evasion, countries do not collect the revenues to which they are entitled. Avoidance occurs when companies (legally) minimize the tax burden through transfer pricing, such that profits are shifted to and reported in the subsidiary with lowest tax burden.

Consistent with this reality, from a development perspective, both major financial flows, including IFFs/flows of capital flight<sup>11</sup>, and large-scale investments in agricultural land are significant features of commodity production and trade.

While the reliability of specific figures remains quite limited (which correspondingly tempers their analytical value)<sup>12</sup>, data from an increasing number of sources illustrate the magnitude of such financial flows and their influence, as well as potential policy responses.

The Organisation for Economic Co-operation and Development (OECD) estimates that global illicit flows, including all illegal and illicit transfers from various sources and sectors in developing countries, amount to approximately USD 850 to 1000 billion per year, far exceeding inflows from Official Development Assistance (ODA), which, in 2011 reached only USD 133.5 billion), and Foreign Direct Investment (FDI). 60 per cent of this outflow is the result of tax evasion. A commission set up by the Norwegian government produced similar figures, estimating that in 2006 IFFs amounted to between USD 640

<sup>10</sup> A few examples are briefly mentioned in this paper. For a detailed description, see the below market price sale of assets in the DRC described in the Global Witness report (2012), *Secrecy Surrounding Glencore's Business Deals in the Democratic Republic of Congo Risks Exposing Shareholders to Corrupt Practices*, [http://www.globalwitness.org/sites/default/files/Global%20Witness%20memo%20on%20Glencore%27s%20secretive%20dealings%20in%20the%20Democratic%20Republic%20of%20Congo\\_1.pdf](http://www.globalwitness.org/sites/default/files/Global%20Witness%20memo%20on%20Glencore%27s%20secretive%20dealings%20in%20the%20Democratic%20Republic%20of%20Congo_1.pdf) (accessed on 6 May 2013).

<sup>11</sup> The OECD defines IFFs as funds whose origin, transfer or use is contrary to international and/or national laws, including the movement of money that has been illegally earned. See OECD (2011). According to the OECD, illicit financial flows include flows from (a) *licit* sources, i.e. from abusive transfer pricing, from tax evasion, and (partly) from trade mispricing; and (b) from *illicit* sources, i.e. money laundering, bribery, and also (in part) from trade mispricing.

<sup>12</sup> Data on financial flows is often scant and aggregated, of highly differing quality, and unequally covering the same aspects. Differing concepts and definitions, as well as methodologies and underlying assumptions in data processing, moreover, further complicate analytical work and dialogue as to the magnitude and primary features of IFFs. See, for example, AfDB, OECD, UNDP, UNECA (2012).

and 980 billion.<sup>13</sup> A study by the African Development Bank (AfDB), OECD, United Nations Development Programme (UNDP) and the UN Economic Commission for Africa calculates that, as of 2011, the incurred net losses (in terms of stock) of Sub-Saharan African countries due to capital flight that occurred from 1970-2008 totalled USD 700 billion. For Switzerland, as a financial flow destination, the Berne Declaration and Alliance Sud – a consortium of NGOs – estimate that by the end of 2011, flows of capital flight from developing and middle-income countries may amount to USD 490 billion (stock). The interest on this capital alone would account for more than twice the amount of annual Swiss ODA (Alliance Sud, Berne Declaration, 2012).

The 2012 edition of the *African Economic Outlook* illustrates the potential impact these funds could have on development (in terms of poverty reduction) were they to be invested in Africa:

‘If flight capital had been reinvested in Africa with the same level or productivity as that of actual investment, the rate of poverty reduction could have increased by 4-6 percentage points a year, on average, over the period from 2000 to 2008. African countries could then as a group have reached the Millennium Development Goal of halving the 1990 level of poverty by 2015.’ (AfDB et al., 2012, 73)

Moreover, the study concludes that, since the actors involved in capital flight are both within and outside the resource-rich countries, international cooperation is crucial to reversing the flow of African capital back towards the continent.

While it is impossible, at this point, to identify the share of capital flight or IFFs specifically related to extractive industries and the commodities trade, the figures provided above are an indication that a significant portion of the revenues derived from natural resources are not retained by resource-rich developing countries. This subject is the focus of debates within international organisations, resource-rich countries, regional economic communities, the finance and development ministries of donor countries, and civil society groups. A recent academic study facilitated by the World Bank estimates the minimal amount of this type of transaction by multinational enterprises across all sectors to be at least USD 160 billion annually. It further concludes that transfer pricing is particularly common among multinational enterprises in extractive industries and commodity trade.<sup>14</sup>

Ultimately, the debate revolves around the driving forces and institutional frameworks that constitute the operational context for IFFs at both the national and international levels:

<sup>13</sup> For data from NGOs, see Kar, D. and D. Cartwright-Smith (2009) and Tax Justice Network, which include older data on Switzerland. [http://www.taxjustice.net/cms/front\\_content.php?idcat=103](http://www.taxjustice.net/cms/front_content.php?idcat=103) (accessed on 6 May 2013). The Swiss federal authorities have no estimates of likely (legal and illegal) international financial flows, according to the Federal Council in its answer to the parliamentary question 11.4096.

<sup>14</sup> Reuter, P. (2012). For a detailed presentation of methods of *Transfer-Pricing*, see p. 288ff. and Part III.

- The responsibilities of multinational corporations, their business models and practices
- The role of governments in resource-rich developing countries (i.e. fiscal regimes, good governance, land tenure)
- The role of countries that receive these financial flows (i.e. taxation laws, oversight of financial markets, international cooperation between tax authorities)

In a path-breaking book, Paul Collier illustrates the development policy challenges posed by these financial flows to resource-rich developing countries, and the importance of sound institutions, through an interesting comparison. He writes, 'for a newly resource-rich country to benefit from its newfound wealth, it must possess the governance levels and institutional quality equivalent to Portugal in the 1980s. In the alternative scenario, oil and mineral wealth increases the prospect of plunder and mismanagement.' (Collier, 2007)

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#### **BOX 2: Resource-rich Developing Countries – Success Stories and Failures**

In terms of the successful use of natural resources, one may find a number of positive as well as negative examples. Angola may be understood as a negative example. From 2007-2010, the International Monetary Fund (IMF) found USD 32 billion in unaccounted government funds, a sum equivalent to a quarter of Angola's annual GDP (IMF, 2011). Similarly, copper-rich Zambia provides yet another example where the proportion of profits remaining in the country bears no resemblance whatsoever to the enormous earnings generated by its copper production. As shown in Grant Thornton's audit of the Mopani copper mines (Counter Balance, 2011), Zambia has suffered from large-scale tax evasion manifest in inexplicable increases in certain operating costs, losses carried forward for 10 years to secure corporate tax exemptions and largely undervalued copper and cobalt exports to Switzerland (which are 'exported' on paper only, before being resold by Swiss-based companies). Were Zambia to actually receive the same price for its copper that Switzerland receives for the copper and intermediate goods derived from these exports, Zambia's GDP would virtually double.<sup>15</sup> A natural resource success story, in contrast, is that of Botswana and the exploitation of its diamond deposits. Between the late 1960s and 2000, Botswana has recorded an average growth rate of 7 per cent per annum,<sup>16</sup> and life expectancy has risen by over 17 years. Ghana and Malaysia represent other positive examples.

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**15** Alex Cobham's (Christian Aid) presentation at 'Trade Mispricing' session, Task Force on Financial Integrity and Economic Development Annual Conference 2011, Paris, France, 7 October 2011, [www.financialtaskforce.org](http://www.financialtaskforce.org).

**16** President Festus Mogae, Botswana's Development Experience, lecture given at the Institute of Development Studies, Sussex University, 21st February 2005, p. 2, as reproduced at SARPN [http://www.sarpn.org/documents/d0001114/P1229-Botswana\\_February2005.pdf](http://www.sarpn.org/documents/d0001114/P1229-Botswana_February2005.pdf) (accessed on April 24, 2013).

## 2.2. The Commodity Trading Industry in Switzerland

What is the significance of the Swiss-based commodity trading industry, its public perception, and its regulatory context? With regard to a number of important aspects, the amount of data available on both individual firms and the industry overall is thin.<sup>17</sup> Nevertheless, it is fair to state that, following the recent establishment of numerous large trading firms, the sector is on the rise. Although the simultaneous heterogeneity and opacity of this sector makes it difficult to put an exact figure on its significance, its contribution to Switzerland's GDP is likely comparable to that of the machinery industry. Economists estimate that the rapid rise of transit trade alone was responsible for some 50 per cent of economic growth in 2010, with commodities accounting for 94 per cent of transit trade in the data assembled by the Swiss National Bank (Swiss National Bank, 2012, 37).

A fundamental characteristic of the Swiss commodity-trading sector is its involvement in so-called transit or merchant trade. The volume of commodities financed, organised and taxed through Switzerland far exceeds Swiss consumption needs. Even though contracts are concluded, ships chartered and goods dispatched by Swiss offices, with the notable exception of gold, which is imported to Switzerland in vast amounts, processed and re-exported, the goods never enter Swiss territory. In contrast to trade within national markets or between governments, trade on the 'free' commodity markets, which includes direct sales through commodity trading companies and commodity exchanges, is financed primarily by either publically-owned cantonal banks or specialised banks with offices in Switzerland.

Recent analyses, such as *Commodities: Switzerland's Most Dangerous Business*, published by the Berne Declaration (2011a), present, for the first time, information on the scope of the commodity trading sector and the regulatory role played by the Swiss state, to a wider audience. The following facts are significant in this regard: Swiss-based firms control 15 – 25 per cent of the global trade in commodities, including fossil fuels, minerals and agricultural commodities. Measured in terms of commercial value, this business amounts to revenues of USD 3000 billion annually. The commodity trading industry has grown rapidly over the last 10 years. Due to the fact that the majority of commodities never physically enter Switzerland, this is not directly reflected in the country's foreign trade figures. Transit trade, one portion of the business, is nevertheless recorded in the balance of payments data. In the last decade, the net income of transit trade has undergone an enormous fifteen-fold growth, primarily as a result of the growing commodity trading industry. About a dozen companies, headquartered around Lakes Zug and Geneva, make Switzerland a heavy weight in this industry.<sup>18</sup> Several Swiss-based commodity-trading companies also rank among the largest mining firms, and are involved in oil and agricultural production. Xstrata, for example, is the world's fourth largest

<sup>17</sup> In May 2012, the Swiss Government tasked three ministries to elaborate a background report. The report has been completed in March 2013 (Editor's Note: see <http://www.admin.ch/aktuell/00089/index.html?lang=en&msg-id=48319> and report on <http://www.news.admin.ch/NSBSubscriber/message/attachments/30136.pdf>, accessed on September 15, 2013).

<sup>18</sup> Glencore, Trafiguar, Xstrata, Vitol, Mercuria, Gunvor, Litasco, ADM, Bunge, Cargill, Dreyfus. For details of their business portfolios see Berne Declaration (2011a).

operator of mines. Fossil fuels figure strongly in the commodity industry in Switzerland. Measured in terms of volume, companies resident in Switzerland control over 30 per cent of the market trade in petroleum. Companies situated on the shores of Lake Geneva control an even larger, at times dominant, share of the trade in agricultural commodities: 35 per cent in the case of grain and oilseeds and 50 per cent in the case of sugar and coffee.

How do these trading companies impact governance and development outcomes in producer countries? These trading companies engage in high-level transactions, including the purchase of states' shares of petroleum or mineral production, with the governments of developing countries. These deals directly affect the level of revenue received by producing countries. Some experts argue that the trading company industry in developing countries is subject to insufficient transparency and oversight (Gillies, 2012).

It is questions such as the one above, in combination with concerns about the ability of large trading companies to influence commodity prices that have prompted the growing public interest in the commodity problematic in general and in the business practices of Swiss-based firms and the role of the Swiss regulatory framework more specifically.

### 3. International Discussions and Policies of Selected Countries

There are currently more than a dozen international initiatives dealing with issues of resource extraction, agricultural production, and the commodities trade. Many countries and regional organisations, such as, for instance, Norway and the European Union, are formulating their own resource strategies.

International debates and the positions of other countries with respect to improving the governance of commodity revenue are relevant for a number of reasons, thus raising the question as to if, and if so, in which processes and to what extent, Switzerland should get further involved. There is also the question, furthermore, of the effectiveness of existing initiatives. At the very least, the international debate facilitates the establishment of a best practices understanding of appropriate policies and concrete measures and may thus inform the formulation of Switzerland's own development policy.

#### 3.1. International Initiatives – A Growing Consensus as to How to Address Challenges

A series of important international initiatives and processes have consistently demanded greater transparency and accountability in the commodity sector.

Within the UN, the most relevant discussions take place in the context of macroeconomic policy issues (a mandate of the Second Committee of the General Assembly), where a Resolution on *Transparency, Sustainable Development and Natural Resources* is currently under discussion (Grynspan, 2012), and under the auspices of the Global Compact. Also of relevance is the much broader debate on development financing. With the overarching goal of mobilizing financial resources for development, this holistic agenda addresses domestic resource mobilization in developing countries, FDI, international trade, international financial and technical cooperation for development, as well as debt and other

systemic issues. Among the central objectives are fiscal reform – improving tax collection, combating tax evasion, strengthening technical assistance and enhancing international cooperation in addressing international tax matters such as double taxation – combating the various factors that contribute to IFFs, and the promotion of corporate social responsibility. Commitments in this regard were formalized in the 2002 Monterrey Consensus of the International Conference on Financing for Development and later reaffirmed in the Doha Declaration, which has come to constitute a major reference point for contemporary international development cooperation. These positions have since been reaffirmed in several resolutions adopted by the UN General Assembly.

Specific initiatives often combine the enforcement of business principles with institutional capacity building in resource-rich developing countries. Other programmes and initiatives focus on the integrity of financial transactions, including the role of tax regimes in recipient and exporting countries. Existing initiatives can be grouped into the following four categories:<sup>19</sup> (1) initiatives intended to promote contract and revenue transparency; (2) certification instruments ('commodity-specific tracking regimes'); (3) instruments to promote broad governance standards; and (4) non-resource-specific initiatives aimed at promoting transparency and integrity in international financial transactions.

Among the most important initiatives, which include the legislation of mandatory transparency rules for multinational enterprises and various efforts to promote transparency in international financial transactions, are:

- US Dodd-Frank Wall Street Reform and Consumer Protection Act, Sections 1502 and 1504
- EU Transparency Directive (2004/109/EC), Accounting Directives (78/660/EEC and 83/349/EEC) and Capital Requirement Directive (CRD IV)
- Extractive Industries Transparency Initiative (EITI)
- OECD Global Forum on Transparency and Exchange of Information for Tax Purposes
- World Bank/UN Stolen Asset Recovery (StAR) Initiative

These initiatives and actions demonstrate a growing consensus that global commodity markets influence the economic prospects of many developing countries and, correspondingly, must be addressed. Transparency, in particular, has risen to the forefront of global responses, and it appears that disclosure practices will be deepened and broadened in the near future, through the strengthening of EITI and the diffusion of mandatory reporting requirements within the US, EU and beyond.

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<sup>19</sup> For the most important initiatives, see list and description in annex.

### 3.2. Initiatives by Resource-rich Developing Countries: The Case of The African Mining Vision

The Africa Mining Vision (AMV) was adopted by African heads of state at the February 2009 African Union summit. As a homegrown strategy to create a ‘transparent, equitable and optimal exploitation of mineral resources to underpin broad-based sustainable growth and socio-economic development,’ the AMV represents Africa’s own response to the paradox of the ‘resource curse’ (ISG, 2011, 1). It challenges the mining sector’s habitual dominance of African economies, seeking to use Africa’s natural resources to transform the continent’s social and economic development process. Its central premise is the need for a shift from Africa’s historic ‘enclaved’ status as an exporter of cheap raw materials towards the development of manufacturing and knowledge-based service sectors.

The AMV will serve as the framework for African states, regional organisations and the African Union for the efficient utilization and management of Africa’s mineral resources. The AMV is founded on the following fundamental objectives:

- Promoting good governance and improved transparency of the mineral sector, with increased benefits stemming from mineral assets for local communities and citizens;
- Optimising revenues and mineral rents management, particularly through the reform of mining legislation, including the renegotiations of contracts and establishment of a framework to address tax avoidance, capital flight and tax havens, with a view toward maximising revenues from highly profitable industries during times of high commodity prices;
- Promoting increased geological knowledge and corresponding benefits from mineral resources;
- Developing a diversified and globally competitive mineral industry, which contributes to broad economic and social growth through the creation of companies with strong economic linkages;
- Mobilising mining and infrastructure investment, with a view towards ‘disenclaving’ the mining industry and investing in inclusive infrastructure, creating opportunities for industrial linkages, notably through improving private-public collaboration and bolstering the capacity of financial systems and regional economic communities to facilitate cross border investment and establish regional capital and commodity markets;
- Harnessing the potential of small-scale mining to improve living standards and integrate artisanal producers into the rural and national economy;
- Promoting sustainable development, particularly environmentally and socially responsible mining, which includes communities and all other stakeholders;
- Improving human and institutional capacities, with special emphasis on innovation, research and development.

In September 2007, an International Study Group (ISG) was established to review Africa’s mineral regimes. The newest report of the ISG analyses in detail the local conditions and effects of resource extraction and trade, and makes

suggestions for improvement (ISG, 2011). The report explores a number of important issues and concludes with a comprehensive list of key policy considerations, including: challenges emanating from the environmental, human and social effects of mining; the performance of regulation mechanisms in Africa; public sector management of mineral revenues; the need for public sector reform in support of mineral-based growth; and recent developments in international trade threaten to significantly constrain Africa's capacity to realize these development objectives.

### 3.3. Setting the Agenda and Policy Standards: Norway and the European Union

For years, Norway has played a prominent role in international discussions focusing on issues of governance and capacity building in developing countries. In 2008, the government established a broad-based, expert Commission on Capital Flight from Developing Countries, which produced a report on *Tax Havens and Development* in June 2009. Building on the report's recommendations, many proposals aimed at improving transparency have since been implemented, while others remain under consideration.

Among the programmes carried out by the Norwegian Ministry of Foreign Affairs or civil society groups (supported through official channels) are:

- *Oil for Development Programme*: Innovative programme playing a pioneering role in matters concerning development finance, capacity building, environmental considerations, and technical cooperation.
- *Taxation for Development Programme*: Programme of the Ministry for Development geared towards meeting the needs of developing countries.
- *Capital for Development*: One-year dialogue project aimed at raising awareness of issues relating to capital flight and development through engagement with parliamentarians, the media and the general public.
- *Task Force on Financial Integrity & Economic Development*: In coordination with the government of Spain, a Task Force funded by the Norwegian Agency for Development Cooperation (NORAD).
- *Extractive Industries Transparency Initiative (EITI)*: EITI Secretariat hosted by Norway, as its first OECD country-member.
- *Revenue Watch Institute* and *Global Financial Integrity*: Long-term partnership with key civil society actors, focussed on tax and commodity issues.

In a similar manner, the EU has also taken a leading role in addressing the commodity trade issue on a number of fronts, such as the business activities of multinational firms, the promotion of good governance in developing countries – including the discussion on smart conditionality ('more for more') – and the reform of trade and tax legislation and cooperation.

Development policy aspects were addressed specifically in the *Conclusions on Tackling the Challenges on Raw Materials and in Commodity Markets* report published by the EU's Competitiveness Council (Council of the European Union, 2011). Essential measures required to achieve development policy objectives were identified as:

- Greater transparency in the resource sector through the implementation of EITI provisions, the launch of other initiatives, the publication of the financial figures of commodity-trading companies, the establishment of a country-by-country reporting mechanism for multinational companies, the creation of international financial reporting standards (IFRS) for the industry as a whole, and provision for the monitoring of third-country legislation.
- The uniform application of higher business practice standards for companies active in developing countries and domiciled both in and outside the EU and the promotion of corporate social responsibility and other relevant codes of conduct.
- A trade policy that works in conjunction with development policy such that development needs of individual countries, particularly the Least Developed Countries (LDC), are taken into consideration.<sup>20</sup>

These recommendations<sup>21</sup> were taken-up again, in part, by the EU Commission in October 2011, in conjunction with a path-breaking proposal to expand the *EU Transparency, Accounting and Capital Requirement Directives*. These proposals would require all EU-listed or large unlisted oil, gas, mining and logging companies to disclose their payments to all governments on a country-by-country and project-by-project basis. The proposed legislation would build on a similar law adopted in the United States in July 2010, the *US Dodd-Frank Wall Street Reform and Consumer Protection Act* (see section 3.1).

#### 4. Current Discussions in Switzerland

The commodity industry has attracted not only the attention of the Swiss media but also became a subject of federal political interest in 2011, when a great number of related parliamentary requests were issued.<sup>22</sup> At its annual press conference in February 2012, moreover, the Swiss Small and Medium Enterprises Business Federation (*Schweizerischer Gewerbeverband - SGV*) called upon the Federal Council to develop an 'interdisciplinary resource strategy.' Their paper, entitled *Strengthening of Commodity Policy Perspectives in Development Policy* seeks to link Swiss development cooperation with privileged access to natural resources (SGV, 2012).

The various 2011 parliamentary requests regarding the commodity trade are roughly arranged around the following issues: Access to strategic resources

<sup>20</sup> That said, in promoting trade policy reform, the Council simultaneously underlined the EU's willingness to pursue 'raw materials diplomacy', meaning that the EU intends to reinforce its trade strategy with an open campaign against export restrictions, to the extent that it will work with other international institutions to foster dialogue for a better understanding of the impact of export restrictions.

<sup>21</sup> For a critical appraisal of this report from a Swiss and development policy perspective see Niggli, P. (2011). The article examines the resource policies of the EU and draws a comparison with Switzerland's resource policy. In Niggli's view, the resource policy of the EU is a 'blunt instrumentalisation of development aid with the aim of furthering its own economic self-interest.'

<sup>22</sup> Parliamentary requests are requests by individual members of the two chambers for action and information on particular topics, and include so-called motions (for legislative action), postulates, interpellations, and questions. Details on <http://www.parlament.ch/e/wissen/taetigkeiten/parlinstvorstoesse/pages/default.aspx> (accessed on 6 May 2013).

and a secure food supply, from the classical perspective of the provision of essential goods.<sup>23</sup>

The role and reputation of Switzerland as a host of multinational enterprises and as an international trading centre,<sup>24</sup> delving into sub-themes such as:

- Money laundering<sup>25</sup>
- Taxation<sup>26</sup>
- Agricultural commodities and food security in the context of international trade<sup>27</sup>
- International trade and embargo policy.<sup>28</sup>
- Good corporate governance standards for multinational firms (not resource specific).
- Business and human rights.<sup>29</sup>
- Financial reporting standards (country-by-country reporting).<sup>30</sup>

In its report on the key aspects of its foreign policy agenda during the 2012-2015 legislative period, the Federal Council acknowledged the strategic importance of the commodity trade for Switzerland. At the same time, the Council identified several risks associated with the commodity trade: potential damage to the reputation of the country, speculation and price fluctuation, unlawful business practices, taxation issues, and access to strategic resources. To ensure that such potential risks are identified early on, the Federal Council recommended that Switzerland develop and implement a coherent foreign policy on this topic.

**23** Ip Germann 11.3929, *Sicherung der Rohstoffversorgung für die Schweizer Industrie*; Ip Füglistaller 11.3905, *Sicherung der Rohstoffversorgung für die Schweizer Industrie*; Bericht des Bundesrates, *Nahrungsmittelkrise, Rohstoff- und Ressourcenknappheit*, 2009.

**24** Po Fässler-Osterwalder 11.3803, *Die Rolle der Schweiz als Sitzstaat von Rohstoff-Handelsfirmen*; Mo Leuenberger Oberholzer 11.3840, *Rohstoffhandelsfirmen regulieren*.

**25** Mo Wyss 11.4161, *Keine Geldwäsche im Handel mit Rohwaren auf eigene Rechnung*; Mo Leutenegger Oberholzer 11.3118, *Ausdehnung des Anwendungsbereiches des Geldwäschereigesetzes auf den Handel mit wertvollen Gütern*; Ip Wyss 12.3138, *Dubiose Vergabe von Minenlizenzen in Kongo. Rolle der Firma Glencore und des IWF*.

**26** Ip Fässler-Osterwalder 11.4096, *Doppelbesteuerungsabkommen mit Entwicklungsländern*; Mo Fässler-Osterwalder 11.4097, *Doppelbesteuerungsabkommen und Verstärkung der guten Unternehmensführung*; Mo Kiener Nellen 12.3612, *Steuerinformationsabkommen mit Offshore-Finanzzentren*; Ip Fehr 11.4065, *Steuerhinterziehungsgelder aus Indien auf Schweizer Bankkonten*; Po Fehr 11.3858, *Reputationsrisiken der Unternehmensbesteuerung*.

**27** Mo Sommaruga 11.4167, *Lutte contre la spéculation sur terres agricoles et les produits alimentaires de base*; Ip Graf 11.3385, *Landgrabbing. Was tut die Schweiz dagegen?*; Ip Bourgeois 11.3822, *Entwicklungszusammenarbeit. Mehr Hilfe für nachhaltige Landwirtschaft und Ernährungssicherheit*; Ip Müller 11.3344, *Anstieg der Nahrungsmittelpreise. Strategie*.

**28** Ip Sommaruga 11.4187, *Ankauf- und Transportverbot für Erdöl aus Syrien wirksam durchsetzen*.

**29** Ip Sommaruga 11.4169, *Principes directeurs de l'OCDE pour les multinationales. Quelle volonté politique?*; Ip von Grafenried 11.4083, *Responsabilité des entreprises en matière de droits de l'homme. Application des lignes directrices de l'ONU en Suisse?*; Ip Bourgeois 11.3489, *Transparence au niveau des placements alternatifs*.

**30** Ip Fehr 11.3859, *Etablissement des comptes par pays. La Suisse accuse-t-elle un retard dans ce domaine?*; Ip Simoneschi-Cortesi 10.3364, *OECD-Leitsätze für multinationale Unternehmen. Country by Country*.

In 2012, the wave of parliamentary requests massively increased.<sup>31</sup> Mirroring this increase in interest, a petition entitled *Corporate Justice – Rules for Business. Rights for People*, signed by approximately 135,000 people, was submitted to Parliament and the Federal Council in June 2012.<sup>32</sup>

In December 2011, the Federal Council declared its willingness to commission a comprehensive analysis of the Switzerland's role as an international hub of commodity trading, issuing a mandate to draft a background report on existing knowledge and current policies. When complete, this comprehensive overview would also serve to frame the 2011 Raw Materials Strategy of the Federal Department of Economic Affairs and several Foreign Economic Policy Reports (in particular those issued in 2008) on the topic of strategic resources. Notably, these Economic Policy Reports consider neither the question of sustainability nor the equity of North-South relations. From a development policy perspective, the following activities are particularly worthy of mention:

- Support, assistance and monitoring of various activities of the OECD via participation in the Informal Task Force on Tax and Development (in addition to a financial contribution to the OECD Programme on Tax and Development), membership in the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, and implementation of the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas.
- Swiss participation in the Extractive Industries Transparency Initiative (EITI).
- Support of the IMF Managing Natural Resource Wealth Topical Trust Fund and the World Bank Extractive Industries Technical Advisory Facility (EITAF).<sup>33</sup>
- Support of the World Bank Stolen Assets Recovery (StAR) initiative and the International Centre for Assets Recovery (ICAR) in Basel.
- Implementation of the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security.
- Support of the Roundtable of Sustainable Biofuels towards the development of voluntary standards for biofuel production.
- Active involvement in, and support of, the UN Global Compact, which promotes corporate social and environmental standards and responsibility.
- Bilateral support to Burkina Faso, Ghana, Mozambique, and Peru on matters of tax reform.

**31** Among them (until mid-2012), see Ip Sommaruga 12.3517, *Durch Tochterfirmen von multinationalen Unternehmen begangene Menschenrechts- und Umweltverletzungen*; Ip Seydoux-Christe 12.3499, *Durch ausländische Tochterfirmen von Schweizer Unternehmen begangene Menschenrechtsverletzungen. Zugang der Opfer zur Justiz*; Ip Ingold 12.3449, *Verantwortlichkeit von international tätigen Firmen mit Sitz in der Schweiz*; Ip Moser 12.3520, *Soziale und ökologische Unternehmensverantwortung. Selbstregulierung oder verpflichtende Regeln*; Ip Haller Vannini 2.3456, *Integration der 'guiding principles' von John Ruggie in die Bundesverwaltung*; Po 12.3503; Ip Grafenried 12.3627, *Eine Ruggie-Strategie für die Schweiz*; Ip Wermuth 12.3442, *Ein- und Ausfuhr von Gold. Offenlegung der Statistik*.

**32** Swiss Corporate Justice Campaign website: <http://www.corporatejustice.ch/en/> (accessed on 6 May 2013).

**33** World Bank, Oil, Gas and Mining Unit, webpage 'Extractive Industries Technical Advisory Facility', <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTOGMC/0,,contentMDK:22366721~pagePK:148956~piPK:216618~theSitePK:336930,00.html> (accessed on 6 May 2013).

## 5. Conclusions on Development Policy Options for and in Switzerland

In contrast to the state of affairs even a decade ago, much is now being done to improve the governance of resource revenues. A plethora of measures have been adopted, most under the auspices of a broad good governance agenda, emphasizing transparency and accountability through voluntary participatory processes. Several major donors, such as Norway, the US and the EU, have played key roles in supporting the emergence and application of these measures, attempting to set norms that benefit local populations in resource-rich developing countries while avoiding harming the interests of their own companies. Most official development agencies, however, take the broader approach of building government capacity and (on a smaller scale) consolidating the input and participation of civil society organizations.

With legislation under way in the EU and pending implementation in the US, 2013 may become a watershed year for revenue transparency in extractive industries and the commodities trade. The European Parliament is expected to vote in 2013 on a final text requiring country-by-country reporting from EU-listed (and also, potentially, large, private) oil, gas and mining companies. Similarly, the US Securities and Exchange Commission is also expected to complete its work on additional regulatory provisions related to the implementation of the Dodd-Frank Act in 2013. The G20, moreover, is actively addressing issues of transparency, anti-corruption and asset recovery, and further action by its Anti-Corruption Working Group is expected. Overall, these events are likely to draw the attention of policy makers and legislators to these issues, particularly with respect to the internationalization of these standards. Companies listed in the US and EU will, in all likelihood, seek to globalize these standards in order to reduce their competitive disadvantage. This will shift the spotlight to jurisdictions that lack reporting requirements.

In addition, the EITI is currently undergoing a process of reform that will culminate in a significant strengthening of its rules in early 2013.<sup>34</sup> This process was initiated following the recognition that the minimal levels of revenue transparency required by existing regulations have not sufficiently mitigated the governance and development challenges faced by many resource-rich countries.

What are the implications of this changing international environment for Swiss international development cooperation? What, in this context, is its most effective contribution to the promotion of the sustainable use of natural resources?

Switzerland possesses specific strengths and limitations that determine the design of coherent development policy and related targeted interventions in this field. These include:

- Expertise in the commodity trade, characterised by: (a) limited technical knowledge about the extraction of fossil fuels and minerals; (b) some recognised expertise in specific areas of international agricultural research; and (c) international leadership in the ‘know-how’ of the trade of raw materials,

<sup>34</sup> For more information, refer to the Extractive Industries Transparency Initiative (EITI) Strategy Review, <http://eiti.org/about/strategy-review> (accessed on April 29, 2013).

due to the large number of Swiss-based companies specialising in this and related fields (logistics, finance and insurance matters).

- The widespread local presence of Swiss international development cooperation in virtually all commodity-exporting developing countries. That said, however, it must be acknowledged that on the ground, Swiss development cooperation often possesses limited, if not actually minimal, independent leverage.
- Swiss participation in selected international initiatives and processes, as well as its membership in multilateral development organizations, such as the UN, the OECD, the World Bank, the IMF and various regional development banks.

Given these capacities, a logical overall Swiss international development cooperation natural resource strategy would be the promotion of public policies in developing and developed countries that require greater transparency and accountability at all levels, on the basis of basic international legal and business standards, as well as fundamental human rights.

To be effective, Swiss international development cooperation should therefore:

- Support poor, resource-exporting developing countries in improving their governance with respect to both public institutions and non-state actors.
- Selectively but pro-actively participate in international initiatives to promote the sustainable use of natural resources.
- Support the design and further refinement of the Swiss regulatory framework in so far as relevant to the nexus between commodity issues and the legitimate needs and interests of developing countries.

Through a balanced approach of this nature, Swiss development and foreign economic policies can help ensure that poor, resource-exporting countries succeed in retaining a greater portion of the profits earned from resource extraction and the commodity trade and, in turn, use these profits to benefit their population. In doing so, Switzerland would expand its contribution to international efforts to address a truly global challenge.

As such, the conditions required for good governance in the poor, resource-exporting partner countries of Swiss development cooperation should be promoted. This would notably include: (a) strengthening state institutions with the goal of achieving better mobilization of domestic resources and the professional management of the expenditure side; and (b) measures to advance transparency and accountability with regard to the conditions, arrangements and agreements related to resource extraction, processing and trade, including the origins and use of financial resources generated by commodity production and trade. Activities on the ground could include:

- Technical support to governments (with respect, for instance, to drafting policy and legislation, contract negotiation, regulations and revenue management).

- Elaboration and encouragement of good practices (to improve governance in resource-rich countries to multiply the efficacy and returns of natural resource exploitation).
- Strengthening the demand for good governance by supporting accountability actors such as parliaments, the media and civil society in monitoring and demanding improvements in the governance of extractive sectors.
- Work with communities to address environmental and social impacts and maximize economic and non-economic gains for locals.

In terms of on-going international initiatives and multilateral negotiations, Swiss authorities would therefore need to clarify:

- which initiatives are (a) most relevant, and (b) most likely to increase in effectiveness following Swiss support? It remains to be decided which, if any, additional standard-setting processes, technically oriented initiatives and key actors should receive support. This could include processes within the UN framework, the OECD, and Bretton Woods institutions, but also those carried out by civil society organisations, either alone or in concert with governments.
- how to best reach the goal of ensuring unhindered and least-cost access to natural resources without compromising development policy objectives and legitimate interests of development countries? Isolated proposals to make development aid conditional upon the abolition of restrictions on access to natural resources are common today. From a development perspective, the imposition of conditionalities and the abolition of restrictions (including taxes) on the export of raw materials from resource-rich developing countries remains a matter of substantial debate and contestation.

With regard to the regulatory framework of Switzerland, public policies would need to address issues of transparency and accountability, in addition to the business practices of multinational companies. Most controversially, the framework must determine the conditions under which legally binding standards, rather than principles, guidelines, and arrangements, would be most effective. Correspondingly, specific concerns of this nature would be, among others:

- Transparency in the activities of commodity companies doing business in and with developing countries. This refers to country-by-country and project-by-project level disclosure of payments to governments, in a manner similar to that currently implemented in the US and the EU.
- The adherence to minimum standards of corporate social responsibility and respect for human rights by companies engaged in investment, trade and extraction, in developing countries. In concrete terms, this would mean either the national implementation of international standards issued by various UN bodies and the OECD or the implementation of provisions similar to those of states whose requirements exceed the average in this regard.

- Improvement in the cooperation between OECD countries and developing countries in regards to the exchange of information with respect to taxation issues, such as the use of double taxation and tax information exchange agreements.
- Combatting corruption, money laundering, tax evasion and tax avoidance. Related topics include transparency with respect to beneficial ownership, due diligence rules and the oversight of financial market actors.

Against this background, the federal offices responsible for the policy formulation and implementation of Swiss international development cooperation should continue to actively participate in current discussions and efforts to address the challenges related to natural resource governance.

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## ANNEX

## Key International Initiatives and Legislative Efforts to Strengthen Resource Governance and Promote Sustainable Natural Resource Use<sup>35</sup>

### Contract and Revenue Transparency

- *Extractive Industries Transparency Initiative (EITI)*: Calls upon governments to publish payments received by extractive companies.
- *US Dodd-Frank Wall Street Reform and Consumer Protection Act*, Section 1504: Requires all oil, mining and gas companies registered with the US Securities and Exchange Commission to report their payments to all governments on a country-by-country and project-by-project basis.
- *EU Transparency Directive (2004/109/EC)*, *Accounting Directives (78/660/EEC and 83/349/EEC)* and *Capital Requirement Directive (CPD4)*: Expansion of current Directives proposed by the EU Commission in 2011, resulting in legislation similar to the *US Dodd-Frank Wall Street Reform and Consumer Protection Act* that requires all EU-listed or large unlisted oil, gas, mining and logging companies to disclose their payments to all governments on a country-by-country and project-by-project basis.
- *International Financial Reporting Standards (International Accounting Standard Board)*: Establishes global disclosure and reporting standards, including specific measures, for the extractive industries.
- *International Financial Institutions (IFIs)*: The World Bank's International Finance Corporation (IFC) requires its extractive industry clients to disclose key material payments made to host governments as a condition of its lending. Additionally, in 2011, the IFC revised its Sustainability Framework to require contract disclosures from all oil, gas and mining industry clients. Other IFIs, such as the European Bank for Reconstruction and Development, which released a new draft Mining Strategy in 2012, may implement similar transparency safeguards.
- *Reports on the Observance of Standards and Codes (IMF)*: Serves as quasi-audits for domestic authorities and risk assessment tools for investors and lenders.
- *Publish What You Pay*: Campaign launched in 2002 by a coalition of 60 NGOs calling for better management of public revenues in order to address poverty and good governance in resource-rich countries. It now has over 650 member organizations. The campaign is supported by the Open Society Institute, which, in turn, supports the Revenue Watch Institute, a specialized organisation on extractive industries, also partially funded by governments.
- *IMF Managing Natural Resource Wealth Topical Trust Fund*: Enables natural-resource-rich low and lower-middle income countries to derive the maximum benefit from their oil, gas and mineral resources by providing technical assistance to draft effective economic policy and build administrative capacities.

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<sup>35</sup> For a more detailed analysis see Le Billon (2011).

### **Certification Instruments (“Commodity-specific Tracking Regimes”)**

- *Kimberley Process Certification Scheme*: Voluntary governance scheme created in 2002 wherein participant countries forego the trade conflict diamonds.
- *US Dodd-Frank Wall Street Reform and Consumer Protection Act*, Section 1502: Seeks to end the illegal exploitation and trade of conflict minerals from the eastern Democratic Republic of the Congo (DRC) through the application of due diligence processes.
- *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas*: Provides management recommendations for responsible global mineral supply chains to help companies respect human rights and avoid contributing to conflict through their mineral or metal purchasing decisions and practices.

### **Broad Governance Standards**

- *UN Guiding Principles on Business and Human Rights*: Outlines general human rights due diligence obligations for companies and special due diligence for conflict zones.
- *Natural Resource Charter*: Twelve principles, created by a group of academics led by Paul Collier, aimed at promoting accountable management, robust fiscal regimes and the sustainable use of resources.
- *UN Global Compact*: Encourages businesses worldwide to adopt sustainable and socially responsible policies and to report on their implementation.
- *Committee on World Food Security*: Endorsement of a set of far-reaching global guidelines entitled the *Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security*.

### **Other Non-resource-specific Intergovernmental Initiatives**

- *Financial Action Task Force on Money Laundering*: Inter-governmental body established in 1989 by the Ministers of its member jurisdictions. The FATF’s objective is to set standards and promote the effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other threats related to the integrity of the international financial system.
- *Informal Task Force on Tax and Development*: Contributes to the OECD Programme on Tax and Development, which aims to strengthen tax systems in developing countries, establish effective transfer price regimes, increase financial data transparency in multinational enterprise reporting and counter international tax evasion by improving transparency and the exchange of information.
- *OECD Global Forum on Transparency and Exchange of Information for Tax Purposes*: Ensures that all jurisdictions implement relevant international standards through a peer review mechanism.
- *World Bank/UN Stolen Asset Recovery (StAR) Initiative*: Supports international efforts to end safe havens for funds generated by criminal activities, including those generated in the extractive sectors in resource-dependent countries.

- *International Tax Compact*: Initiative launched by the German Federal Ministry for Economic Cooperation and Development with the aim of strengthening international cooperation to fight tax evasion and avoidance.
- *World Bank/IFC Global Tax Simplification Programme*: Provides technical assistance to developing countries on the issue of transfer pricing.
- *African Tax Administration Forum*: OECD-sponsored forum seeking to develop best practices among African tax administrations, including a transfer pricing project aimed at a more effective application of the 'arm's length principle'.
- *Financial Accountability and Corporation Transparency Coalition (FACT)*: US-based coalition of civil society organisations focussing on the reporting obligations of US-listed companies, now turning its attention to the extractive sector.
- *Task Force on Financial Integrity & Economic Development*: Global coalition of civil society and more than 50 governments working together to advocate for greatly improved transparency and accountability in the global financial system.
- *Open Government Partnership (OGP)*: International initiative aimed at securing concrete commitments from governments to promote transparency, increase civic participation, fight corruption, and harness new technologies in order to promote open, effective and accountable government.

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 Reaction by Alexandra Gillies, Head of Governance, Revenue Watch Institute  
 <<http://www.revenuewatch.org/>>.

## Crafting a Strategic Response to the Commodity-Development Conundrum

A response to ‘Commodities and Switzerland: Development Policy Challenges and Policy Options’  
 by Werner Thut

The risks that accompany natural resource wealth are well-known. Developing countries with large stores of oil, gas and mineral resources often fall victim to what is commonly known as the ‘resource curse.’ Its symptoms vary from place to place, but frequently include persistent poverty, stagnant non-resource sector growth, fiscal instability, unsustainable levels of spending, high levels of corruption and public institutions that are unaccountable to their citizens.

Global efforts to respond to these problems have gathered pace since the late 1990s. At varying speeds, and to varying levels of success, governments, companies and civil society groups have developed approaches to the set of challenges associated with resource wealth and development. Given the highly globalized and interconnected nature of the commodity sector (and the financial system into which commodity profits enter), diverse players share responsibility for the hardships that often accompany resource wealth, as well as for finding a solution.

The 2013 paper ‘Commodities and Switzerland: Development Policy Challenges and Policy Options’, by Werner Thut of the Swiss Agency for Development and Cooperation, represents part of the Swiss awakening to their own role in addressing these challenges. Thut calls for a policy response that features three parts: supporting good governance in poor resource-exporting countries; participating in international initiatives; and, improving the Swiss regulatory framework. These areas make sense as a general framework, but more urgency and more critical thinking are needed for Swiss efforts to be more than just ‘window dressing’.

In the comments below, I further defend that a targeted and strategic response by the Swiss government is needed now, and suggest two specific areas where they could make a tangible contribution, given the particular political economy that characterizes many resource-rich developing countries. These ideas build upon the foundational work of Dr. Thut, but aspire to challenge policymakers further to take the kind of action that can have an impact.

### The urgent need for Swiss action

Commodities can drive development if governments receive a fair share of revenues and utilize it well. Getting this right is a massive and time-sensitive challenge. Three hundred million citizens of resource-rich countries live in dire poverty, surviving on less than USD 2 per day. Eighty-five percent of these

people live in poorly governed countries (Kaufmann, 2012). *Non-renewable* resources, valued at over one trillion dollars per year, are being extracted at quickening rates from these countries. The longer it takes to improve governance, the fewer resources will be left to benefit citizens.

Switzerland plays a major role in the global commodities market, as noted by Werner Thut. Swiss companies, such as Glencore, Vitol and Trafigura, handle around 35 percent of the global physical oil trade and 60 percent of metals and minerals (Bosley C. and M. Kolesnikova, 2013) – business that amounts to more than USD 3 trillion.<sup>36</sup> And business is booming. In the past decade, the top 20 commodity traders netted USD 243 billion in total profits (up from just USD 2 billion in 2000), and individual company profits outsized those of Wall Street's largest banks (Blas, 2013). As Swiss companies cash in on resource wealth, the government must ensure that their business is not conducted at the expense of the developing countries where the raw materials are sourced.

The Swiss government has explicitly stated that it faces increasing reputational risks due to its large commodity trading sector. In their response, the government should not just carry out superficial steps to assuage their critics. These kind of symbolic measures feature heavily among the recommendations contained in the much-anticipated March 2013 Federal Council report on commodities (Federal Department of Federal Affairs, 2013), which, in particular, calls for Switzerland to support voluntary codes of conduct for trading companies and various international standards. Issuing benign corporate guidelines or supporting a UN resolution do not constitute action. Nor is a bit more aid sufficient, given the scale of the challenge around natural resources and development: in 2011, Nigeria's oil revenues were 60% larger than all foreign aid to the continent of Africa (NEITI, 2013).<sup>37</sup>

In his paper, Thut offers the beginning of an answer to the 'what to do?' question by recognizing the need for policy coherence. Commodity markets (and the financial markets where commodity revenues end up) are highly globalized, so Swiss policy must contain both domestic and externally-facing elements. Below I describe two areas where timely and assertive action has a good chance at making a difference in the specific political economy realities that define resource-rich developing countries.

### Power, profits and plunder

The academic literature around the so-called 'resource curse' describes the kind of citizen-state relations which commonly emerge in environments with large oil, gas or mining revenues and weak institutions.<sup>38</sup> The term 'rentier state' is used to describe the political environment in which large resource rents accumulate in the state, usually in the hands of a few powerful individuals. The government does not rely on domestically generated revenues

<sup>36</sup> Al-Jazeera 'The Giants of Commodity Trading' (2012) <http://www.aljazeera.com/programmes/countingthecost/2012/09/2012927123919121653.html> (Accessed on May 13, 2013).

<sup>37</sup> Aid estimate from the OECD; Nigerian oil revenue figure from Nigerian Extractive Industries Transparency Initiative – NEITI (2013) 'Financial Audit: An Independent Report Assessing and Reconciling Financial Flows within Nigeria's Oil and Gas Industry, 2009-2011.' (Abuja: Nigerian Extractive Industries Transparency Initiative) [http://eiti.org/files/NEITI-EITI-Core-Audit-Report-Oil-Gas-2009-2011-310113-New\\_4.pdf](http://eiti.org/files/NEITI-EITI-Core-Audit-Report-Oil-Gas-2009-2011-310113-New_4.pdf) (Accessed on May 13, 2013).

<sup>38</sup> See the selected readings on the political economy of resource rich states in the references list below.

and therefore has limited material interest in the prosperity of its people. The exercise of power involves allocating valuable industry assets (upstream licenses, service contracts, export permits, top industry positions, etc.) and resource revenues.

The resource-rich state (called the ‘rentier state’ by some scholars) dominates at the expense of an independent private sector, and business tends to form a parasitic relationship with the wealthy state. Public officials often hold private interests in the extractive industries, generating conflicts of interest. Accountability actors including the media, parliament, opposition parties and civil society tend to be weak or co-opted into the rentier system, as do many checks on executive power like elections or audits. Even international players, like the World Bank and other donors, have limited influence given the financial and political autonomy enjoyed by the political elites and ample international competition among extractive industries to access their subsoil assets.

Where such a political system is allowed to persist, the public will not receive maximum benefits of from its resource wealth. International actors, including Switzerland, can work to increase the capacity of resource-rich government agencies (one of the Federal Council report recommendations) and support voluntary international standards, but unless they tackle the imbalances of power which enable the persistence of the ‘rentier state’, impacts on the lives of citizens will remain limited. The two interventions mentioned below – transparency regulations and support for accountability actors – reflect areas where Swiss action could make a real difference.

### **Transparency regulations for commodity traders**

While not solely sufficient as a tool for realizing change, transparency does address one problem at the core of the rentier political economy: informational asymmetries. The political elite who control countries like Angola, the DRC and Turkmenistan hold onto important information in order to expand the ease and discretion with which they operate. These imbalances in information occur between the state and its citizens, as well as within government itself. In Nigeria, for example, the government’s finance agencies and the national oil company regularly disagree on how much money one party owes to the other, with the former unable to access adequately detailed information about oil revenue generation. As a result, the public, accountability actors like journalists, and parliamentarians and even government officials cannot engage in an informed debate about natural resource governance.

Switzerland itself illustrates this point. As noted by the Berne Declaration (a NGO coalition), the Federal Administration’s own March 2013 report failed to disclose how much commodity trading companies pay in taxes to Switzerland, stating, ‘There are, at present no figures available on tax revenues deriving from the commodities industry’ (Berne Declaration, 2013). If the public is meant to weigh the benefits and costs of hosting these massive companies, and to consider what policy response is appropriate, the amount of tax revenues is a crucial fact to consider.

Dr. Thut, in his paper, calls for ‘the design and further refinement of the regulatory framework in Switzerland, in so far as relevant to the nexus

between commodity issues and the legitimate interests and needs of developing countries.' The U.S. and the E.U., themselves home to many large oil and mining companies, have responded to this same challenge by introducing regulations that require extractive companies to publish the payments they make to foreign governments on a per project basis. Following this lead, and ensuring that the laws apply to commodity traders, represents a basic first step to ensure coherence between regulation at home and development programs abroad.

Commodity trading is in particular need of this kind of regulation. The deals between traders and governments, both the purchase of raw materials and the sale of refined products, often have massive financial implications for developing countries. To give a sense of the scale, for example, Glencore was just awarded the license to buy oil from the government of Chad. In January 2013, the company shipped its first cargo of 950,000 barrels.<sup>39</sup> This single sale would net at least USD 80 million. This may represent a small- or medium-sized deal for Glencore, but for a poor country like Chad, this is a massive transaction: the revenues from this single sale are enough to pay for half of the country's yearly education budget. In countries including Nigeria, Congo-Brazzaville, Azerbaijan, Yemen, Iraq, Libya, South Sudan and Angola, the sale of oil by the state generates more than half of government revenues. For many other states, these sales generate the single largest revenue stream.

On the import side, oil trader Trafigura currently supplies *all* of Angola's fuel needs, which is a multi-billion dollar business. And these sales can be corruption-prone: Nigeria spent USD 22 billion on fuel subsidies from 2009-2011, with significant fuel being bought from Swiss traders such as Mercuria and Trafigura, and around USD 7 billion was lost due to a scam of historic proportions.<sup>40</sup>

Without the disclosure of basic information around commodity sales, corruption risks increase, and there is little chance for citizens, journalists and parliaments to know how much their country receives for its public resources. Requiring companies to operate in a transparent and responsible manner does not constitute unfair or uncompetitive treatment. Trading companies are huge global players that buy billions of dollars of oil and minerals from poor countries. Wherever they are headquartered in the world, they should be the subject of robust oversight and scrutiny. Ensuring this is the case is a basic responsibility of the home government, and one which the Switzerland should not avoid.

Opacity in payments by traders is not the only practice requiring the attention of the Swiss authorities. Other practices that generate concern include the influence of huge traders on global market and price integrity, the trade in stolen oil, such as from Nigeria, or sanctioned oil, such as from Iran, and taxation and transfer pricing abuses by trading companies. But given the precedent set by the US and EU governments, and the prevalence of high-

<sup>39</sup> Reuters (2012) 'Glencore signs contract to export oil from Chad in 2013' <http://www.reuters.com/article/2012/12/14/glencore-chad-contract-idUSL5E8NECN620121214> (Accessed on May 13, 2013).

<sup>40</sup> Reuters (2012). 'Nigeria investigates 21 firms for fuel subsidy fraud' <http://uk.reuters.com/article/2012/08/17/nigeria-subsidy-fraud-idUKL6E8JH65K20120817> (Accessed on May 13, 2013).

value deals between trading companies and producer countries with bad governance, robust and mandatory reporting standards are a good place to start tackling some of the challenges associated with such trade.

### **Recognizing the silent majority**

The second recommendation is hinted at in both Dr. Thut's paper as well as the Federal Council's report: development assistance that specifically aims specifically to improve the public accountability of governments in resource-rich, poor countries. Providing technocratic advice to the authorities in these countries can be useful, but not when the prevailing political economy environment enables a small elite to benefit at the expense of the majority. From Kazakhstan to Equatorial Guinea, the voices of citizens, civil society and the media need to be heard so that resources are directed to meeting the long-term needs of the population.

This idea of supporting civil society and other accountability players is widely supported in development circles, but usually plays second fiddle to engagement with governments. In light of the power imbalances that oil and mineral wealth can help to propagate, these kinds of accountability-focused interventions should rather be in the lead. In such an effort, even a relatively small donor like Switzerland can make a difference. There are examples – activists asking questions about the below market value sale of assets by the Congolese state, a Public Interest and Accountability Commission in Ghana issuing regular reports that identify when government veers from the rules set out in their new oil legislation, courageous activists who speak out in authoritarian contexts like Gabon and Azerbaijan – of how this work can make a difference. And it is not expensive.

The paper by Werner Thut, together with other discussions within the Swiss government this year (particularly, forthcoming discussions in the parliament), represent a promising discourse. They reflect growing awareness about the need to respond to the global challenges which surround the production, trade and consumption of natural resources. These are daunting. But with collective, serious efforts that extend beyond reputation-driven maneuvers, the most damaging costs from extraction can be minimized and the benefits to developing countries increased.

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## Going Beyond Transparency and Good Governance

A response to ‘Commodities and Switzerland: Development Policy Challenges and Policy Options’  
 by Werner Thut

The paper by Werner Thut ‘Commodities and Switzerland: Development Policy Challenges and Policy Options’, from the Swiss Agency for Development and Cooperation, has great relevance as it comes from a country that is key to the extractive and food industries. This relevance does not come as much from Switzerland’s role as a producer, but from the fact that, as demonstrated by the figures given by Thut, it is the world’s largest commodity trading ‘hub’.

Furthermore, this paper comes at a time when several developed countries have taken significant measures to promote transparency in the extractive industries. The Dodd-Frank Act of 2010 from the United States requires extractive companies to disclose information regarding the payments they make to states, on an individual and project-by-project basis. Similarly, the European Union just voted to approve a project along the same lines, and the Canadian government has announced an identical measure. The United States is currently implementing the Extractive Industries Transparency Initiative (EITI), of which Norway has been a member since 2011 and the United Kingdom and France will be joining in 2013-2014. In addition, the United Nations is currently discussing a resolution regarding transparency in natural resources.

The Swiss development cooperation initiative suggests that it is helpful to distinguish between three spheres of action: first, internal development within Switzerland; second, the projects currently in operation around the world, and; third, the agency’s role in ensuring, along other Swiss government agencies, ‘policy coherence’ that facilitates greater transparency, and the equitable end-use, of the production of extractive industries in resource-rich countries.

It is important to point out from the start that there is a constant conflict, as noted in the paper, between, on one hand, the proposal from the Swiss development cooperation initiative, and the proposal made by other Swiss government agencies, particularly those closely associated with production and trade, on the other.<sup>41</sup>

This conflict between proposals, we believe, is illustrated by the Swiss Federal Council’s recent report on Swiss commodities. This report has been strongly criticized by Swiss civil society organizations for its insufficient new data and, as the report merely makes recommendations and voluntary actions, above all, for its lack of concrete measures. We will come back to this subject later.

In this paper, we will discuss not only the Swiss development cooperation issue, but I will also reflect upon some additional subjects relevant to the Latin

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<sup>41</sup> The paper references questions arising as to the coherence for development of some components of Swiss policy, including trade and international taxation policies.

American perspective. This will allow us to identify both the strengths and weaknesses of some of our policies.

### 1. Importance of the 'Commodity Trading Hub'

It is important to stress that, in this area, Switzerland's key is that of a 'broker' or 'transit country', and not a major consumer of raw materials. This is a different approach, for example, than that of Germany and its access to raw materials strategy and campaign.

1. Correspondingly, one of the key points to emphasize is that both extractive and trading companies should be held to the same levels of transparency. In this sense, we must mention that the recent measures implemented by the United States and the European Union have a direct impact on Swiss extractive companies, as they trade on the US and European stock markets.

The question thus becomes: What will happen to Swiss trading companies? Will they also be subject to the transparency requirements?

We must not forget that many of these companies are vertically integrated, from production all the way to sales, mediated by shipping and distribution. As a result, in order for such policies to be effective, the entire length of the value chain must be transparent. This issue must be regulated by legal provisions set by the Swiss government.

2. In the paper, Werner Thut states, 'While evidence is not conclusive, some analyses have found a connection between the business practices of certain private actors in the financial markets and a trend towards speculative trades, large-scale land grabs and even human rights abuses.'

We believe that there is conclusive evidence of a significant financial capital participation in the commodity markets that, in turn, as indicated by recent works of the United Nations Conference on Trade and Development (UNCTAD), demonstrates speculative intervention. The Dodd-Frank Act of the United States has gone a step further, mandating the Commodity Futures Trading Commission (CFTC) to set limits on the positions companies take in commodity futures markets.<sup>42</sup>

We think it is very important that Switzerland recognizes the central role played by Swiss markets and private companies in the price formations of the commodities markets. What we do not seem to have, however, are concrete measures to progress in this direction.

3. Thut's paper mentions that a merger between two Swiss companies, Glencore (a commodity trader) and Xstrata (a mining company), was imminent, which would make the merged company the fourth largest in the world. This took place in April-May 2013, when the Ministry of Commerce of the People's Republic of China (MOFCOM) approved the merger. Initially, the Chinese government was concerned, as the dominant market position of Glencore-Xstrata could affect the supply of minerals to China.

As a condition of the merger's approval, the MOFCOM required the exclusion of Las Bambas, a Peruvian copper mine acquired by Xstrata in 2004, from

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<sup>42</sup> That said, in September 2012, in the District Court of the District of Columbia, Judge Robert Wilkins threw out the U.S. Commodity Futures Trading Commission's new position limits rule, and sent the regulation back to the CFTC for future consideration. The future status of such regulations is thus, at this time, unknown.

the merger. Glencore and Xstrata accepted this restriction without consulting the Peruvian government, which stopped just short of denouncing the deal. Other politicians suggested that a complaint regarding this lack of transparency should be made to the WTO.

There is no guarantee, furthermore, that the new company will comply with the environmental standards Xstrata followed in the past. Additionally, as, it has been agreed that the Las Bambas sale must provide a profit to Glencore-Xstrata, the start of production at the mine could easily be delayed.<sup>43</sup>

Is this top-down approach consistent with transparency?

4. Finally, the paper also provides important data on illicit financial flows and the need to combat them. We completely agree with this point, but would argue that the same emphasis must be placed on stemming licit financial flows, which results in currency appreciation, a key symptom of Dutch disease.

In resource-rich countries, in this era of high mineral prices, these licit financial flows are added to the export of natural resources. To combat these licit financial flows, states must possess the tools sufficient to prevent capital inflow. Governments are frequently unable to take such measures, however, due to the fact that even though the IMF now permits them, they are banned under several international instruments, including free trade agreements (see Ocampo and Gallagher, 2013).

It is important for governments from developed countries, particularly the Swiss government, to take Thut's words to heart. 'A trade policy that works in conjunction with development policy such that development needs of individual countries, particularly the Least Developed Countries (LDC), are taken into consideration' is absolutely necessary. In order to do so, it is important to have a holistic vision of development, as suggested at the 2002 United Nations Monterrey Conference.

## 2. The Resource Curse: Going Beyond Transparency Towards Production Diversification

There is empirical evidence that countries with significant natural resource revenue, have, in many cases, lower growth rates, and higher rates of corruption, than those with no natural resources. This is the so-called 'resource curse', the impetus for the increased focus on transparency as a means of fighting corruption. This objective has been taken up by the EITI, and the measures undertaken to pursue it should be strengthened.

There is also abundant empirical evidence confirming that it is necessary to go one step further, towards the forging of effective overall governance that includes, of course, transparency. In this sense, we agree with Paul Collier's statement: 'Essentially, if a country has decent governance, the long-run effects of high-commodity prices reinforce the benefits of short-run effects. The resource curse is confined to countries with weak governance' (Collier, 2010, 46).

<sup>43</sup> The 'predetermined' selling price must be greater than the total costs incurred by Glencore and Xstrata at Las Bambas, and greater than the market price at which Glencore valued Las Bambas. <http://gestion.pe/movil/noticia/2063842>.

This issue is underlined in the paper by Thut, wherein he references the examples of Norway, the European Union and parliamentary requests in Switzerland, to name a few.

Having said that, as indicated by the Resource Governance Index 2013 from the Revenue Watch Institute (RWI), several Latin American countries do, in fact, demonstrate good governance. Brazil, Mexico, Chile, Colombia, Peru and Trinidad and Tobago appeared among the top 11, with a *satisfactory* rating, while Bolivia, Ecuador and Venezuela achieved a rating of *partial* good governance.

### 3. Issues of importance for Development Cooperation with the Swiss Government

It is evident that the policies for development cooperation must allow mutual collaboration. The primary objective of good governance initiatives is, firstly, responsibility from resource-rich countries. At the same time, in this area, Latin American countries are able to benefit from the international, including Swiss, cooperation for development.

Let us take a look at some critical Latin American governance issues.

1. The paper recommends that Switzerland should ‘support the design and further refinement of the Swiss regulatory framework in so far as relevant to the nexus between commodity issues and the legitimate needs and interests of developing countries’.

This could be just as, if not more, important than the measures taken in producing countries. It is also important to provide technical assistance to producer states in order to better enable them to fight illegal financial flows, as mentioned above.

2. It is crucial that revenue obtained from natural resources reaches regional and local governments. This is an issue currently under debate throughout Latin America.

It is not only revenue allocation of revenue that is an important issue, moreover, but so its final destination. Revenue must be directed in such a way that it is able to contribute to the states’ sustainable development. This is a subject of great interest for Latin American countries, and is already being analysed by the Union of South American Nations (UNASUR) and the Economic Commission for Latin America and the Caribbean (ECLAC).

The Swiss development cooperation could be very helpful in this area, due to its experience in handling decentralized funds and in the quality of the investment to be developed.

3. Even though progress has been made, tax authorities in resource-rich countries often lack the appropriate technical expertise required to effectively tax revenues from extractive companies operating in their states. The same is true of the government agencies charged with promoting competition.

From this perspective, the Swiss proposals could be more explicit, creating cooperation programs for tax authorities and competition policy-making agencies. Development cooperation is welcome in these cases.

4. Civil society organizations from resource-rich states have contributed to better monitoring of extractive industries, with respect to issues of trans-

parency and governance, as well as environmental conservation (a subject That explicitly does not consider in his paper).

Along these lines, in January 2013, the Latin American Network of Extractive Industries presented the EU/LA parliaments with a proposal containing eight conditions for European-based extractive investments in Latin America at in the EU/Latin America Summit in Santiago. This initiative could be reviewed and updated.<sup>44</sup>

#### 4. Conclusion

We need to go beyond the issue of good governance of natural resources and, though it is somewhat outside the scope of this paper, advance towards non-excessive dependence on the export of natural resources. This is particularly important in today's economic climate, when we seem to be entering the last stretch of the super cycle of commodity prices. This means creating policies to diversify production and promote technological and scientific development. It is therefore essential for governments to have the necessary 'policy space' to implement such policies, an area wherein developed states, working through various international organisations (such as the IMF, World Bank and WTO, etc.), could be extremely helpful.

We are at a time when greater initiatives could be implemented and, above all, important achievements in the transparency and governance of extractive industries could be made. Successfully achieving these goals must be an objective of international organizations, developed countries, the governments of resource-rich states and global civil society. We believe that Swiss development cooperation has set the benchmark for this undertaking. Now is the time for the Swiss government, at its highest levels, to carry out these proposals, in keeping with Switzerland's status, as the world's largest commodity trading hub, as one of the most important links in the natural resources value chain.

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<sup>44</sup> see <http://www.oidhaco.org/uploaded/content/article/2042018323.pdf>.

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## Reassessing the Merchants' Role in a Globalized Economy

A response to 'Commodities and Switzerland: Development Policy Challenges and Policy Options'  
 by Werner Thut

Since the 18<sup>th</sup> century, the perception of the merchants' role has been constantly misunderstood. However, history teaches us that commercial trade is key to bringing products to the markets, particularly in an increasingly globalized and complex economy. In an evolving environment, the merchants' role needs to be reassessed. The question of their role in the transparency debate is relevant but requires a better understanding of the merchants' current function in the value chain.

### Definition of Commodity Trading

The commodity value chain involves a large variety of actors performing different activities (extraction, logistics, shipping, transformative industries, financing, etc.) belonging to the same value chain but following distinct business models. As the main professional association for commodity trading and shipping in Switzerland we will focus on the role and corporate responsibilities of our industry.

Due to the fact that commodity trading houses do not directly serve consumer markets, the general public has a limited understanding of the role they play in the value chain. The commodity traders play a crucial role in managing the relationship with producers and buyers and bridge the gap between supply and demand along the commodity value chain. They act as an organizer and generate added value from their ability to optimize the logistics chain and to overcome the price risks (volatility of prices during the transport) and operational risks (e.g. climatic hazards, currency volatility, piracy, counterparty risks and legal risks). They also secure access to resources through the establishment of reliable partnerships with producing counterparts.

The publication of the *Background Report on Commodities to the Federal Council*<sup>45</sup>, in early 2013, has been a key driver in gathering data and dispelling misconceptions about the commodity industry and extractive activities:

Commodity trading operates in a highly competitive business environment and works with a whole range of clients (from private and stock-listed companies to state-owned ones), while extractive companies deal exclusively with governments.

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<sup>45</sup> Hereafter 'Background Report' (downloadable on <http://www.news.admin.ch/NSBSubscriber/message/attachments/30136.pdf>, accessed on September 15, 2013).

Commodity trading wins contracts mainly through commercial public tenders and works on a much shorter term basis in comparison to the extractive industry.

Commodity trading is an indispensable intermediary remunerated for the services provided along the value chain independent of the commodity price level, while the extraction industry operates at only one end and generates its profits from the difference between extraction costs and market prices.

It is commonly accepted that commodity trading activities are ten to fifteen times less profitable than extractive ones, and much more volatile.

When discussing the function of the commodity market these specifics need to be recognized but they do not in any way negate their interrelation and the common responsibility of commodity trading towards source of supply, just as with any other industrial activity (i.e. food processing, distribution, etc.).

### **'Resource curse' or 'governance curse'?**

Although it is true that resource-rich countries face challenges in the management of their resources – and more specifically in the allocation of revenue generated by their exploitation – it appears that the 'resource curse' is more of a 'governance curse' than anything else.

Since the end of the Cold War, the reorganization of the switch of twenty-five African countries to democratic regimes has been accompanied by an improvement in their economic outlook. This democratic trend - even though not perfect - is synonymous with better governance, increased stability and economic development opportunities for these countries (i.e. the promising economic perspectives of sub-Saharan Africa).

The argument that when it comes to making a deal on oil or cereals private corporations are in a stronger position than states might have been true some decades ago. It is, however, now irrelevant and refers to a pre-OPEC<sup>46</sup> vision. The prices of commodities are public, accessible, quoted both in the market and on platforms, and continuously updated. Therefore it is difficult to argue that there is real asymmetry of information between private corporations and states; this is especially the case in countries where national oil companies are strong players. We need to recognize that today 80% of global oil reserves are in the hands of national corporations. These companies are not subject to the same duty of care and governance as independent trading companies based in Switzerland. African states reclaim 60% to 90% of the petroleum yield depending on their tax system and enforce very strict localized rules (e.g. the mandatory recruitment of local workforce and sub-contractors) on foreign operators.

In order to secure their deals and to be able to channel goods from supplier to customer, commodity traders need reliable partners and a solid infrastructure. In that respect, a failed state presents far more problems than good market opportunities in jeopardizing their sustainable access to resources.

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<sup>46</sup> Organization of the Petroleum Exporting Countries (OPEC).

## Is transparency in payments the appropriate tool?

The commodity trading industry faces increasing demands to make the supply chain more transparent, as a common accusation is that trading companies are less transparent than mining companies. However the previously discussed differences in business models between the sectors are of key significance here.

Commodity trading companies are not contracting states but operate in an open competitive environment. They therefore have to preserve their competitive advantage and protect their intangible assets that justify a price premium, given that the price for a specific commodity is already known publicly and automatically. The mining sector operates on a completely different competitive playing field as there is no public price quotation for resource concessions or royalty payments arising from extractive activities.

The real question is whether a transparent revenue policy as advocated by Alexandra Gillies would achieve the desired goals. Would payment disclosure make firms and governments more accountable than they already are? Would it really be the antidote to bribery and market abuses? Are commodity trading firms in the position to play this role?

Firstly, the payment disclosure policy raises several technical questions. There are some limitations to be taken into account due to the much greater amount of transactions in the commodity trading industry compared to the mining industry. The trades are made up of a multitude of daily contracts with various counterparts and are based on short term contracts, where revenues are generated mainly from the volume of transactions, as opposed to extraction contracts made on a long term agreement over several years involving huge financial investment.

Another concern is to ensure that an independent actor is able to undertake the task of reconciling those huge volumes of payments and that the benefits of fulfilling this task outweighs the cost. Moreover it is necessary to be able to analyze the results of such disclosures and understand what disparate figures mean. Indeed in some countries where the tender processes for oil are undertaken by a board, a certain percentage of the royalties is retained to cover administrative costs. The amount paid by the company will therefore not tally with the money received by the government, even though the process has been legal and fair. This can be easily explained on a specific transaction, but the task becomes unmanageable on a larger scale of transactions. To all of these questions, there are only partial answers and it is not completely clear that this process would be worth the administrative burden put on the economic agents. Moreover, international organizations like the World Bank or IMF are in a much stronger position than private firms to promote better governance.

Furthermore, with the continuing increase in the cost of operating in some African countries and the growing regulatory pressure on international firms to adapt to local state regulation and enforcement, several multinational players are being forced to reconsider their involvement in Africa due to the discrepancy between home requirements and the local environment business regulations. Such moves, if confirmed, would undermine the local economies and contravene the appeal of the Africa Union Commission for more foreign

direct investment.<sup>47</sup> Here again there is a real dilemma concerning the question of foreign policy coherence, as economic development is the best way to reduce poverty (e.g. consider the example of Asia over the last twenty years). This makes the industry favor a multilateral and international approach aimed at developing a level playing field, involving local governments.

### The challenge of reputational risk

In Werner Thut's article 'Commodities and Switzerland: Development Policy Challenges and Policy Options', as well as Alexandra Gillies in her subsequent comments ('Crafting a Strategic Response to the Commodity-Development Conundrum'), assert the risk for Switzerland's reputation raised by activities in the commodity sector. This risk is also mentioned in the *Background Report*. Commodity trading firms are conscious of this challenge. It is as crucial for the Swiss government as it is for private commodity houses, which heavily depend on various sources of financing. The increased requirements of banks and capital markets with regards to corporate social responsibility at a time when commodities are becoming more expensive and loans more difficult to obtain, confirm that trading companies need to strengthen their creditworthiness and their image.

The Swiss-based commodity industry is at a cross-roads. Just as in any other business sector, its practices are quickly evolving. These changes are driven by varying demand and by new stakeholder expectations. Through experience, their staff have become aware of their influence at a social and environmentally sustainable level and have proactively and voluntarily decided to enhance the management of their companies. The visible effects of these decisions are compulsory codes of conduct and training that are applicable to all staff members. They have also increased the number of internal compliance authorities in order to ensure the both Swiss and international legal networks are respected as they provide a complex direct and indirect compulsory framework.

In his call for action, Werner Thut advocates a Swiss foreign policy which would help to ensure that resource profits benefit their population. Clearly this is an agreeable objective. However this approach raises question with regards to the sovereignty of these countries: knowing that producing countries already control the major part of their resources, how could this be achieved without interfering in other state matters? Cohesion is also needed in the way Switzerland deals with its partners. The Swiss authorities usually promote mutual respect rather than a more patronizing approach, and it would be sharply felt if they were to apply a different criteria to their emerging state counterparts than their European counterparts.

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<sup>47</sup> See the address by Dr. Nkosazana Dlamini Zuma, the first woman to head the African Union Commission, who urged African Member States and international partners to invest more in order to promote job creation in the region. (ILO web site: [http://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS\\_216158/lang-en/index.htm](http://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_216158/lang-en/index.htm), accessed on August 7, 2013).

## Conclusion

The commodity trading sector operates in a globalized economy and is subject to the same challenges as all other economic agents with a global footprint. Its practices are adapting to meet new expectations and there are no grounds for pinpointing them more than other multinationals. This is especially true when it comes to transparency. Indeed the charge of a lack of transparency is not only leveled at corporations but is also a current debate within the not for profit sector and NGOs.

The Swiss commodity sector has spontaneously committed itself to participating in the multi-stakeholder dialogue launched by the Swiss authorities to promote the implementation of the UN guiding principles on business and human rights. The industry is also proactively engaging with the administration to follow up on the 17 recommendations made at the conclusion of the *Background Report*. With its expertise and humanitarian tradition, Switzerland offers a multilateral and unique platform conducive to thoughtful leadership and improvements in the management of the commodity economy worldwide. It would clearly be of no use for Switzerland to implement a policy on its own with little impact on a globalized economy. Those who campaign for Switzerland to play a leading role and to set an example should commend the courage of the Swiss authorities in adopting an innovative approach that aims to make a real difference and is far more exacting than simply passing more regulations.