

Combating corruption in the Petroleum Sector:  
Implementation of Extractive Industries  
Transparency Initiative (EITI)

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## Combating corruption in the Petroleum Sector: Implementation of Extractive Industries Transparency Initiative (EITI)

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### Abstract

Corruption in the petroleum sector such as bribery of state officials and embezzlement of petroleum revenues could be reduced if the petroleum industry and its wealth management regime become more transparent. One practical step towards transparency in the petroleum sector is adoption and implementation a global standard to promote open and accountable management of natural resources called the Extractive Industries Transparency Initiative or “EITI”. Having no legally-binding effect, EITI Requirements as stipulated in the EITI Standard are correctly qualified as soft law. Regular publication of EITI reports directly tackle opacity of the petroleum sector and deter corrupt practices. Implementation of the EITI does not change how legal framework of the petroleum industry works, but makes the public more informed about petroleum exploitation and its wealth management. In this more transparent environment, it is more difficult for state officials to act corruptly. The power of deterrence in this case is likely to come predominantly from the more informed citizens. However, it should be noted that the EITI and its transparency regime are not a magical solution to corruption in the petroleum sector. Successful implementation of the EITI also relies on other factors such as, usage of the information by the public, and dependency of the government on their citizens.

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## บทคัดย่อ

การเสริมสร้างความโปร่งใสในการจัดการรายรับของรัฐจากอุตสาหกรรมปิโตรเลียม นั้นเป็นแนวทางที่สำคัญแนวทางหนึ่งในการต่อสู้กับปัญหาความทุจริตในภาคบิโตรเลียม เช่น การติดสินบนเจ้าพนักงาน และการยักยอกรายรับของรัฐจากอุตสาหกรรมปิโตรเลียม เป็นต้น การเสริมสร้างความโปร่งใสดังกล่าวควรดำเนินไปอย่างเป็นระบบและมีมาตรฐาน ในปัจจุบัน มาตรฐานความโปร่งใสในอุตสาหกรรมปิโตรเลียมที่สำคัญและเป็นที่ยอมรับในระดับนานาชาติได้แก่ โครงการเพื่อความโปร่งใสในการสกัดทรัพยากรธรรมชาติ (Extractive Industries Transparency Initiative หรือ EITI) รัฐที่เข้าเป็นสมาชิกของโครงการมีหน้าที่ ต้องปฏิบัติตามข้อบังคับของ EITI (EITI Requirement) ตามที่ระบุในมาตรฐานความโปร่งใส ในการสกัดทรัพยากรธรรมชาติ (EITI Standard) ข้อบังคับเหล่านี้ได้มีผลบังคับผูกพันในทางกฎหมายให้รัฐสมาชิกต้องปฏิบัติตามแต่ประการใด อย่างไรก็ตาม บทความนี้ได้วิเคราะห์ว่า ข้อบังคับของมาตรฐานความโปร่งใสในการสกัดทรัพยากรธรรมชาติดังกล่าวยังมีคุณสมบัติ ความเป็นกฎหมายอยู่แม้จะไม่ได้มีผลผูกพันในทางกฎหมายกับรัฐสมาชิก โดยมีสถานะเป็น กฎหมายหรือแบบแผนการปฏิบัติที่ไม่ได้มีผลผูกพันในทางกฎหมายอย่างเคร่งครัด หรือที่ เรียกว่า “soft law”<sup>1</sup> หัวใจสำคัญของข้อบังคับตามมาตรฐานความโปร่งใสในการสกัด ทรัพยากรธรรมชาติ (EITI Report) การติดตามดังกล่าวจะช่วยจัดสภาพคลุมเครื่อ ของการจัดการรายรับของรัฐจากอุตสาหกรรมปิโตรเลียม อันจะส่งผลให้ประชาชนซึ่งเป็น เจ้าของทรัพยากรที่แท้จริงได้รับรู้และเข้าใจถึงแนวทางการบริหารจัดการทรัพยากร ปิโตรเลียมโดยรัฐ หรือ กล่าวอีกนัยหนึ่งคือการสร้างความโปร่งใสให้กับประชาชน ในการปฏิรูปภาค ปิโตรเลียมตามแนวทางนี้ ปัจจัยสำคัญในการต่อสู้กับปัญหาความทุจริตนั้นมีใช้ตัวบท กฎหมายหรือการลงโทษผู้กระทำความผิดในทางอาญา หากแต่เป็นการมีส่วนร่วมของ ประชาชนในการตรวจสอบการทำงานของรัฐ อนึ่ง ความโปร่งใสจะสามารถลดปัญหาความ ทุจริตได้อย่างแท้จริงที่เมื่อประชาชนในรัฐสมาชิกสามารถเข้าใจและใช้ประโยชน์จาก รายงานความโปร่งใสในการสกัดทรัพยากรธรรมชาติที่ถูกตีพิมพ์ได้ นอกจากนี้ ประชาชนใน รัฐดังกล่าวยังจะต้องสามารถวิจารณ์และมีสิทธิเลือกผู้ปกครองประเทศได้หากพบการทุจริต

<sup>1</sup> Black's Law Dictionary (8<sup>th</sup> edition) ได้ให้ définition ของ soft law ในความหมายโดยรวมว่า “กฎหมายที่ไม่ได้มีผลผูกพันในทางกฎหมายโดยเคร่งครัด หรืออาจกล่าวได้ว่าไม่มีผลผูกพันในทางกฎหมาย เลย” ในบริบทของกฎหมายระหว่างประเทศนั้น soft law หมายถึง แนวปฏิบัติ คำประกาศว่าด้วย นโยบาย หรือประมวลแนวทางปฏิบัติที่ดี ซึ่งไม่ได้มีผลผูกพันในทางกฎหมาย

หรือไม่เพอใจกับผลงานในการบริหารทรัพยากรปิโตรเลียม มีฉะนั้นแล้วความโปร่งใสก็จะเป็นเพียงหลักฐานยืนยันปัญหาความทุจริตในภาคบิโตรเลียมโดยมิอาจลดปัญหาดังกล่าวได้

**คำสำคัญ:** ปัญหาความทุจริต ภาคบิโตรเลียม กฎหมายที่หรือแบบแผนที่ขาดผลผูกพันในทางกฎหมาย

**Keywords:** corruption, petroleum sector, soft law

## 1. Introduction

Exploitation of petroleum resources in one country could contribute to economic prosperity and well-being of the citizens of such country.<sup>2</sup> However, when corruption in the petroleum sector is exacerbated, petroleum exploitation and the wealth generated might not be transformed into country's benefits,<sup>3</sup> but may accrue mainly to a handful of corrupt state officials and private oil companies.<sup>4</sup> As a response to this problem, a petroleum-country should consider implementing a global standard to promote open and accountable management of natural resources called the Extractive Industries Transparency Initiative (hereinafter "EITI"). This article analyses that EITI Requirements as stipulated in the EITI Standard are correctly qualified as soft law. Moreover, it contends that regular publication of EITI reports directly tackle opacity of the petroleum sector and reduce the chances of corruption. The power of deterrence in this case is likely to come predominantly from the more informed citizens.<sup>5</sup>

This article begins by answering how legal framework of the petroleum industry contributes to flourishing of corruption. In turn, it discusses a principal-agent problem to explain why opacity is a driving reason behind

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<sup>2</sup>Gilles Carbonnier, "Introduction: the Global and Local Governance of Extractive Resources," *Global Governance* 2011, 17 (April-June 2011): 142.

<sup>3</sup>Nicholas Shaxson, "Oil, corruption and the resource curse," *International Affairs* 2007, 83 (October 2007): 1125; Charles McPherson and Stephen MacSearraigh, "Corruption in the Petroleum Sector," in *The Many Faces of Corruption: Tracking Vulnerabilities at the Sector Level*, edited by J. Edgardo Campos and Sanjay Pradhan, 1st ed. (Washington DC: The World Bank 2007), pp. 198-199.

<sup>4</sup>Michael L. Ross, *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations*, 1st ed. (New Jersey: Princeton University Press, 2012), pp. 59-62; Nico Schrijver, *Sovereignty over Natural Resources: Balancing Rights and Duties*, 1st ed. (New York: Cambridge University Press, 1997), p. 308.

<sup>5</sup>Paul Collier, "Laws and Codes for the Resource Curse," *Yale Human Rights & Development Law Journal* 2008, 11 (March 2008): 5.

corrupt practices in the petroleum sector. The second and third section explains objectives and functions of the EITI and how the EITI Report could be utilized by concerned citizens of an EITI-implementing country as a means to counteract corruption. The last section analyses legal nature of the EITI Requirements and addresses why the EITI and its soft law approach have been globally accepted as ways forward.

## 2. Legal framework of the petroleum industry and corruption

Legal framework of the petroleum industry can be disaggregated into four tiers.<sup>6</sup> The first tier typically comprises a country's constitution and legislation defining ownership of petroleum resources.<sup>7</sup> The second tier typically involves petroleum legislation concerning authorization and regulation of petroleum exploitation.<sup>8</sup> Moreover, this tier usually concerns how the state could maximize its revenues from petroleum exploitation.<sup>9</sup> The third tier comprises contractual authorization arrangements between the state and the investor such as petroleum concessions and production sharing contracts (PSCs).<sup>10</sup> The fourth tier concerns contractual relationship between

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<sup>6</sup> Evelyn Dietsche, "Sector Legal Frameworks and Resource Property Rights," in **Global Resources: Conflict and Cooperation**, edited by Wojciech Ostrowski and Roland Dannreuther, 1st ed. (Hampshire: Palgrave Macmillan, 2013), p. 161.

<sup>7</sup> For example, Section 23 paragraph 1 of the Thai Petroleum Act, B.E. 2514 (1971); Section 37(a) of the Constitution of Myanmar (2008); and Section 139 of the Constitution of Timor-Leste.

<sup>8</sup> Bernard Taverne, **Petroleum, Industry and Governments: An Introduction to Petroleum Regulation, Economics and Government Policies**, 1st ed. (London: Kluwer Law International 1999), p. 135.

<sup>9</sup> Carole Nakhle, **Petroleum Taxation Sharing the Oil Wealth: A Study of Petroleum Taxation Yesterday, Today and Tomorrow**, 1st ed. (Oxford: Routledge 2008), p. 36.

<sup>10</sup> Ernest E. Smith and other, **International Petroleum Transactions**, 3rd ed. (Colorado: Rocky Mountain Mineral Law Foundation, 2010), pp. 415-417.

the investors such as joint venture agreements between the consortium members comprising the resource developer.<sup>11</sup>

### 2.1 Corruption in the petroleum sector

In reality, legal framework of the petroleum industry brings both opportunities and challenges. As regards opportunities, it allows the state to effectively exploit petroleum resources through cooperation with foreign investors as well as maximize revenues from such exploitation. The World Bank suggested that wealth accruing to the state from petroleum exploitation, if prudently and sustainably managed by the state, could contribute to economic prosperity of the country.<sup>12</sup> As regards challenges, the state might fail transform petroleum wealth into sustainable benefits of the country and the people. In explaining this failure, some scholars argued that an oil-dependent state tends to less democratic and less accountable to its citizens.<sup>13</sup> Moreover, they highlighted that exacerbated corruption in the petroleum sector is one major concern of oil-producing countries.<sup>14</sup>

An orthodox definition of corruption is abuse or misuse of public power by state officials for private benefits.<sup>15</sup> This abuse of power involves not only state actors but private actors. Corruption can be the collaboration between public officials and private actors for private financial gains in

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<sup>11</sup> Scott C. Styles, “Joint Operating Agreements” in **Oil and Gas Law: Current Practice and Emerging Trends**, edited by Greg Gordon, John Paterson, and Emre Üşenmez, 2nd ed. (Dundee: Dundee University Press, 2011), p. 359.

<sup>12</sup> Naazeen H. Barma and others, **Rents to Riches: The Political Economy of Natural Resource-Led Development**, 1st ed. (Washington DC: The World Bank, 2012), p. 5.

<sup>13</sup> Michael L. Ross, “Will Oil Drown the Arab Spring: Democracy and the Resource Curse,” **Foreign Affairs** 2011, 2 (September/October 2011): 3.

<sup>14</sup> Peter Eigen, “A Coalition to Combat Corruption: TI, EITI, and Civil Society,” in **Corruption, Global Security, and World Order**, edited by Robert I. Rotberg 1st ed. (Massachusetts: Brookings Institution Press, 2009), p. 423.

<sup>15</sup> Ivar Kolstad and Arne Wiig, “Is Transparency the Key to Reducing Corruption on Resource-Rich Countries?,” **World Development** 2009, 37(3) (March 2009): 522.

contravention of the public's interest.<sup>16</sup> Different types of corruption include petty or incidental, small-scale embezzlement, misappropriation, bribes, favouritism, and discrimination.<sup>17</sup> Taking the nature and types of corruption into account, corruption associated with the extractive industries can be described as a situation whereby political elites and their families plunder resources for self-enrichment or where senior officials demand large kick-backs while they are brokering deals with private companies.

A question then arises as to when and how could these corrupt practices take place in the petroleum industry? One way to answer this question is to refer to key sequence of steps that a petroleum-producing country must undertake in transforming its petroleum resources in developmental riches. An early step of petroleum exploitation involves authorization of exploration and production activities through awarding of concessions or production sharing contracts (PSCs).<sup>18</sup> Apart from authorizing petroleum exploration and production, the state is responsible to regulate the authorized operational activities. As the owner of petroleum resources, the state has legitimate rights to collect, manage, and spend petroleum revenues through several types of tax and non-tax instruments.<sup>19</sup>

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<sup>16</sup> Hongying Wang and James N. Rosenau, "Transparency International and Corruption as an Issue of Global Governance," *Global Governance* 2001, 7(1) (January 2001): 26.

<sup>17</sup> Patricio Maldonado and Gerardo D. Berthin, "Transparency and Developing Legal Frameworks to Combat Corruption in Latin America," *Southwestern Journal of Law and Trade in the Americas* 2004, 10 (2004): 244.

<sup>18</sup> Jubilee Easo, "Licenses, concessions, production sharing agreements and service contracts," in *Oil and Gas: A Practical Handbook*, edited by Geoffrey Picton-Turbervill 1st ed. (London: Globe Business Publishing Ltd 2009), p. 27.

<sup>19</sup> Emil M. Sunley, Thomas Bausgaard and Dominique, "Revenue from the Oil and Gas Sector: Issues and Country Experience," in *Fiscal Policy Formulation and Implementation in Oil-Producing Countries*, edited by J.M. Davis, R. Ossowski and A. Fedelino 1st ed. (Washington D.C.: International Monetary Fund 2003), pp. 154-155.

Unfortunately, different types of corrupt practices can take place throughout the chain of petroleum exploitation and its wealth management as illustrated by Figure 1 below:

Figure 1: Corruption associated with the petroleum industry				
Natural resource potential				Sustainable development
	Sector organisation and contract awards	Regulation and monitoring of operations	Collection of oil and gas revenues	Revenues distribution and management
- Illegal benefits in exchange for state authorisation; and	- Favourably awarding a concession to a person	<ul style="list-style-type: none"> <li>- Embezzlement of petroleum revenues from state's coffer; and</li> <li>- Spending oil and gas revenues for officials' private gains</li> </ul>		
← Corruption →				

From the outset, oil companies may seek to influence the length of operation, environmental concerns, rate of exploitation, contractual obligations of all sorts, and report commitments.<sup>20</sup> For example, Elf offered bribes to gain concessions in several African countries; and Statoil paid bribes in Iran to get access to petroleum fields.<sup>21</sup> In addition, a petroleum concession

<sup>20</sup> Ivar Kolstad and Tina Søreide, "Corruption in natural resource management: Implications for policy makers," *Resources Policy* 2009, 34(4) (December 2009): 221.

<sup>21</sup> *Ibid.*

might be awarded to a company that pays bribe, regardless of its limited technical and financial capability. Furthermore, awarding of a concession that was influenced by a bribe might contain fiscal components that fail to maximize state's benefits.

As regards challenges associated with petroleum revenues, state officials who are responsible for collection and management could embezzle these revenues for their personal gains. This corrupt practice is academically referred to as "grand corruption". For example, an internal audit, conducted in 1979, revealed that US\$5 billion were missing from Nigerian National Petroleum Corporation accounts.<sup>22</sup>

Likewise, approximately 4 billion dollars of oil revenue went missing in Angola during 1997 and 2002.<sup>23</sup> It was believed that billions was put in a number of government officials' offshore accounts.<sup>24</sup> If these revenues had not been missing, they would have substantially contributed to providing of public services such as development of education and basic infrastructure of the country.

## 2.2 Explanation of corruption: an agency problem

Recent studies concerning negative impacts of petroleum exploitation and wealth are based on two main explanations: the structural

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<sup>22</sup>Uwem E. Ite, "Poverty Reduction in Resource-Rich Developing Countries: What have Multinational Corporations Got to Do with It?," *Journal of International Development* 2005, 17(7) (September 2005): 919.

<sup>23</sup>Human Rights Watch, *Transparency and Accountability in Angola: An Update* [Online], available URL: [http://www.hrw.org/sites/default/files/reports/angola0410\\_webcover\\_1.pdf](http://www.hrw.org/sites/default/files/reports/angola0410_webcover_1.pdf): Human Rights Watch, 2010 (April).

<sup>24</sup>Matthew Genasci and Sarah Pray, "Extracting Accountability: The Implications of the Resource Curse for CSR Theory and Practice," *Yale Human Rights and Development Journal* 2008, 11(1) (2008): 49.

and the agency-based explanation.<sup>25</sup> The former argues that a petroleum-producing country tends to be less democratic and less accountable to its citizens; whereas, the latter argues that a resource-producing tends suffer exacerbated corruption.<sup>26</sup> The agency-based explanation finds that state officials may fail to faithfully respond to the public interest, but their own private gains.<sup>27</sup> In the context petroleum industry, the citizens can be regarded as the principals; whereas state officials are the agent. State officials get more rewards through shares of petroleum either in cashes or in kinds or informally through bribe from the managers of extractive companies than from their citizens.<sup>28</sup> This problem tends to be exacerbated when the people are not well informed about the petroleum industry and its wealth management regime.

When the citizens and non-governmental organizations (hereinafter “NGOs”) are less informed, it is easier for state officials to act corruptly and ensure their private gain.<sup>29</sup> From the outset, petroleum bidding and concession negotiating that are done behind the close door are vulnerable to corruption and favouritism. When an awarding of a petroleum concession is not publicly announced and is not subject to the public scrutiny, it is easier for corrupt state officials to favourably or discriminately award to an oil company that lacks technical and financial capability instead of a capable

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<sup>25</sup>Paul Stevens and Evelyn Dietsche, “Resource curse: An analysis of causes, experiences and possible ways forwards,” *Energy Policy* 2007, 36(1) (November 2007): 57.

<sup>26</sup>Ibid.

<sup>27</sup>Kaare Strøm, “Delegation and accountability in parliamentary democracies,” *European Journal of Political Research* 2000, 37(3) (September 2003): 270; Michael Ross, “The Natural Resource Curse: How Wealth Can Make You Poor,” in *Natural Resources and Violent Conflicts: Options and Actions*, edited by Ian Bannon and Paul Collier, 1st ed. (Washington DC: The World Bank 2003), pp. 25-26.

<sup>28</sup>Dilan Ölcer, *Extracting the Maximum from the EITI* [Online], available URL: <http://www.oecd.org/dev/42342311.pdf> 32: OECD Development Centre, 2009 (February).

<sup>29</sup>Ibid.

one.<sup>30</sup> Knowing that actual terms of petroleum concession will not be subject to public scrutiny and criticism, corrupt state officials may choose to accept a bribe and, consequently, agree to terms that fail to protect the best interest of the country<sup>31</sup> for example, a fiscal clause that allows an investor to unreasonably earn its revenues.

In addition to awarding of petroleum authorisation contracts, Terry Lynn Karl and Michael Ross, two leading scholars, noted that secrecy is one driving reason behind corruption in the upstream industry. They noted that the government of a petroleum-producing country tends to keep the following information away from the public eye: the amount of resources available to be exploited; rate of exploitation, the funds that government actually receive, management and spending of these funds.<sup>32</sup> Without being provided with this information, the people who are the real owner of petroleum resources<sup>33</sup> are not capable of tracing and monitoring how their government exploited the resources on their behalf. In this non-transparent environment, it is easier for corrupt state officials to act corruptly such as embezzling petroleum revenues or spending petroleum revenues for their private gains.

Since opacity is identified as a driving reason behind corruption associated with the petroleum sector, it appears logical to promote transparency in the petroleum industry and its wealth management regime.

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<sup>30</sup> Peter Cramton, “How Best to Auction Oil Rights,” in **Escaping the Resource Curse**, edited by Macartan Humphreys, Jeffrey D. Sachs and Joseph E. Stiglitz, 1st ed. (New York: Columbia University Press, 2007), p. 117.

<sup>31</sup> Jenik Radon. “How to Negotiate an Oil Agreement” in **Escaping the Resource Curse**, edited by Macartan Humphreys, Jeffrey D. Sachs and Joseph E. Stiglitz, 1st ed. (New York: Columbia University Press, 2007), p. 97.

<sup>32</sup> Terry Lynn Karl. “Ensuring Fairness: The Case for a Transparent Fiscal Social Contract,” in **Escaping the Resource Curse**, edited by Macartan Humphreys, Jeffrey D. Sachs and Joseph E. Stiglitz, 1st ed. (New York: Columbia University Press, 2007), p. 266

<sup>33</sup> Leif Wenar, “Property Rights and the Resource Curse,” **Philosophy & Public Affairs** 2008, 36(1) (April 2008): 9.

As of the beginning of the twenty-first century, several quasi-legal and legal instruments have been promulgated and developed as a means to facilitate transparency in the petroleum sector including, global transparency standard, the individual right of access to state-held information, a special petroleum transparency statute, corporate and stock exchange laws.<sup>34</sup> This article restricts its scope of discussion and analysis only to an international transparency standard called the “EITI”.

### 3. The EITI and its requirements

If the government of a petroleum-producing country has decided to commit itself to the EITI, it will have to comply with a series of rules and requirements as stipulated in the EITI Standard. There are two groups of implementing countries: EITI Candidate and EITI Compliant countries.<sup>35</sup> EITI Candidate is a temporary state which is intended to lead to compliance with the EITI Standard. To become an EITI Candidate, an EITI-implementing country has to demonstrate that it has met four of the sign-up steps as stipulated in Requirement 1 of the EITI Standard. To achieve compliant status, an EITI Candidate country has to demonstrate through an external assessment process called “Validation” that it has met Requirement 1 to 7 of the EITI Standard.

#### 3.1 Becoming an EITI Candidate country

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<sup>34</sup> For scholarly comments please see for example: Open Society Institute, **Legal Remedies for the Resource Curse**, 1st ed. (New York: Open Society Institute, 2005); and James Van Alstine, “Transparency in Resource Governance: The Pitfalls and Potential of “New Oil” in Sub-Saharan Africa,” **Global Environmental Politics** 2014, 14(1) (February 2014): 34. For laws and regulations please see for example: Section 1504(q) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (United States).

<sup>35</sup> Sam Bartlett and Dyveke Rogan (eds), **The EITI Standard** [Online], available URL: [https://eiti.org/files/English\\_EITI\\_STANDARD.pdf](https://eiti.org/files/English_EITI_STANDARD.pdf): EITI, 2015 (January 1).

Requirement 1 of the EITI Standard requires an EITI-implementing country to complete 4 of sign-up steps. Firstly, it is required to issue an unequivocal public statement of its intention to implement the EITI for example, a public statement signed by the Minister of Mine<sup>36</sup> and a Presidential Decree<sup>37</sup>. Secondly, it has to appoint a senior leader or the “EITI champion” on such implementation. In most EITI-implementing countries, the EITI Champions are usually a member of a cabinet or a senior adviser in the office of the head of state.<sup>38</sup> Thirdly, a multi-stakeholder group (hereinafter “MSG”) must be established to oversee the implementation of the EITI.

The MSG must comprise appropriate stakeholders, including but not limited to: the private sector; civil society; and relevant government entities. This participative composition is meant to ensure that stakeholders outside of government are included in the EITI implementation. Fourthly, the MSG is responsible to formulate a work plan which identifies objectives of EITI implementation and sets out actions required to meet the identified objectives. Once the country has completed these sign-up steps, it shall submit an EITI Candidate Application to the EITI Board for its assessment. In the case the Board is satisfied with the application, it will admit the country as an EITI Candidate and establish deadlines for publishing the first EITI Report.

### 3.2 Becoming an EITI Compliant country

An EITI Candidate is required to produce and publish its EITI Report in accordance with the EITI Requirements. As displayed in Table 2, EITI report-making process involves three steps: data collection; data reconciliation; and publication of the report. For the data collection, the government is required

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<sup>36</sup> For example, the government of Ethiopia’s an unequivocal public statement of its intention to implement the EITI.

<sup>37</sup> For example, Presidential Decree 99/2012 (14 December 2012) (Myanmar).

<sup>38</sup> The World Bank, *Implementing the Extractive Industries Transparency Initiative: Applying Early Lessons From the Field*, 1st ed. (Washington DC: The World Bank 2008), p. 11.

to disclose the amount it received from oil and gas development to an independent administrator. On the other hand, the extractive companies are required to disclose the amount it paid to the government to the same independent administrator. As regards reconciliation, the independent administrator is responsible for reconciling the information it collected from the government and extractive companies. Lastly, the MSG is responsible to review and approve the EITI Report.

Table 0: EITI report-making process		
Steps	Activities	Oversighting by the MSG
<b>Data collection</b>	Extractive corporations disclose their payments and the government discloses receipts of revenues to an Independent administrator.	The MSG appoints an Independent administrator.
<b>Reconciling process</b>	An Independent administrator reconciles the payments.	- The MSG reviewing the draft EITI Report.
<b>Production of the report</b>	Including the information as required by the EITI Requirements.	- The MSG approves and publishes the final EITI Report.

The EITI Report produced in compliance with the current EITI Standard does not only display how much the government earned from the petroleum industry, but also other contextual information.<sup>39</sup> Contextual information include: description of the legal framework and fiscal regime; an overview of the extractive industries; the extractive industries' contribution to the

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<sup>39</sup> Peter Eigen, "International Corruption: Organized Civil Society for Better Global Governance," *Social Research* 2013 80(4) (Winter 2013): 1305.

economy; production data; state participation in the extractive industries; revenue allocations and the sustainability of revenues; license registers and license allocations; and any applicable provisions related to beneficial ownership and contracts. The aforesaid contextual information is included to ensure comprehensiveness and usability of the EITI Report by the general public.<sup>40</sup>

#### 4. Usage of the EITI Report

Regarding the EITI Requirements as discussed in the previous section, publication of an EITI – public availability of information on the revenue and the contextual information – is an important outcome of EITI implementation. However, it must be noted that availability of information is the ultimate goal of the EITI, but usage of such information by the public.<sup>41</sup> Publication of an EITI Report does not change how the legal regime governing the petroleum sector works; however, it directly addresses corruption by making the public more informed, thus combating asymmetry of information between the government and the people.

##### 4.1 Tackling a principal-agent problem through information

A more transparent concession awarding process could make it more difficult for state official to act corruptly. Regarding the dictum “*sunlight is the best disinfectant*”,<sup>42</sup> it is more difficult for government officials to corruptly conclude an agreement with oil companies when the agreement

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<sup>40</sup>Clare Short, “The Development of the Extractive Industries Transparency Initiative,” *Journal of World Energy Law and Business* 2014, 7(1) (January 2014): 10.

<sup>41</sup>Deval Desai and Michael Jarvis, “Governance and Accountability in Extractive Industries: Theory and Practice at the World Bank,” *Journal of Energy & Natural Resources Law* 2012, 30(2) (June 2012): 108.

<sup>42</sup>Louis D Brandies, *Other People’s Money and How the Bankers Use It* (New York: Frederick A Stoke Company, 1914), p. 92.

will be made publicly accessible.<sup>43</sup> A fiscal clause in a petroleum concession that extremely gives favour to the investor as a consequence of a bribe will be subject to the public scrutiny. Concerned citizens and non-governmental governmental organizations with information on fiscal components of petroleum concessions can debate and determine whether a nation is receiving a fair return as well as whether oil companies are plundering the oil resources of the country.<sup>44</sup>

Crucially, an EITI report could be used to expose financial discrepancies in the government's dealings with oil companies, thus exposing the serious systemic corruption often associated with the upstream industry.<sup>45</sup> Being provided with revenue information, the people and civil society groups can work toward a democratic debate over the effective use and allocation of oil and gas revenues and public finance in order to meet development objectives, improve public services, and redistribute income.<sup>46</sup> Where no convincing explanation to a discrepancy between receipts and payments can be found, the people would demand the government to explain. Moreover, this more transparent environment would make it more difficult for

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<sup>43</sup> Peter Rosenblum and Susan Maples, **Contracts Confidential: Ending Secret Deals in the Extractive Industries** (New York: Revenue Watch Institute, 2009), p. 17.

<sup>44</sup> David Johnston, "How to Evaluate the Fiscal Terms of Oil Contracts," in **Escaping the Resource Curse**, edited by Macartan Humphreys, Jeffrey D. Sachs and Joseph E. Stiglitz, 1st ed. (New York: Columbia University Press, 2007), p. 55.

<sup>45</sup> Christopher Gilbert Sheldon and others, **Innovative Approaches for Multi-Stakeholder Engagement in the Extractive Industries** (Washington DC: The World Bank, 2013), p. 26.

<sup>46</sup> Virginia Haufler, "Disclosure as Governance: The Extractive Industries Transparency Initiative and Resource Management in the Developing World," **Global Environmental Politics** 2010, 10(3) (August 2010): 59.

governmental officials to mismanage and take personal advantages from oil and gas revenues.<sup>47</sup>

Beyond criticizing the discrepancy, concerned citizens, interested Members of Parliament and non-governmental organisations could formally seek justification from the government for any action they find questionable. For example, NGOs in Myanmar<sup>48</sup> have started to ask why, at a time when their country is not engaged in a military conflict, the amount of oil revenues spent on military equipment exceeds that for education or basic development. Questions such as these will generate public debate about resource wealth management, based on reliable and comprehensive information. Informed public debate could serve as a tool to provide the people with knowledge of how their resource wealth is managed. What is more, it will allow the people to express their views on how they think their wealth should be managed.

Taking the above discussion into account, publication of an EITI Report should significantly contribute to a decline of corruption in an EITI-implementing country. However, is this expectation statistically proven? The EITI International acknowledged and attempted to answer this question by referring to the Corruption Perception Index (CPI)<sup>49</sup>. A simple hypothesis is that EITI-implementing countries should climb on the CPI. Referring to the 2014 CPI, the EITI International found that most of EITI countries have improved their scores compared to the 2013 CPI, especially Afghanistan, Côte d'Ivoire,

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<sup>47</sup> Alexandra Gillies, "Reputational Concerns and the Emergence of Oil Sector Transparency as an International Norm," *International Studies Quarterly* 2010, 54(1) (March 2010): 103.

<sup>48</sup> Myanmar was accepted as an EITI Candidate at the International EITI Board meeting on 2 July 2014.

<sup>49</sup> First launched by an international NGO called Transparency International in 1995, the CPI is a ranking of countries according to the extent to which corruption is believed to exist. It measures the perceived levels of public sector corruption in 175 countries and territories.

and Mali.<sup>50</sup> However, four countries including, the Central African Republic, Liberia, Tanzania, and Timor-Leste have received worse scores.<sup>51</sup>

While reading any statistic on corruption and transparency, one should keep in mind that there is neither single nor straightforward remedy to corruption associated with the petroleum sector. In addition to implementation of the EITI, there are a wide range of factors contributing to level of corruption in the petroleum industry of one country, such as poor rule of law, culture of corruption, and even democratisation.<sup>52</sup> Given this complexity, implementation of the EITI in one country might or might not contribute to a better rank in the CPI.

#### 4.2 Practical challenges of transparency

The previous section suggests that EITI implementation in one country inevitably involves participations of the public, the host government, and the operating oil companies. However, in reality, these stakeholders might not perform their roles as ideally expected by the EITI Standard. On the one hand, the public might lack awareness or understanding on the petroleum industry. On the other hand, the host government as well as the operating oil companies might perceive the EITI disclosures as a threat to security, sovereignty, and business confidentiality.

##### 4.2.1 Usage of the EITI Report by the public

Ability of the concerned citizens to comprehend and use the information is always a challenge of the EITI regime. In developing countries, it might be difficult to expect citizens living in a poor country where most people are suffering poverty to pay attention to complex oil revenue-related

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<sup>50</sup> Pablo Valverde, *The 2014 Corruption Perception Index. How have EITI countries fared?* [Online], available URL: <https://eiti.org/blog/2014-corruption-perception-index-how-have-eiti-countries-fared>: EITI, 2014 (December, 16).

<sup>51</sup> Ibid.

<sup>52</sup> Dawit Kiros Fantaye, “Fighting corruption and embezzlement in Third World countries,” *Journal of Criminal Law* 2004, 68(2) (April 2004): 170.

information and calling for better governance.<sup>53</sup> While collecting the Liberian's and Timorese's attitudes towards the EITI, O'Sullivan faced the question asking what is the relevance of the information provided by the EITI to citizens who are mostly living on or close to the poverty line and whose attention is restricted to only their daily needs?<sup>54</sup>

However, it must be noted that the users of the EITI Report are not restricted only to citizens, but also include members of the Parliament, the media, and members of NGOs. These actors tend to be more knowledgeable about and more familiar with the petroleum sector than laypersons. They can simplify highly-technical issue for example, how fiscal clauses in a petroleum concession work. Moreover, being provided with the revenue and the contextual information, they can initiate a campaign against wasteful spending of petroleum revenues by the government. These activities could facilitate public debates over the effective use and allocation of petroleum revenues as well as raise the public awareness of corruption associated with the petroleum sector.

Even if the concerned citizens and other actors are capable of comprehending the report and criticizing the government, corruption in the petroleum sector might not still effectively tackled if the government is not dependent of the people. Publication of the EITI Report would not deliver the desired outcome in conditions where an unpopular and corrupt government retains power because the people do not have the political capacity to replace it. For example, an EITI Report might bring to light the government's failure to spend on basic public services. The same report could reveal that large amounts of oil and gas revenues are missing from the state's accounts. In these conditions an EITI Report would simply inform powerless citizens that

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<sup>53</sup>Diarmid O' Sullivan, **What's the point of transparency** [Online], available URL: <http://www.publishwhatyoupay.org/resources/whats-point-transparency>: Publish What You Pay, 2013 (May, 21).

<sup>54</sup>Ibid.

their rulers are benefiting at their expense.<sup>55</sup> If the government does not get its mandate to rule from the people, it might have limited incentive to act for their benefit. This implies that practical impacts of EITI implementation in one country also rely on democratization.

#### 4.2.2 Disclosure as a threat to security, management, and business confidentiality

Disclosure of petroleum revenues accruing to the host government in conjunction with details of exploration and production projects could be perceived as a threat to security and management of petroleum wealth. The American Petroleum Institute (API) claimed that disclosure of payments at the project level could provide significant information to aid organisations seeking to cause economic harm and destabilise a government by targeting economically important projects.<sup>56</sup> Moreover, some governments could view the EITI disclosure as an intervention to its sovereign power to manage petroleum revenues. For example, officials from Equatorial Guinea say they can use oil money as they see fit.<sup>57</sup> Hence, the EITI disclosures would act as interference to this management by allowing the public or staffs of NGOs to criticise or even influence usage of petroleum revenues.

This article, however, finds the abovementioned claims unconvincing. Firstly, some oil companies such as, Tullow Oil Plc and Statoil

<sup>55</sup> Susan Rose-Ackerman, “The Challenge of Poor Governance and Corruption,” *DIREITO GV Law Review Especial 2005*, 1 (November 2005): 243.

<sup>56</sup> Kyle Isakower and Patrick T. Mulva, *Letter to SEC Re: Dodd-Frank Act – Section 1504: Disclosure of Payments by Resource Extraction Issuers* [Online], available URL: <https://www.sec.gov/comments/df-title-xv/specialized-disclosures/ specializeddisclosures-27.pdf>: U.S. Securities and Exchange Commission, 2010 (October, 12).

<sup>57</sup> Andreanna M. Truelove, “Oil, Diamonds, and Sunlight: Fostering Human Rights Through Transparency in Revenues From Natural Resources,” *Georgetown Journal of International Law* 2003-2004, 35 (December 2002): 149. United States Department of State, *United States G8 Partnership with Myanmar on Extractives* [Online], available URL: <http://www.state.gov/e/enr/rls/210632.htm?goMobile=0>: United States Department of State 2013 (June, 2013).

have asserted that disclosure of payment at the project level is not harmful. In 2013, Tullow Oil Plc voluntarily disclosed what it paid to the host governments at the project level.<sup>58</sup> Since the disclosure, there has been no evidence of any harm to security of the reported projects. Secondly, inference by the public especially, the concerned citizens are very justifiable. It is worth to stress that the state and its officials exploit and manage petroleum wealth on behalf and for sustainable benefits of the people. If this position is accepted, it will be irrational to prohibit the concerned citizens – the real owner of the resources – from expressing how they think that their petroleum resources and wealth shall be managed by their agents. In this regard, a claim to non-interference that is based on sovereign power of the state should be deemed unconvincing.

In addition, there is a legal challenge stemming from a potential clash between transparency promotion and confidentiality protection.<sup>59</sup> The government or an oil company could claim that disclosure and publication of information relating to petroleum exploration and production might detrimentally affect the viability of petroleum business.<sup>60</sup> As such, there emerges a task to strike a balance between the legitimate commercial concerns and the necessity to promote transparency.<sup>61</sup> To answer this controversial question, it is necessary to define the data and information that legitimately deserve confidentiality protection.

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<sup>58</sup> Tullow Oil PLC, *Creating Shared Prosperity through Transparency* [Online], available URL: [https://www.tullowoil.com/Media/docs/defaultsource/5\\_sustainability/tullow\\_2013\\_transparency\\_report.pdf?sfvrsn=4](https://www.tullowoil.com/Media/docs/defaultsource/5_sustainability/tullow_2013_transparency_report.pdf?sfvrsn=4): Tullow Oil PLC: Tullow Oil PLC, 2014 (March, 24).

<sup>59</sup> Bronwen Morgan and Karen Yeung, *An introduction to law and regulation: text and materials*, 1st ed. (New York: Cambridge University Press, 2007), p. 97.

<sup>60</sup> Joseph E. Stiglitz, *Making Globalization Work*, 1st ed. (The United States: Penguin Books, 2006), p. 152.

<sup>61</sup> Philip Swanson, Mai Oldgard and Leiv Lunde, "Who Gets the Money? Reporting Resource Revenues" in *Natural Resources and Violent Conflicts: Options and Actions*, edited by Ian Bannon and Paul Collier, 1st ed. (Washington DC: The World Bank 2003), p. 49.

In brief, confidential information in the petroleum industry is for example technological and innovative information relating to oil exploration and production.<sup>62</sup> Disclosure of the aforesaid information will cause substantial competitive harm to oil companies. Taking this finding into account, this article is of the view that the EITI disclosure does not infringe legitimate confidentiality protection. This is because the EITI Requirements do not require inclusion of any technological and innovative information relating to oil exploration and production. Even if there is a claim for protection of business confidentiality, Joseph E. Stiglitz interestingly opined that: “*The citizens' right to know should trump any claims to business confidentiality.*”

## 5. Legal nature of the EITI Requirements

As discussed in the previous section, the EITI and its requirements were formulated and have been developed by a private association under the Norwegian law. The EITI Requirements are therefore not enacted by a sovereign. Based on the voluntary approach, they lack legally-binding effect and do not call for promulgation of reporting laws and regulations. In addition, it must be noted that an EITI-implementing country can abandon the initiative without being held liable.<sup>63</sup> Taking this nature of the EITI Requirements into account, some lawyers – especially those strongly believing in black-and-white distinction of law and non-law – can reasonably argue that the EITI Requirements not qualified as “law”. These requirements

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<sup>62</sup> Martin Ewan, “Law and Technology in the Oilfield,” in **Oil and Gas Law: Current Practice and Emerging Trends**, edited by Greg Gordon, John Paterson, and Emre Üşenmez, 2nd ed., (Dundee: Dundee University Press, 2011), pp. 500-502.

<sup>63</sup> Bede Nwete, “Corporate Social Responsibility and Transparency in the Development of Energy and Mining Projects in Emerging Markets; Is Soft Law the Answer?,” **German Law Journal** 2007, 8(1) (January 2007): 327.

are too “soft”<sup>64</sup> and as such might not capable of legally influencing disclosure. However, this article argues that the EITI Requirements are qualified as “soft law” and practically workable.

### 5.1 The EITI Requirements as soft law

Hard law is always binding.<sup>65</sup> It normally has enforcement mechanisms and appropriate sanctions for abuse.<sup>66</sup> However, in the twenty-first century, legal studies have extended their scope to non-binding and unenforceable documents or instruments, commonly referred to as soft law.<sup>67</sup> Despite having no universally accepted definition,<sup>68</sup> soft law is usually referred to as any written international instrument, other than a treaty, containing principles, norms, standards, or other statements of expected behaviour.<sup>69</sup> Soft law promotes the norms that are believed to be good and which therefore should have general or universal application.<sup>70</sup> The term “law” in the context of “soft law” implies the fact that at issue must be rules of

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<sup>64</sup> Thomas N. Hale, “Transparency, Accountability, and Global governance,” *Global Governance* 2008, 14(1) (January-March 2008): 74.

<sup>65</sup> Alan Boyle, “Soft Law in International Law-Making,” in *International law edited by Malcolm D. Evans*, 3rd ed. (New York: Oxford University Press, 2010), 124.

<sup>66</sup> Adefolake Adeyeye, “Corporate responsibility in international law: which way to go?,” in *Singapore Year Book of International Law*, edited by C.L. Lim and Joel Lee, 1st ed. (Singapore: National University of Singapore, 2007), p. 148.

<sup>67</sup> Gregory C. Shaffer and Mark A. Pollack, “Hard vs. Soft Laws: Alternatives, Complements and Antagonists in International Governance,” *Minnesota Law Review* 2010, 94(1) (November 2010): 712.

<sup>68</sup> Cynthia Crawford Lichtenstein, “Hard Law v. Soft Law: Unnecessary Dichotomy?,” *The International Lawyer* 2001, 35(1) (Spring 2001): 1433.

<sup>69</sup> Dinah Shelton, “Soft law,” in *Routledge Handbook of International Law*, edited by David Armstrong, 1st ed. (Oxford: Routledge, 2011), p. 69.

<sup>70</sup> Anthony Aust, *Handbook of International Law*, 6<sup>st</sup> ed (New York: Cambridge University Press 2010), p. 11

conduct.<sup>71</sup> A rule of conduct that is qualified as soft law requires the state's consent to the norm.<sup>72</sup> Joseph Gold noted that the essential ingredient of soft law is "*an expectation that the states accepting these instruments will take their content seriously and will give them some measure of respect*"<sup>73</sup> This consent gives the soft law an authoritative basis.

Taking elements of soft law into account, this article is of the view that EITI Requirements as stipulated in the EITI Standard are correctly qualified as soft law as displayed in Table 3 below. They codify how and to what extent a country should publish information about its extractive industries and, therefore, act as a code of conduct for extractive industries transparency. Adoption and implementation of the EITI depends on the state's consent. Importantly, compliance with the EITI Requirements is fundamentally voluntary rather than mandatory.

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<sup>71</sup>Linda Senden, *Soft Law in European Community Law*, 1st ed. (Oregon: Hart Publishing, 2004), p. 112.

<sup>72</sup>Lili Jiang, "An Evaluation of Soft Law as Method for Regulating Public Procurement from a Trade Perspective," (PhD Thesis, University of Nottingham 2009), p. 10.

<sup>73</sup>Joseph Gold, "Strengthening the Soft International Law of Exchange Arrangements," *American Journal of International Law* 1983, 77(3) (July 1983): 443.

Table 3: EITI Requirements as soft law		
Legal quality of soft law		EITI Requirements
Being rules of conduct	Promoting or influencing norms that are believed to be good	Rules on extractive industries transparency to be adhered by countries implementing the EITI
	Types of soft law instruments	Recommendations that have considerable impacts in terms of international practice passed by NGO
State's consent	State's consent to respect the norms	Unequivocal state's intention to adopt and adherence to the EITI Requirements
	Lacking legally-binding effect	No legally-bind effects

## 5.2 Practical advantages of the soft law approach

Given the soft law nature of the EITI Requirements, implementation of the EITI and production of EITI Reports in one country are fundamentally based on the state's voluntary participation. In other words, promotion of transparency through the EITI approach relies heavily on state's willingness to be more transparent. Taking this reliance into account, it could be asked whether a soft law instrument like the EITI could actually attract petroleum-producing countries and extractive corporations to participation in the EITI and comply with the EITI requirements.

As regards state's participation and compliance, the EITI is practically workable approach because of its moral authority. It is reasonable

to argue that a sovereignty state is free to adopt or ignore soft law requirements of the EITI.<sup>74</sup> However, this sovereign power has been challenged by moral pressure or authority generated by the EITI.<sup>75</sup> In reality, states might face moral pressure urging the state to adopt the EITI. The said moral pressure is generated by, for example, unfavorable comparisons being drawn with compliant countries. After the launch of the EITI, there are now two groups of countries: those willing to comply with the EITI principles and requirements; and those ignoring them. There are therefore strong incentives for governments not to reveal themselves as being in the latter category. In addition to the moral authority *per se*, a petroleum-producing country might be urged by foreign country to adopt the EITI for example Myanmar.<sup>76</sup> As of October 2015, there are 48 of EITI-implementing countries.<sup>77</sup> There are 31 countries that are compliant with the EITI Requirements. There are 39 countries that have published revenues. These numbers prove that the EITI is capable of attracting states to join. Moreover, it proves that the EITI Requirements are practically adhered to, despite having no legally-binding effect.

As regards corporations' participation and compliance, the EITI Requirements could ultimately compel extractive corporations to make their report. Operating oil companies not only have to comply with the hard law, but also frequently with the host government's demands. Peter Eigen clearly pointed out that, at the international level, a government is free to choose to

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<sup>74</sup> Peter Eigen, "Fighting Corruption in a Global Economy: Transparency Initiatives in the Oil and Gas Industry," **Houston Journal of International Law** 2007, 29(2) (Winter 2007): 337.

<sup>75</sup> Gilles Carbonnier, Fritz Brugger and Jana Krause, "Global and Local Policy Responses to the Resource Trap," **Global Governance** 2011, 17(2) (April-June 2011): 251.

<sup>76</sup> United States Department of State, **United States G8 Partnership with Myanmar on Extractives** [Online], available URL: <http://www.state.gov/e/enr/rls/210632.htm?goMobile=0>: United States Department of State 2013 (June, 2013).

<sup>77</sup> EITI, **EITI Countries** [Online], available URL: <https://eiti.org/countries>: EITI, 2015 (October).

adopt the EITI or not. If it chooses to adopt the EITI, it will be required by the implementing process to disclose specified information. Apart from ensuring its own compliance, the government will also need to ensure that all companies active within its borders submit their data to the independent administrator/auditor of the scheme. Eigen, therefore, concluded that: “*if a country complies with the EITI Criteria it is not voluntary for a company to participate*”. Therefore, not only can the government demand secrecy, it can also demand transparency. In this regard, it is not a hard law that substantially dictates a transparency practice,<sup>78</sup> but the physical reality of petroleum resources.

## 6. Conclusion

Given functions of the EITI and legal quality of the EITI Requirements, this article is of the view that a soft law instrument is capable of promoting of transparency in the petroleum sector. The EITI Requirements, as a kind of soft law instruments, do neither rely on legally-binding effect nor coercive force to urge the government, but moral authority or pressure at the international level. At the national level, extractive corporations are likely to support the government’s decision to implement the EITI. ‘An outcome of EITI implementation – the EITI Report – is capable of directly tackling opacity of petroleum industry and its revenue management, which acts as one driving reason behind corruption in the petroleum sector. In this more transparency environment, it is more difficult for corrupt state officials and politicians to act opportunistically and corruptly. The court-inflicted penalties need not be severe because the power of deterrence in this case is likely to come predominantly from citizens.

However, it should be note that the EITI and its transparency regime are not a magical solution to corruption in the petroleum sector. In reality,

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<sup>78</sup>Terence Daintith, “The Techniques of Government,” *The Changing Constitution*, edited by Jeffrey Jowell and Dawn Oliver, 3rd ed. (Oxford: Clarendon Press 1994), p. 209.

successful implementation of the EITI also relies on other factors such as usage of the information by the public and dependency of the government on their citizens. On the one hand, public availability of the information – in the other words transparency – is not capable of combating or deterring corruption associated with the petroleum sector unless the information is utilized by the public. However, the term “public” in this context does not only include concerned citizens, but also members of the Parliament, NGOs, and the media. These actors could help simplifying the EITI Report and facilitating public debate over the effective use and allocation of petroleum revenues. On the other hand, if the government does not get its mandate to rule from the people, it might have limited incentive to act for their benefit. This implies that practical impacts of EITI implementation in one country also rely on democratization.

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