

Research Paper

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# Transparency in Transition

## Climate Change, Energy Transition and the EITI



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## Summary

Transparency has long underpinned efforts to improve the governance of oil, gas and mineral resources, and to avoid the negative impacts of the ‘resource curse’. The transition to a sustainable, decarbonized economy is now reshaping the extractive industries, and in turn the risks and opportunities they present for producer countries. This will have profound implications for what the good governance of extractive resources looks like, and for the kinds of data, disclosures and dialogues that will be required to support accountability. Transparency is also central to international efforts to support transition, including the reporting of emissions and the disclosure of climate risks. To date, however, there has been little consideration of how extractives transparency may be affected by these trends, or of the role it could play in supporting an orderly transition.

As the global standard for transparency in extractives, the Extractive Industries Transparency Initiative (EITI) will have to respond to this changing global context, and to the evolving needs of producer countries. Transition will present different risks and opportunities for producer countries, depending on the type and scale of their resources, their stage of production, and the extent of their economic, energy and industrial dependence on the sector. While EITI dialogues are framed in terms of sustainable development, their engagement with energy transition and climate change has so far been limited. With effective engagement, EITI could help ensure that implementing countries have full sight of the risks and opportunities in their national context, and access to the information required to navigate them. Without it, EITI risks becoming less effective as a governance standard, and less relevant to implementing countries and supporters.

EITI’s existing Requirements offer several entry points for engagement with transition. In many cases, better use could be made of existing disclosures, alongside publicly available information. The analysis of revenues and revenue forecasts, for instance, could help identify economic risks including lower-than-anticipated revenues, and stranded assets. The disclosure of state participation in the sector could help estimate the full scale of public finance ‘at risk’ under different transition scenarios. Contract analysis could help identify early signs of an increasingly competitive market driving a ‘race to the bottom’ between producer countries. In other cases, additional disclosures could support the use of EITI data to analyse the commercial viability of projects and the carbon intensity of exports, and the impact of subsidies and emissions on domestic energy transition.

EITI has potentially transformative reach, through its national secretariats and multi-stakeholder groups (MSGs). Spanning 53 implementing countries, with a combined population of almost 1.8 billion, EITI is well positioned to raise awareness around the risks and opportunities associated with transition, and to build the capacity of stakeholders in government, business and civil society to engage in informed debate on these issues. In this context, MSGs can play an important role in assessing whether policies and decisions relating to the extractive sector are aligned with wider sustainable development goals – including energy transition policies and Nationally Determined Contributions (NDCs) under the Paris Agreement – as well as highlighting where corruption and state support for the extractive sector may act as a barrier to transition and increase its costs.

Extractives transparency could also play a role in international efforts to manage an orderly and equitable transition. EITI could both leverage and contribute to international processes such as the Task Force on Climate-related Financial Disclosures (TCFD) and the Network for Greening the Financial System (NGFS), and the UN Framework Convention on Climate Change (UNFCCC). It could focus on addressing asymmetries of information between national and international stakeholders where discussions relating to energy transition and climate risks are concerned, by making international best practice accessible to producer countries, and considering the relevance of EITI disclosures for international processes. The development of partnerships in these areas could avoid overburdening EITI stakeholders, or duplicating efforts at national or international level.

Balancing the urgency of action with the importance of a stakeholder-led approach and broad consensus among EITI stakeholders will not be without challenges. There is already great uncertainty around the speed and shape of transition, and the COVID-19 crisis has exacerbated this. While a 'green recovery' could accelerate transition and the decline of global fossil fuel demand, the crisis has already pushed many EITI-implementing countries into severe economic distress. Their immediate economic needs may set back climate considerations and extend the life of fossil fuels and high-carbon infrastructures. While this paper focuses on the strategic direction of EITI and its implementing countries, its findings may also help inform debate as governments and their development partners seek to support a recovery in line with a 'well below 2°C' world.

### Recommendations

- **Make a high-level policy commitment to mainstreaming transparency on energy transition and climate risk through the next EITI Standard:** The EITI Board should make this commitment, recognizing both the economic and energy implications of transition. It should approach transition not as an additional agenda, but as a cross-cutting issue for good governance. This would provide a clear strategic direction for EITI's long-term policy response, and a mandate for immediate practical steps towards it.
- **Identify practical next steps for the use of EITI data and disclosures:** The EITI International Secretariat should work in partnership with national secretariats, MSGs and partners to: develop analysis of existing data and disclosures, including the comparative analysis of summary data; advance national analysis and reporting in priority areas through pilot studies and peer learning; and develop clear guidance notes and requirements for countries, in order to raise awareness and build capacity.
- **Enhance dialogue and coordination at national and international level:** EITI's national and international stakeholders should work towards: integrating transition within the mandate and membership of MSGs; sharing international best practice with producer countries, by developing links with the TCFD, NGFS and UNFCCC and building awareness and capacity to engage with them; and exploring EITI's contribution to international processes, through both data and dialogue with implementing countries and supporters.

# 1. Introduction

Well-governed extractive resources have the potential to contribute to sustainable economic development and long-term wealth generation in several ways. The extractive industries can help generate financial flows through revenues and other payments to government, provide inputs to the domestic economy (such as fossil fuels for power generation, and minerals for industrial development), and support the development of public and private sector capacity, from state-owned enterprises (SOEs) in the extractive industries, to local content. Realizing this potential has proven complicated, however, with many resource-rich countries experiencing the negative governance and economic impacts associated with the ‘resource curse’.<sup>1</sup> The ‘good governance’ agenda that emerged in response to these impacts through the late 1990s and early 2000s emphasized the need for transparency, on the basis that publicly available information and civil society engagement could enhance government accountability. This logic has underpinned a generation of advice and assistance to producer countries, and has been central to the establishment of transparency standards for extractive industries and supply chains, most notably the Extractive Industries Transparency Initiative (EITI) in 2003.

## Extractives in transition

The global transition to a sustainable, decarbonized economy is now reshaping the extractive industries, and, in turn, the risks and opportunities that producer countries face. For fossil fuel-producing countries, the transition to a ‘well below 2°C’ world<sup>2</sup> will have profound implications, with fossil fuels sharply declining as a share of the global energy mix.<sup>3</sup> Their oil and gas company partners are facing growing pressure to reduce their upstream emissions and make the transition to a ‘Paris-aligned’ business model. For minerals producers, the scaling of renewable energy (RE) and clean technologies is raising expectations of a surge in demand for commodities such as cobalt, lithium and copper, and of renewed investment in the mining sector. At the same time, there is growing scrutiny of the climate impact of mining and minerals supply chains, and many mining companies are now seeking to decarbonize their activities. The transition from linear supply chains to a circular economy, where metals are reused and recycled, will also affect mineral demand and investment over time.

Producer countries will face different risks and have different choices available to them, depending on the type and scale of their extractive resources, their stage of production, and the exposure of their economy, energy systems and industrial sectors to the extractive industries. Decarbonization is likely to exacerbate and/or change the nature of many well-known resource curse risks, with implications

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<sup>1</sup> For a review of these, see Lahn, G. and Stevens, P. (2017), *The curse of the one-size-fits-all fix: Re-evaluating what we know about extractives and economic development*, WIDER Working Paper 21/2017, Helsinki: UNU-WIDER, <https://www.wider.unu.edu/publication/curse-one-size-fits-all-fix> (accessed 11 May 2020).

<sup>2</sup> In line with the Paris Agreement, under which countries committed to ‘holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels’. See United Nations (2015), *Paris Agreement*, [https://unfccc.int/sites/default/files/english\\_paris\\_agreement.pdf](https://unfccc.int/sites/default/files/english_paris_agreement.pdf) (accessed 21 May 2020).

<sup>3</sup> Scenarios vary in their implications for fossil fuel use, depending on their level of climate ambition and their assumptions regarding carbon capture and storage (CCS) and negative emissions. The UN International Panel on Climate Change (IPCC)’s review of 1.5°C scenarios suggests an average absolute decline in coal use to 18 per cent of 2020 levels by 2050, oil to 34 per cent and natural gas to 57 per cent; see <https://www.ipcc.ch/sr15/> (accessed 10 Jun. 2020). (For comparison, in the early months of the COVID-19 crisis, global oil demand fell to around 70 per cent of its previous level.)

for thinking about what constitutes the ‘good governance’ of extractives resources. For example, where economic governance is concerned, uncertainty around future demand and prices for fossil fuels casts doubt on the concept of reserves as ‘high-value’ national assets, and on the reliability of the revenue forecasts that underpin macroeconomic policy. Where energy and industrial policy is concerned, the rapidly declining cost of RE and other clean technologies suggests that the ‘least cost’ route to universal access to energy may also be the cleanest. Where governments are active in the extractive industries, SOEs may reduce or increase a country’s exposure to transition risks, depending on their governance and incentives.

**Extractives transparency – and the civic space required to enable civil society engagement and public scrutiny – are prerequisites for an orderly national transition.**

Many producer countries are now asking how to maximize the potential of their extractive resources, while managing their risks.<sup>4</sup> Chatham House has delivered integrated climate, energy and economic capacity-building courses for officials from across government, including ministries of finance and national planning, energy and resources, and climate and environment. Many of these officials ask about the economic and energy implications of transition, and express concern about making long-term policy and planning decisions amid great uncertainty. They stress both the need for timely, reliable data to inform policy development and decision-making, and the potential for civil society engagement with climate change and energy transition to help create the political conditions for policies that address the economic risks associated with transition and support domestic energy transition. In this context, extractives transparency – and the civic space required to enable civil society engagement and public scrutiny – are prerequisites for an orderly national transition.

### Box 1: Definitions

This paper focuses on the good governance of *fossil fuels* (oil, gas, coal) and *minerals* (metals, minerals) and collectively, *extractives*, while acknowledging their very different exposure to climate and energy trends.

It refers to *energy transition* as one aspect of a wider *transition* to a sustainable, decarbonized economy by mid-century – in line with the long-term goals of the Paris Agreement – while acknowledging that the world is not currently on track to deliver this. It pays special attention to:

- The *economic implications* of transition, including the declining economic value of carbon-intensive assets and the risk of stranded assets or undeveloped resources (*transition risks* or *climate-related financial risks*) and the growth of investment in sustainable areas of the economy; and
- The *energy implications* of transition, including the opportunities presented by RE and clean technologies such as batteries, and the decarbonization of domestic energy use, including the use of RE and the reduction of emissions in the extractive industries (*energy transition*).

While not its primary focus, *physical climate impacts* – including rising sea levels and temperatures, and the increasing severity and occurrence of extreme weather events, droughts and wildfires – are acknowledged, given their impact on civil society and political debates, and the wider context for transparency and good governance.

<sup>4</sup>Based on Chatham House’s experience of working with fossil fuels- and minerals-producing countries on issues relating to climate risk and energy transition between 2014 and 2020, including research projects and capacity-building courses held in partnership with donors and multilateral development banks.

## Transparency in transition

There has been little dedicated research into the role that extractives transparency can play in supporting the transition to a decarbonized, sustainable economy. This paper aims to address that gap, and to explore how extractives transparency might help enhance the resilience of producer countries through transition, by providing data and supporting dialogues that can help government, business and civil society understand the risks and opportunities that transition presents in their national context, and hold decision-makers to account. It also considers the extent to which transparency can help address the structural barriers to transition that often emerge alongside the extractive industries (the so-called political economy). These include corruption, rent-seeking and the (often related) lock-in of carbon-intensive infrastructure and consumption patterns. In this context, the traditional focus of extractives transparency on anti-corruption may already contribute to transition, even if this contribution has not been articulated as such.

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Enhanced transparency and debate about the links between the extractive industries, energy transition and climate change will also be crucial to the extractive sector's continued social licence to operate. Transition will undoubtedly affect the industries' value proposition for host countries and communities over time, in terms of the income, energy and employment it can provide. Energy transition is one part of a wider structural shift, with digitization and automation reshaping industry and employment, and with growing inequality highlighting the need for inclusive, sustainable models of growth. Countries and communities that are dependent on fossil fuel production and carbon-intensive industries are typically among the most exposed and least resilient to these shifts. While physical climate risks are beyond the scope of this paper, the increasing frequency and severity of such climate impacts may also create feedback loops that influence civil society debates, and affect societal acceptance of the extractive industries.<sup>5</sup> The impacts of climate change may also complicate economic diversification, where this relies on highly exposed sectors like agriculture in which productivity may be compromised.

## The role of EITI

The extractives landscape has been transformed since 2003, when EITI was founded. With the 'resources boom' of the late 2000s, producer countries and the development assistance community broadly agreed that, with rising global resource demand and prices, 'extractives-led' growth could offer countries a transformative development opportunity.<sup>6</sup> The commodities price collapse of 2014 sent many of these countries into deep and unexpected economic shocks; and more recently, the impacts of the COVID-19 pandemic have sent commodities demand and prices plummeting. Depending on recovery, there is every chance of a much more disruptive decline in fossil fuel demand than anticipated. While demand for metals and minerals is likely to grow, the trajectory of this

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<sup>5</sup> As, for instance, is already happening in Australia in relation to the country's coal production, following the wildfires of early 2020.

<sup>6</sup> The extractives-led growth model is examined in Lahn, G. and Bradley, S. (2016), *Left Stranded? Extractives-Led Growth in a Carbon-Constrained World*, Research Paper, London: Royal Institute of International Affairs, <https://www.chathamhouse.org/publication/left-stranded-extractives-led-growth-carbon-constrained-world/2016-06-17-left-stranded-extractives-bradley-lahn-final.pdf> (accessed 11 May 2020).

growth remains dependent on technology choices and consumer trends, as well as on improvements in resource efficiency and the substitution of these resources by new technologies and materials.<sup>7</sup> Meanwhile, donors and multilateral development banks (MDBs), which provided extensive advice and assistance throughout this period, are now realigning their assistance with the Paris Agreement, and acknowledging the risks of supporting good governance of the extractive industries in isolation from wider climate and energy trends.

For EITI to remain effective and relevant as the central governance standard in the extractives sector, it will need to respond to this changing global context for extractives governance, and to the evolving needs of its implementing countries. These countries have disclosed over \$2.5 trillion in payments and revenues from the extractive industries over the past decade, a significant proportion of which was reinvested in the expansion of the extractive industries and the development of fossil fuel-based energy systems. Civil society groups have previously called upon EITI to acknowledge climate risks.<sup>8</sup> Several speakers at EITI's Global Conference in 2019 raised the issue of energy transition, and participants at a side event on the issue broadly agreed that EITI should explore its potential role in supporting an orderly transition.<sup>9</sup> The results of a recent EITI country consultation also suggest that most implementing countries support EITI involvement in discussions about energy transition, and see it as consistent with EITI's mission (see Appendix). Some implementing countries are already incorporating relevant issues in their EITI processes and reporting (see boxes 2, 3 and 4).

**While the direction of travel in public policy and in civil society debates is increasingly clear, EITI faces real challenges in balancing urgency of action with the need for consensus among its different constituencies.**

Still, there remain significant policy and practical questions. Some stakeholders cite the recent addition of beneficial ownership, gender and environment Requirements to the EITI Standard<sup>10</sup> as evidence of EITI's continual 'mission creep', and raise concerns that engagement with energy transition might further detract from EITI's core focus on transparency and anti-corruption, as well as duplicating other processes.<sup>11</sup> Many stakeholders cite practical concerns relating to the capacity of the EITI International Secretariat and of national secretariats and MSGs. There are also questions around the level of EITI's engagement, including whether Requirements relating to energy transition should be voluntary or mandatory.<sup>12</sup> While the direction of travel in public policy and in civil society debates is increasingly clear, EITI faces real challenges in balancing urgency of action with the need for consensus among its different constituencies, and their often competing perspectives and priorities.

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<sup>7</sup> Consumer concerns about the security of cobalt supply chains and their human impacts have spurred innovation in battery technologies, which have rapidly reduced the amount of cobalt required for batteries, and may eliminate the need for cobalt altogether in this context.

<sup>8</sup> Global Witness et al. (2015), *RE: Climate Change and the Extractive Industries Transparency Initiative*, Letter to the EITI Board and the EITI Secretariat, [https://www.globalwitness.org/documents/18123/eiti\\_letter.pdf](https://www.globalwitness.org/documents/18123/eiti_letter.pdf) (accessed 11 May 2020).

<sup>9</sup> From comments of business leaders, discussion at the side event.

<sup>10</sup> Since 2013, the EITI Standard has been updated at three-yearly intervals, the most recent instance being the 2019 Standard. See EITI (2019), *EITI Standard 2019*, Oslo: EITI International Secretariat, <https://eiti.org/document/eiti-standard-2019> (accessed 21 May 2020).

<sup>11</sup> Some supporting countries and companies expressed these concerns in discussions ahead of the EITI Global Conference and in the workshop held at Chatham House in January 2020.

<sup>12</sup> Some implementing countries raised concerns in EITI's strategy consultation (see Appendix) about Validation, if EITI keeps adding to the Standard.



### About this paper

This paper explores the economic and energy implications of the transition to a sustainable, decarbonized economy for EITI-implementing countries, and the potential policy and practical responses for EITI. It builds upon a series of discussions with EITI stakeholders and with climate risk and energy transition experts, including the EITI Global Conference side event *Extractives, climate action and energy transition – what role for transparency?* held in Paris in June 2019, the Chatham House workshop *Climate Change, Energy Transition and the EITI* held in London in January 2020, and a dedicated session at the EITI Board Strategy Retreat in Oslo in February 2020. The paper proceeds as follows:

- Chapter 2 explores how existing EITI data, disclosures and dialogues might help countries manage the economic risks associated with shifting demand and investment patterns and support their domestic energy transition, and where there may be a case for additional data and disclosures.
- Chapter 3 considers how EITI can contribute to improved national and international governance, including how the analysis and discussion of transition might help inform economic, energy and upstream policy, and enhance government accountability.
- Chapter 4 concludes with a series of policy and practical recommendations for the consideration of the EITI Board, EITI-implementing countries, and other relevant stakeholders.

While the EITI Board ultimately defines EITI's mandate, the importance of stakeholder-led EITI processes and reforms, and the considerable efforts that some MSGs have already made to put energy transition on the agenda, should be restated. The analysis and recommendations presented in this paper are intended to guide a wide range of EITI stakeholders – including the Board, the International Secretariat, national secretariats and MSGs, and their partners in government, business and civil society – as well as non-EITI stakeholders with an interest in energy transition and climate risk as they consider the implications of the transition to a sustainable, decarbonized economy for the good governance of the extractive industries. While the recommendations outline potential next steps for EITI as an organization, the subsections of chapters 2 and 3 may already provide a useful checklist of areas and questions for MSGs and other interested stakeholders to explore.

## 2. Data, Disclosure and Dialogue

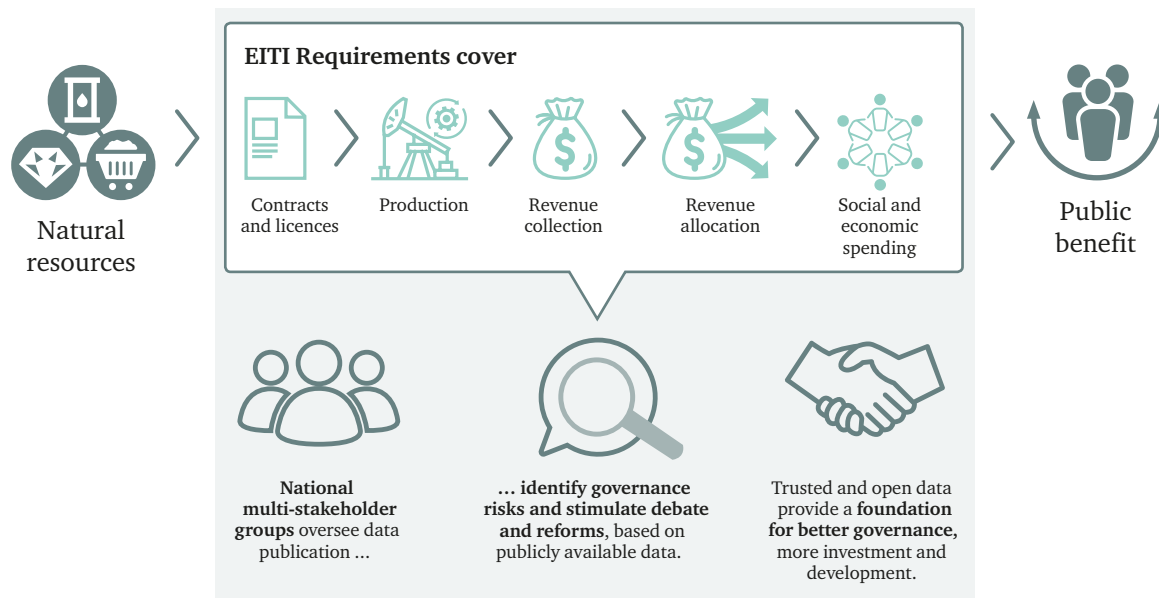
There are several entry points for the discussion of transition within the existing EITI Standard and its Requirements. This chapter explores first, where there may be ‘quick wins’ by asking new questions of the data and disclosures EITI already generates, such as those relating to revenues and contracts; and second, where there may be a case for EITI to encourage the consideration of additional data or disclosures. Some, like greenhouse gas emissions and carbon prices, may already be known and available elsewhere, and could usefully be linked to EITI data. Others, such as the cost of production, may be known but may not be widely or publicly available, and EITI could encourage or require their disclosure. This approach reflects the strategic and capacity concerns noted above, and is intended to encourage stakeholders to address transition as a cross-cutting issue, rather than an additional agenda.

[Some of the data and disclosures that EITI generates may already be relevant, when viewed through a transition lens.](#)

The public policies and financial flows that guide the extractives sector can all help shape the supply and demand of extractive resources. Accordingly, they have the potential to either support or undermine transition over time, depending on how they are designed and implemented. The scope of EITI’s Requirements for implementing countries are set out in Figure 1. Some of the data and disclosures that EITI generates may already be relevant, when viewed through a transition lens. For example:

- Contracts and licences – the distribution of risk and reward through the legal and fiscal terms of production, and the contracts between the state and operating companies;
- Exploration and production – the type and scale of extractive resources (i.e. the reserves to production ratio) and the stage of development (i.e. exploration and/or production);
- Revenue collection – payments and revenues to government, and the gross contribution of the extractive industry to national income, growth and the balance of trade;
- Revenue allocation – the distribution of revenues to spending and investment, including reinvestment in the extractive sector through SOEs; and
- Social and economic spending – social and environmental spending by extractive companies, the environmental impacts of production, and the net contribution of the extractive industry to the economy.

Figure 1: How the EITI works and how it achieves impact



Source: EITI Standard 2019.

Across the areas outlined above, EITI provides three levels of guidance for implementing countries. The distinction is important, as each implementing country undergoes a process of Validation every three years, where a country’s compliance with the EITI Standard and its Requirements is assessed.

There are mandatory areas that countries *must*, *should* or are *required* to report. These issues will be accounted for in country Validation and the EITI Board’s assessment of a country’s compliance. There are expected areas where countries are *expected* to or *should* consider, documenting their discussions and their rationale for disclosure/non-disclosure (including barriers to disclosure). These issues and their documentation are considered in Validation. Finally, there are optional areas – areas that countries are *recommended* to, are *encouraged* to, *may wish* to or *could* consider. These are documented in Validation, but do not form part of the assessment of country compliance.

In some cases, existing data and disclosures could support analysis and dialogue, if linked to contextual information and guidance. In other cases, such analysis and dialogue would require additional country or project information, which could require the ‘upgrading’ of an existing Requirement, or the expansion of the scope of the data and disclosures required by the 2019 EITI Standard. These areas of analysis and dialogue are summarized in Table 1, and introduced in turn below.

Table 1: Entry points for the discussion of transition within the 2019 EITI Standard

Issue	Relevant EITI Requirements	Questions for MSGs	Additional data needs
Revenue resilience	5.3 Revenue management and expenditures (part C)	<ul style="list-style-type: none"> <li>How do national price/demand assumptions compare to their international equivalents?</li> <li>How might revenues be affected under different transition scenarios?</li> <li>What are the implications for national spending/debt?</li> </ul>	
	6.3 Contribution of the extractive sector to the economy		
Project viability	4.1 Comprehensive disclosure of taxes and revenues	<ul style="list-style-type: none"> <li>What is the cost of production?</li> <li>How does this compare to other projects at home and abroad (in terms of position on the cost curve)?</li> </ul>	<b>Contextual information</b> <ul style="list-style-type: none"> <li>Mainstream climate and energy scenarios</li> <li>Viable cost of production under different scenarios</li> <li>Domestic energy mix and energy policy</li> <li>National climate policies including NDCs and 2050 plans</li> <li>Commitments to fossil fuel phase-out/Just Transition plans</li> </ul>
	5.3 Revenue management and expenditures		
Distribution of risk	2.1 Legal framework and fiscal regime	<ul style="list-style-type: none"> <li>Do legal and fiscal regimes account for transition risks?</li> <li>Do contracts contain 'risky' clauses?</li> <li>Is there evidence of the 'green paradox' in new contracts or amendments?</li> </ul>	
	2.4 Contracts		
Public finance at risk	2.6 State participation	<ul style="list-style-type: none"> <li>What is the total sum of public finance invested in the extractive industry (including assets and liabilities)?</li> <li>How much public finance is 'at risk' in a rapid transition scenario?</li> <li>Does SOE governance encourage energy transition and assess climate risk?</li> </ul>	
	4.5 Transactions related to SOEs		
	5.1 Distribution of extractive industry revenues		
	6.3 Contribution of the extractive sector to the economy		
Carbon pricing	6.1 Social and environmental expenditures by extractive companies	<ul style="list-style-type: none"> <li>Is there a carbon pricing regime?</li> <li>Are the carbon price assumptions of operating companies known?</li> <li>Do SOEs apply internal carbon pricing?</li> </ul>	
Emissions reporting	6.4 Environmental impact of extractive activities	<ul style="list-style-type: none"> <li>Are data on emissions at project level available?</li> <li>What is the emissions intensity of production?</li> <li>Are extractive sector emissions considered in NDC and 2050 plans?</li> </ul>	<b>Additional data and disclosures</b> <ul style="list-style-type: none"> <li>Cost of production</li> <li>Break-even/shut-in prices</li> <li>Carbon prices</li> <li>Greenhouse gas (GHG) emissions</li> <li>Carbon intensity</li> <li>'Unseen' subsidies including public health and environmental damages</li> </ul>
Subsidies	5. Revenue allocation	<ul style="list-style-type: none"> <li>How can state support to production and consumption be properly accounted for?</li> <li>Are 'unseen' subsidies accounted for?</li> <li>How does state support affect project viability?</li> <li>What is the net contribution of the extractive sector to the economy?</li> <li>How do subsidies affect the competitiveness of clean energy technologies?</li> <li>How could subsidy reform support NDC delivery?</li> </ul>	
	6.2 Quasi-fiscal expenditures		
	6.3 Contribution of the extractive sector to the economy		
	6.4 Environmental impact of extractive activities		
Fossil fuel phase-out	4.6 Subnational payments	<ul style="list-style-type: none"> <li>Is there a plan for the decline of the sector?</li> <li>How will subnational income be affected by transition?</li> <li>How will transition affect employment in the extractive industry and supply chains?</li> <li>Where might energy transition support green growth and jobs?</li> </ul>	
	5.2 Subnational transfers		
	6.2 Quasi-fiscal expenditures		
	6.3 Contribution of the extractive sector to the economy		

Source: Chatham House analysis of the 2019 EITI Standard, not exhaustive.

### Setting the context

The inclusion of contextual information can help set the scene for country discussions relating to climate change and energy transition. Many EITI stakeholders are considering the potential for energy scenarios to provide some wider context for national discussions about transition. Mainstream scenarios, such as those produced by the International Energy Agency (IEA) and the International Renewable Energy Agency (IRENA), for example, can help countries understand the likely evolution of supply and demand under different transition pathways, and test the resilience of their extractive sector plans under these assumptions. However, in a side event at EITI's Global Conference in 2019, many EITI stakeholders expressed their need for a better understanding of these scenarios, as well as of their implications for demand, prices and investment. Germany's experience may be helpful here. Its MSG commissioned a study on future demand for metals, and included a descriptive chapter on the share of RE in the domestic energy market in its EITI reporting (see Box 2).

#### Box 2: Germany's experience

Germany is one of the world's largest importers and consumers of mineral resources, and a significant producer of lignite (brown coal) for use in its domestic energy system. Energy transition is high on the political agenda, particularly where the scaling of renewables and the phase-out of coal-fired power generation is concerned. Germany has been an EITI implementing country since 2016, and its MSG has explored several issues relating to energy transition – particularly the relationship between RE and future demand for raw materials. This work has included the following:

- Aggregating data from public sources on national energy transition, including the share of RE in power generation and subsidies paid, and presenting this in an easy-to-access and easily understood online platform.
- Including a chapter on RE within Germany's domestic energy mix in EITI reports. The MSG also considered extending EITI reporting to fiscal flows relating to RE, but this proved challenging, given the decentralized nature and the multiplicity of actors in the RE sector, with over 10,000 actors compared with just 19 reporting under EITI in the extractive sector.
- Addressing the role of minerals in low-carbon technologies, including commissioning a review of the government's energy transition scenarios and their implications for mineral demand.
- German civil society proposed a reporting approach that compared the cost of different kinds of power generation, including subsidies, in a transparent way, but the market structure of the power sector presented a challenge. Lignite is mined and used by vertically integrated power companies, rather than being traded on the market. Moreover, where subsidies are concerned, there are often no financial flows to report, as subsidies are mostly tax exemptions, and environmental contributions are in kind.

There are concerns about the MSG's expertise and resources to cover the field of energy transition and climate change, and the best way to link EITI and energy transition. There are also overlaps with other governance processes such as the Commission on Growth, Structural Change and Employment, which holds discussions on issues relating to the phasing out of power generation from lignite and the related extraction of lignite. While acknowledging these challenges, the MSG remains interested in exploring new areas related to energy transition, and particularly in reporting on the process of phasing out coal, in legal and economic terms.

Based on: Country presentation at the expert workshop *Climate Change, Energy Transition and the EITI*, convened by Chatham House on 17 January 2020.

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Another option would be to expand EITI's focus from extractive resources to energy systems. Many EITI-implementing countries suggest that EITI could engage with domestic energy and power reforms (see Appendix). Some EITI supporters have also suggested that it may be more natural for EITI to expand to include fiscal flows relating to RE, rather than to include non-fiscal flows relating to extractives.<sup>13</sup> While the inclusion of contextual information on energy transition may add value to MSG dialogues, the inclusion of RE reporting presents challenges. Extractives tend to generate large, centralized financial flows, while RE markets are characterized by smaller, decentralized financial flows. This makes them very different to extractives in terms of both the 'rent' they offer elites<sup>14</sup> and the feasibility of project-level reporting, given the far greater number of actors and payments involved. Germany has explored this (see Box 2).

### Opportunities for new analysis

While the inclusion of contextual data may help set the scene for national discussions relating to energy transition, more granular country- and project-level analysis and reporting will be required to build a fuller picture of a national exposure to transition risks and preparedness for low-carbon opportunities. The following eight areas emerged from research and dialogue, and provide a starting point for engagement with transition.

**There is a strong case for producer countries to undertake scenario analysis and stress-test their economies under different transition pathways.**

### Revenue resilience

The impact of transition on resource revenues over time is perhaps the single most important question for producer countries. EITI already requires countries to further public understanding and debate, including around the sustainability of revenue collection and allocation. EITI Requirement 5.3 encourages countries to consider 'projected production, commodity prices and revenue forecasts arising from the extractive industries and the proportion of future fiscal revenues expected to come from the extractive sector'.<sup>15</sup> There is a strong case for producer countries to undertake scenario analysis and stress-test their economies under different transition pathways.<sup>16</sup> MSGs could help encourage this by exploring the demand and price assumptions that underpin national forecasts, and asking governments to explain how these assumptions compare to those that underpin more rapid transition scenarios. At a high level, such discussions could shine a light on the resilience of revenue forecasts under a range of transition scenarios. They could also call into question the sustainability of sector-linked debt, including infrastructure investment and resource-backed loans.

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<sup>13</sup> In discussion at the EITI Global Conference, June 2019.

<sup>14</sup> RE markets have limited cost differentials, with no producers' surplus and strong competition – i.e. no supernormal profits, so there is little or no 'rent'. This makes RE markets very different from extractives.

<sup>15</sup> EITI (2019), *EITI Standard 2019*.

<sup>16</sup> Bradley, S., Lahn, G. and Pye, S. (2018), *Carbon Risk and Resilience: How Energy Transition is Changing the Prospects for Developing Countries with Fossil Fuels*, Research Paper, London: Royal Institute of International Affairs, <https://www.chathamhouse.org/sites/default/files/publications/research/2018-07-12-carbon-risk-resilience-bradley-lahn-pye.pdf> (accessed 11 May 2020).

### Project viability

While top-down assessments can give some indication of the resilience (or vulnerability) of revenues, building a more comprehensive picture of national exposure to climate-related risks will require a granular, bottom-up assessment. With its focus on project-level reporting, EITI is well placed to support assessments of the commercial viability of existing and proposed projects. The vulnerability of any project to being stranded (or of any resource being left undeveloped) can be inferred from its position on a wider cost curve of production. Put simply, projects with a higher cost of production will be more vulnerable to stranding. There are two key metrics here: first, a project's break-even price (or shut-in price, if it is already online), and second, how this price compares to those of other projects along the cost curve. The think-tank Carbon Tracker has shown how all the major international oil companies (IOCs) sanctioned projects in 2018 that conflict with the long-term goal of the Paris Agreement and represent capital at risk in a 'well below 2°C' world, based on their cost of production.<sup>17</sup>

**EITI could help make the data that are required to assess project viability publicly available, or at a minimum, highlight barriers to doing this.**

IOCs and their investors have access to commercial data, including estimates of the price of production and sophisticated cost curves. Country stakeholders – including governments, civil society organizations and citizens – often struggle to obtain comparable information. This can lead to unrealistic expectations about both the commercial viability of projects and the potential for the domestic use of fossil fuel supply for power generation and in industry. Cost audits were raised as a 'missing item on the transparency agenda' by Oxfam America at EITI's 2019 Global Conference.<sup>18</sup> By expecting the disclosure of data on the cost of production, EITI could help make the data that are required to assess project viability publicly available, or at a minimum, highlight barriers to doing this. Barriers to this are likely to include the fact that the cost of production is not static,<sup>19</sup> and that these data may expose the share prices of IOCs to scrutiny.

Encouraging comparative analysis and peer learning between implementing countries could help build a wider discussion around project viability and the risks of stranded assets. EITI data and disclosures typically inform analysis and debate at a country level, and there is limited comparative analysis. The EITI International Secretariat could consider restructuring EITI summary data to support such analysis.

### Distribution of risk

The legal and fiscal regimes that guide the extractive industries and the contracts that define the terms of any given project all have a bearing on the cost of production and the commercial viability of a project. They also determine how the balance of risk and reward is distributed between the state and the private sector, and between a country and its international partners. Striking the right balance here is crucial to the perception of a 'fair share' of wealth from extractive resources, and to the sector's social licence to operate. Many of the assumptions underpinning these regimes and contracts,

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<sup>17</sup> Carbon Tracker (2019), *Breaking the Habit – Why none of the large oil companies are 'Paris-aligned', and what they need to do to get there*, Carbon Tracker, <https://carbontracker.org/reports/breaking-the-habit/> (accessed 11 May 2020).

<sup>18</sup> See the Oxfam America side event at the EITI Global Conference 2019, *Cost Auditing in the Petroleum Sector: A Missing Item on the Transparency Agenda?* Details available at: <https://eiti.org/conference/2019-paris/programme/partner-event-cost-auditing> (accessed 11 May 2020).

<sup>19</sup> For example, rapid declines in costs were seen in the post-2014 period.

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including the overall time frame for production, will be challenged by transition. There is also the risk of a ‘race to the bottom’ among fossil fuel producers if countries try to bring reserves to market rapidly before demand and prices decline (the so-called ‘green paradox’).<sup>20</sup> Similar pressures may be evident for prospective minerals producers too, as they compete with established producers for investment.

**Many of the assumptions underpinning these regimes and contracts, including the overall time frame for production, will be challenged by transition.**

EITI has a unique opportunity, with all implementing countries being required to disclose contracts and amendments in real time from 2021. First, EITI could encourage analysis of existing contracts for clauses that present transition risks. For example, where the overall share and timing of revenues to a country are concerned, these revenues may be compromised where the time frame for production is shorter than anticipated, and where country returns are scheduled after those of companies. ‘Take-or-pay’ clauses to supply production to the domestic market – where the host country must take supply or pay a penalty – may present substantial economic risk where this fossil fuel supply (and the infrastructure required to utilize it) becomes more expensive than clean alternatives. Second, EITI could explore whether the real-time disclosure of contracts – and amendments to them – could help provide early warning of material deviations to fiscal or contractual terms. The drivers of these deviations could then be explored, including whether a country’s approach is exhibiting signs of a ‘race to the bottom’, and how that might affect the relative risks and rewards from the sector.

### Public finance at risk

A considerable share of extractive revenues is channelled through SOEs and reinvested in the extractive industry. National oil companies (NOCs) can be particularly powerful actors, receiving and retaining large percentages of revenues, accumulating large assets and taking on large debts, with limited transparency or accountability. For example, data from the Natural Resource Governance Institute (NRGI) show that in 2015 the Nigerian National Petroleum Company (NNPC) retained revenues worth over five times as much as Nigeria’s annual healthcare budget. The Ghana National Petroleum Corporation (GNPC) has received around one-third of Ghana’s oil revenues to date. Colombia’s Ecopetrol and Indonesia’s Pertamina carry long-term liabilities worth 3.8 times and 1.8 times total annual oil and gas revenues to government, respectively. In total, NRGI defines at least 25 countries – including seven EITI-implementing countries – as ‘NOC-dependent’, meaning that the NOC collected more than 20 per cent of total government revenue.<sup>21</sup>

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<sup>20</sup> Consideration of the green paradox has focused on the choices of international companies, and the extent to which rising carbon taxes might affect these, and found little evidence of this to date. See Bauer, N., McGlade, C., Hilaire, J. and Ekins, P. (2018), ‘Divestment prevails over the green paradox when anticipating strong future climate policies’, *Nature Climate Change*, 8, pp. 130–4, doi: 10.1038/s41558-017-0053-1 (accessed 11 May 2020). There is relatively less research on how a tightening market might affect country choices regarding the pace of production.

<sup>21</sup> EITI countries include Mexico, Iraq, Nigeria, Colombia, Trinidad and Tobago, Kazakhstan and Norway. See Heller, P. and Mihalyi, D. (2019), *Massive and Misunderstood: Data-driven Insights into National Oil Companies*, New York: Natural Resource Governance Institute (NRGI), [https://resourcegovernance.org/sites/default/files/documents/massive\\_and\\_misunderstood\\_data\\_driven\\_insights\\_into\\_national\\_oil\\_companies.pdf](https://resourcegovernance.org/sites/default/files/documents/massive_and_misunderstood_data_driven_insights_into_national_oil_companies.pdf) (accessed 11 May 2020); for underlying data, see NRGI (2019), *National Oil Company Database*, December 2019, <https://www.nationaloilcompanydata.org/> (accessed 11 May 2020).



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Assessments of ‘capital at risk’ of stranding have helped shareholders to engage IOCs on their management of climate-related financial risks. There remains no comparable assessment of ‘public finance at risk’ ...

In recent years, assessments of ‘capital at risk’ of stranding have helped shareholders to engage IOCs on their management of climate-related financial risks.<sup>22</sup> There remains no comparable assessment of ‘public finance at risk’ or mechanisms for stakeholder engagement with NOCs. EITI would be well placed to explore this, with its existing Requirements for disclosures on the distribution of extractive industry revenues, state participation in the sector and transactions related to SOEs, including the publication of balance sheet information. Building on these data and encouraging MSGs to estimate the full scale of public finance at risk under different scenarios could help encourage SOEs to develop corporate climate governance, and governments to consider the risks associated with reinvesting in the sector. This could fill an important gap in awareness and accountability at national level, as well as contributing to a more comprehensive assessment of systemic risk at international level.<sup>23</sup>

### Carbon pricing

Carbon price assumptions are another key variable where the commercial viability of projects is concerned. EITI already requires disclosure of the fiscal regimes guiding the sector and encourages the disclosure of social and environmental expenditures. These could include carbon price regimes and tax payments, although only nine EITI countries currently implement carbon price regimes.<sup>24</sup> By contrast, most companies and many MDBs apply internal carbon pricing in their economic analysis and decision-making, and some disclose their carbon price assumptions through their annual reports and mechanisms such as CDP.<sup>25</sup> For national decision-makers, the disclosure of carbon prices used by investors – and scrutiny of them in comparison to those used by others – may help support sound decision-making in the sector, and provide an indication of the relative preparedness of operating partners. Such disclosures may also help encourage the development of domestic carbon price regimes and national carbon accounting capacities within the sector, especially in SOEs, and in linked power and industry.

### Emissions reporting

There is growing international scrutiny of the emissions associated with the production of extractive resources. The oil and gas sector is under increasing pressure to address its upstream emissions, especially flaring and fugitive non-CO<sub>2</sub> emissions like methane (due to leakage and venting).<sup>26</sup> The mining sector must also decarbonize if its contribution to transition is to be sustainable, and progress is now being made on the electrification and the integration of RE in mining activities.<sup>27</sup> While many companies disclose greenhouse gas emissions through their annual reports or mechanisms

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<sup>22</sup> Carbon Tracker estimates that between 2018 and 2019 some \$50 billion of capital expenditure was committed to projects that are not compatible with the Paris Agreement. See Carbon Tracker (2019), *Breaking the Habit*.

<sup>23</sup> See Chapter 3: Managing the economic impacts of transition.

<sup>24</sup> According to the World Bank, as of June 2019 Argentina, Colombia, Germany, Kazakhstan, Mexico, the Netherlands, Norway, Ukraine and the UK had carbon pricing regimes (tax and/or ETS) implemented or scheduled for implementation, and Senegal and Côte d'Ivoire were considering them. World Bank (2019), *State and Trends of Carbon Pricing 2019*, World Bank: Washington, DC, June, doi: 10.1596/978-1-4648-1435-8 (accessed 11 May 2020).

<sup>25</sup> See CDP (formerly Carbon Disclosure Project), <https://www.cdp.net/en> (accessed 11 May 2020).

<sup>26</sup> See for example the Climate and Clean Air Coalition (CCAC), (2019), The Global Methane Alliance, UNEP CCAC, <https://www.ccacoalition.org/en/activity/global-alliance-significantly-reduce-methane-emissions-oil-and-gas-sector-2030> (accessed 1 Jun. 2020).

<sup>27</sup> For progress on the integration of RE, see Maennling, N. and Toledano, P. (2018), *The Renewable Power of the Mine – Accelerating Renewable Energy Integration*, New York: Columbia Centre on Sustainable Investment (CCSI), <http://ccsi.columbia.edu/files/2018/12/3418-CCSI-RE-and-mining-report-09-lr-reduced-optimized-07-no-links.pdf> (accessed 28 May 2020).

such as CDP, few disclose these data at national or project level (whereas EITI disclosures are made at the project level).

For many producer countries, the extractive sector will be among the largest sources of national emissions. Building national emissions-reporting capacity is important, as the Paris Agreement comes into effect. Countries such as Trinidad and Tobago are already exploring how they might integrate emissions into their EITI reporting (see Box 3), and others have also voiced their interest.<sup>28</sup>

Efforts to address upstream emissions may also generate financial flows, which would benefit from transparency. Governments have a range of fiscal tools available to them, including disincentives such as carbon taxes or environmental penalties, and incentives such as the desire to recoup revenues (which would otherwise be lost where there is methane leakage, for example) and to access carbon markets (where upstream emissions reductions are packaged into carbon offsets, and traded in return for carbon finance). Carbon finance often flows directly to NOCs, and would benefit from scrutiny.<sup>29</sup>

### Box 3: Trinidad and Tobago's experience

Trinidad and Tobago (T&T) is a resource-rich small island state and one of the world's largest exporters of liquefied natural gas (LNG). It has a long history of large-scale oil and gas production, and small-scale mining, and joined EITI in 2011. Despite being a vulnerable island state with urgent climate adaptation needs, political and societal awareness of the implications of climate change and energy transition remain low. A 2016 survey found that less than 5 per cent of the population and less than 3 per cent of industry (including the extractive industry) saw climate change as a major challenge facing the country. At the same time, successive governments have been unwilling to take the perceived political risk of reducing energy subsidies.

TTEITI has been successful in improving the availability of data around the extractive industries and in being a credible, independent voice. TTEITI believes it has an important role to play in developing public awareness around climate change and energy transition, and the MSG has begun reassessing the elements of 'good governance', including beneficial ownership and contract transparency. TTEITI is making progress in encouraging civil society to look beyond financial reporting, and towards the wider environmental and social impacts of the extractive industries. It has been an active advocate of environmental reporting within EITI, including CO<sub>2</sub> emissions, and notes the incorporation of environmental reporting in the 2019 EITI Standard as a milestone in this regard.

TTEITI has established an environmental subcommittee with the responsibility of furthering a work programme on environmental reporting, although CO<sub>2</sub> emissions are not part of EITI's environmental reporting requirements. While there are no statutory systems for emissions monitoring in T&T, a pilot programme has been implemented by the Ministry of Planning and Development for the monitoring and verification of emissions. TTEITI has now developed a voluntary template for reporting resource impacts – including electricity, water usage, CO<sub>2</sub> and methane – as well as statutory requirements related to air and water pollution. The subcommittee's long-term aim is to move towards the incorporation of environmental and climate impacts in the sector, including a natural capital approach,<sup>30</sup> in conjunction with the Central Bank of Trinidad and Tobago and other agencies, in order to support a broader approach towards the good governance of natural resources.

Based on: National MSG presentations at the expert workshop *Climate Change, Energy Transition and the EITI*, convened by Chatham House on 17 January 2020.

<sup>28</sup> Discussions at the EITI Board Strategy Retreat.

<sup>29</sup> There are much wider questions about the transparency of voluntary offset markets, which are likely to be beyond EITI's mandate. However, where offsets from upstream mitigation are concerned, EITI could shed light on financial flows between international carbon investors and NOCs.

<sup>30</sup> See 'Subsidies' below.

There may also be value in disclosing the carbon intensity of production. Carbon intensity may provide an indication of a supply chain's climate-resilience and competitiveness over time, and it varies considerably between countries.<sup>31</sup> For minerals producers, the primary concern will be the CO<sub>2</sub> emissions associated with extraction, processing and transport, and the availability of options to reduce the emissions associated with these processes and ultimately decarbonize them. For fossil fuel producers, upstream emissions mitigation may significantly improve carbon intensity, but the embedded CO<sub>2</sub> in the fuel that is produced and ultimately burned will be the primary driver of carbon intensity.<sup>32</sup> Investors and consumers of both minerals and fossil fuels are increasingly looking to carbon intensity as a comparative measure between producer countries and companies. As a metric, carbon intensity will almost certainly increase in prominence as the EU and others consider the introduction of carbon border adjustment mechanisms. Carbon intensity may also add to the overall cost of production if it is considered alongside carbon pricing and internalized, and may bring a project's commercial viability into question. National governments should have a strong interest in data and analysis on the carbon intensity of their production, as it may enable them to reduce the carbon intensity (and enhance the competitiveness) of their exports and their domestic energy sector, as well as informing their discussions with the EU and other trading blocs.

### Subsidies

The allocation of resource revenues to spending (through the national budget) and to savings and investments (through sovereign wealth or strategic development funds) may help support sustainable, low-carbon areas of the economy and 'crowd in' international climate finance. However, the presence of production and consumption subsidies acts as a barrier to sustainable investment. Fossil fuel subsidies effectively raise the cost of bringing energy efficiency and RE to the market, as such technologies must be subsidized to compete with fossil fuels, even where they are at price parity (or even 'subsidized twice', where they are not).

Fossil fuel subsidies also obscure the real contribution of the extractive industries to the economy. EITI already encourages countries to disclose quasi-fiscal expenditures and to consider the net contribution of the extractive industry to the national economy, and the consideration of subsidies may materially change this picture (see Box 4).

**The quantification and disclosure of 'unseen' subsidies to the sector could support a more comprehensive assessment of the sector's net contribution to economic development, and of the trade-offs associated with developing and producing extractive resources.**

There are various ways to quantify subsidies, further explored in the next chapter. While some focus purely on the economic costs, others include 'externalities' such as the cost of environmental and public health damages. EITI already encourages MSGs to report on the social and environmental impacts of extractive activities. The quantification and disclosure of 'unseen'

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<sup>31</sup>For an example of the range for crude oil, see Masnadi, M. S. et al. (2018), 'Global carbon intensity of crude oil production', *Science*, 361(6405), pp. 851–3, doi: 10.1126/science.aar6859 (accessed 11 May 2020).

<sup>32</sup>For exporters, these would be considered Scope 3 or exported emissions, as they are burnt elsewhere. For countries with domestic consumption, the carbon intensity of reserves will be a factor in domestic energy transition and emissions mitigation. The only way to address emissions in combustion will be through abatement with carbon capture and storage (CCS) or other negative emissions technologies. It is worth noting that CCS is not currently materializing at the speed or scale expected by many mainstream energy scenarios.

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subsidies to the sector could support a more comprehensive assessment of the sector's net contribution to economic development, and of the trade-offs associated with developing and producing extractive resources. Disclosures on social and environmental expenditures, considered alongside those on social and environmental impacts, could support estimates of the social cost of carbon and encourage natural capital accounting approaches.<sup>33</sup>

### Fossil fuel phase-out

A growing number of countries have now made commitments to phase out coal, and commitments to phase out oil and gas may follow in time. As of June 2020, the national governments of 33 countries have committed to phasing out coal consumption, and some cases, linked domestic coal production.<sup>34</sup> Germany has committed to ending coal-fired power generation and to closing its coal mines by 2038 at the latest, at a cost of €40 billion. Several EITI-implementing countries face declining oil and gas production in the coming years, and there will be important discussions to be had around the subnational impacts of this transition. Whether the phase-out of fossil fuels is policy- or market-driven, support for a managed and equitable decline will be crucial. Indeed, the need for a 'just transition', which addresses the impacts of transition on fossil fuel dependent countries, regions and communities, is enshrined within the Paris Agreement.

Early consideration of the implications of transition – including how resilient revenues are likely to be throughout transition and how vulnerable assets are to stranding – may help governments anticipate the economic and social impacts of transition, and develop plans to support affected regions and communities. In this respect, the areas outlined above can all contribute to a government's ability to manage the inevitable decline of the sector. Ensuring that packages of support for fossil fuel-producing regions are transparent in their design and delivery will be crucial to society's support for transition at national and international levels. This support may include subsidies, compensation and other public financial flows which could, in theory, be considered within many of EITI's existing Requirements, including subnational payments, transfers and quasi-fiscal payments. Germany is exploring the potential for this (see Box 2). Data on the contribution made by the extractive sector to the economy, including employment, may also help inform planning for an orderly and equitable decline.

### Integrating transition within EITI's Requirements

Despite the opportunities outlined above, there remain practical questions about how the data and analysis introduced above might integrate with existing EITI Requirements. Some stakeholders note a tension between EITI's need for precision and its focus on historical data, and the inherent uncertainty and forward-looking nature of forecasts and scenarios.<sup>35</sup> These tensions will be familiar to those working on the disclosure of climate-related financial risks. However, there

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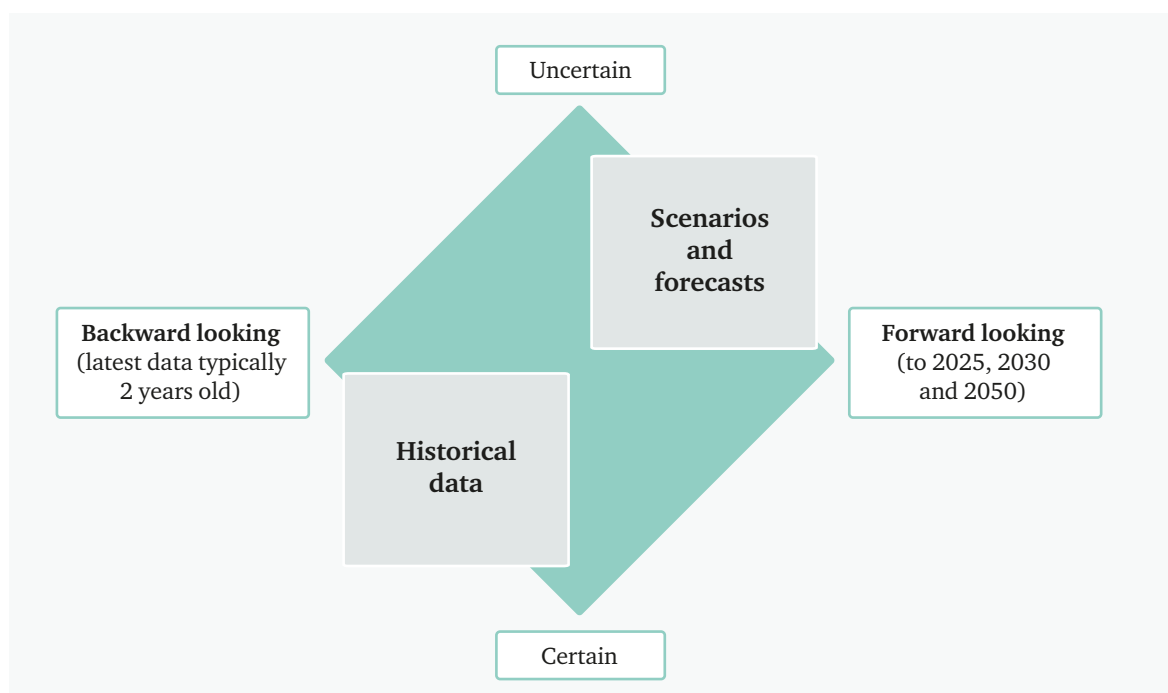
<sup>33</sup> Natural capital includes renewable and non-renewable resources (including air, water, land and biodiversity) and the ecosystem services that underpin them (such as air and water filtration, carbon storage, pollination and the provision of habitats for wildlife). Natural capital contributes to human wealth, health and security, but traditional measures of economic development such as GDP and GNI (gross national income) do not account for the contribution of natural capital to economic development, or indeed the impact of economic development on natural capital. Many countries are now developing natural capital approaches with the objective of incorporating these issues into national accounting and decision-making. See for example the World Bank-led WAVES partnership (Wealth Accounting and the Valuation of Ecosystem Services), which counts 11 EITI-implementing countries (Colombia, Germany, Guatemala, Indonesia, Madagascar, the Netherlands, Norway, Philippines, Uganda, the UK and Zambia) among its country and donor partners. See World Bank (2020), *Wealth Accounting and the Valuation of Ecosystem Services (WAVES)*, World Bank Global Program on Sustainability (GPS), [www.wavespartnership.org/en](http://www.wavespartnership.org/en) (accessed 21 May 2020).

<sup>34</sup> See the Powering Past Coal Alliance, <https://poweringpastcoal.org/news/PPCA-news/financial-institutions-leading-coal-to-clean-energy-transition>.

<sup>35</sup> This was discussed at the expert workshop *Climate Change, Energy Transition and the EITI*, convened by Chatham House on 17 January 2020.

is an important distinction to be made between forecasts, which represent a projection of current trends, and scenarios that are designed to ‘stress-test’ forecasts under a range of credible pathways and inform planning, policy and investment. As outlined above in Figure 2, below, EITI already encourages the disclosure of forward-looking data in several areas, including government forecasts for production and revenues.

**Figure 2: Types of data considered by EITI**



Based on EITI Standard, workshop and country discussions.

The consideration of forward-looking data and analysis – and of the assumptions that underpin it – appears well aligned with EITI’s mission and Requirements. As EITI’s founding principles state: ‘We recognise that a public understanding of government revenues and expenditure over time could help public debate and inform choice of appropriate and realistic options for sustainable development.’<sup>36</sup> In this context, the purpose of analysing EITI data through a transition lens, and considering additional disclosures where appropriate, is to shine a light on the assumptions that underpin decisions being taken today and to allow stakeholders to assess which data are driving those assumptions and whether these data are appropriate and up to date. The next chapter considers how these data, disclosures and dialogues can contribute to improved national and international governance.

<sup>36</sup> EITI Principle 4.

## 3. National and International Governance

For data, disclosures and dialogues to have impact, they must influence and improve governance. Spanning 53 producer countries with a population of almost 1.8 billion, EITI dialogues – facilitated by national secretariats and MSGs in each country – have unique reach. Effective EITI engagement with energy transition and climate change – and their implications for the good governance of extractive resources – could be transformative. This chapter sets out some of the ways in which EITI could contribute to improved governance at the national and international level, and help support an orderly and equitable transition. Given the strategic and capacity constraints to EITI's involvement in global discussions on energy transition and climate change, this chapter emphasizes the potential of partnerships, and the need to avoid the duplication of efforts at national or international level.

### National governance

By providing a forum for the exchange of well-informed discussion, EITI's national dialogues have the potential to raise awareness of the economic and energy implications of transition, and encourage a more integrated approach to extractives governance, ensuring that decisions taken in the sector are aligned with wider economic, energy and climate goals, and accountable to the public.

### Supporting policy alignment

While EITI is framed in the language of sustainable development, its engagement with the UN Sustainable Development Goals (SDGs) – particularly those relating to affordable and clean energy (SDG 7) and climate action (SDG 13) – has so far been limited. Energy transition and climate policy increasingly intersect with the sustainable development agenda, and shape the options available to developing countries. Donors and MDBs are now realigning their finance and policy assistance with the Paris Agreement, in many cases halting their support to fossil fuels while scaling up their support for climate finance. Energy transition is just one part of a wider transition to a decarbonized economy, but political and economic dependence on carbon-intensive sectors represents a real barrier to transition. Dependence on fossil fuels has until recently represented something of a 'blind spot', with initiatives such as the MDB joint framework for alignment with the Paris Agreement focusing largely on the facilitators of transition, rather than the barriers to it.<sup>37</sup>

The impact of extractive industry decisions on national energy transition and climate commitments warrants particular attention. All EITI-supporting and -implementing countries have submitted Nationally Determined Contributions (NDCs) to the UN Framework Convention on Climate Change (UNFCCC) under the Paris Agreement. These are designed to increase in ambition over time, and they will be accompanied by long-term emissions reduction plans to 2050. As noted above, extractive industries are often among the largest sources of energy demand – and of emissions – in developing countries. They can also lock in carbon-intensive infrastructures and consumption

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<sup>37</sup>The MDBs are now focusing on a just transition. See the *High Level MDB Statement* at the UN Secretary-General (UNSG) Climate Action Summit, 22 September 2019, <https://www.adb.org/sites/default/files/page/41117/climate-change-finance-joint-mdb-statement-2019-09-23.pdf> (accessed 11 May 2020).

patterns, which may constrain a country's ability to deliver its NDC commitments and increase its climate ambition over time. While many countries have included commitments to clean energy and afforestation in their NDCs, few have included commitments relating to the extractive industries. Nigeria is one of those that have, committing to ending gas flaring by 2030.<sup>38</sup> There is now increasing discussion about whether to include extractive sector commitments in NDCs, including among new producers. Uganda is considering including its oil and gas sector – which stands to increase its annual emissions by around 10 per cent – in its revised NDC.<sup>39</sup>

### Box 4: Indonesia's experience

Indonesia joined EITI in 2011; it is a major producer of fossil fuels and minerals, and the world's largest exporter of coal. Production of oil and gas is now declining, and the country is increasingly reliant on imports of fuel oil, the consumption of which is heavily subsidized. I-EITI notes several policy challenges relating to energy transition. Most of Indonesia's emissions emanate from its forestry and energy sectors. The country has made clear commitments to climate action (in terms of both mitigation and adaptation) under its NDC, and national policies, including the draft National Medium-Term Development Plan for 2020–24 and the national energy policy, aim to reduce domestic fossil fuel use. However, there are challenges relating to policy alignment, due to overlapping responsibilities between ministries and inconsistencies in technical implementation, given the highly decentralized nature of governance in Indonesia.

Given Indonesia's dependence on coal exports and fuel oil imports, the MSG is particularly concerned about the transparency of data on exports and imports, as well as information on revenues and costs. The MSG has a clear work plan exploring fiscal risk. It notes the net contribution of the extractive industries to the economy, which is effectively negated by state support to the sector, and the contribution of fuel oil imports to Indonesia's balance of payments, which are dependent on high levels of government subsidies. It highlights the potential for investment in extractives and energy infrastructure to present an 'economic trap', given the country's energy transition ambitions. It also cites broader civil society concerns about rent-seeking, from the political influence of major coal and power companies (the 'coal lobby'), to the market influence of oil importers (the 'oil cartel').

There are clear opportunities for I-EITI to help address these inconsistencies between Indonesia's extractive sector planning and its wider energy transition policy. The MSG is encouraged to use high-level advocacy for engagement with energy transition, exploring how to leverage EITI analysis in policy dialogues, and considering the scope of useful information and disclosures, including the appropriate level of disaggregation (upstream, energy, SOEs), the mechanism (template, system) and the type of data (production cost, price, project-level emissions, deforestation, etc.). Where dialogue is concerned, I-EITI is engaging with SOEs that play a primary role in the power sector and encouraging independent power providers to operate with transparency and to be accountable to the public. Looking ahead, it plans to define a clear role for the MSG in NDC processes and build its capacity in areas related to climate and energy transition, including the extractive industries.

Based on: National MSG presentations at the expert workshop *Climate Change, Energy Transition and the EITI*, convened by Chatham House on 17 January 2020.

<sup>38</sup> See Nigeria's first NDC. Government of Nigeria (2017), *Nigeria's Intended Nationally Determined Contribution*, UNFCCC NDC Portal, [https://www4.unfccc.int/sites/ndcstaging/PublishedDocuments/Nigeria%20First/Approved%20Nigeria's%20INDC\\_271115.pdf](https://www4.unfccc.int/sites/ndcstaging/PublishedDocuments/Nigeria%20First/Approved%20Nigeria's%20INDC_271115.pdf) (accessed 11 May 2020). Nigeria's NEITI has previously argued that penalties for gas flaring have not provided a sufficient deterrent, and has made a series of recommendations in its EITI reports to enforce gas flaring penalties. See NEITI (2015), *Final Report on 2015 NEITI Oil and Gas Industry Audit*, <https://eiti.org/files/documents/neiti-oil-gas-report-2015-full-report-281217.pdf> (accessed 11 May 2020).

<sup>39</sup> As discussed at the New Petroleum Producers Discussion Group (New Producers Group, or NPG) National Seminar, held in Kampala in November 2019. The NPG is a peer learning group convened by Chatham House, NRG and the Commonwealth Secretariat. See Chatham House (2020), *New Petroleum Producers Discussion Group*, <https://www.chathamhouse.org/about/structure/eer-department/new-petroleum-producers-discussion-group-project> (accessed 21 May 2020). Climate risk and energy transition training and discussions, led by Chatham House, featured in NPG Annual General Meetings and National Seminars in Kampala (2019), Accra (2018), Georgetown (2017), Nairobi (2016) and Dar es Salaam (2015).

EITI's national secretariats and MSGs are well placed to identify inconsistencies between decisions taken in the extractive industries and wider sustainable development goals, including domestic energy transition targets and international climate commitments. Indonesia, for example, has been exploring the impact of extractive sector plans on national energy transition ambitions (see Box 4). From the resilience of revenues, to the emissions associated with the extractive sector, the areas of analysis that were introduced in the previous chapter will present economy-wide challenges. With the right information, MSGs could play a key role in raising these issues on the national agenda, while continuing to play a central role in countering corruption and vested interests, which may act as a barrier to transition. Effective engagement here may also help address wider questions of economic justice, as well as those relating to a just transition away from fossil fuels and carbon-intensive industry over time. As a result, there is a clear case for EITI to encourage the development of a role for national secretariats and MSGs in SDG and NDC processes.

### Addressing barriers to transition

The political economy that emerges around the extractive industries and state support to fossil fuels can act as a barrier to transition. This reinforces the importance of EITI's core mission, enhancing transparency and addressing corruption. It also highlights the importance of transparency around fossil fuel subsidies and other forms of state support to the sector, including direct transfers, loan guarantees, preferential credit, tax exemptions and price support. These are typically opaque and hard to assess. The definition of a subsidy is also contested, with some countries arguing that the domestic cost of production and delivery should be the benchmark, rather than international market prices. The OECD and IEA follow the World Trade Organization (WTO) definition of subsidies as financial transfers from government – namely direct budgetary and tax support. They estimate total global subsidies to fossil fuels in 2018 at \$526 billion.<sup>40</sup> The definition used in IMF research is broader, and includes 'post-tax' subsidies, including environmental and physical externalities that impose public costs. The IMF's estimate (for 2017) stands at \$5.2 trillion.<sup>41</sup>

**EITI could play an important role in reporting data on subsidies across a wider range of countries, and particularly where tax exemptions and opaque forms of support to the sector are concerned.**

Beyond the opportunity costs and the tax revenue that is foregone, price support can create economic distortions. The sale of fuel to the domestic market untaxed, or below export prices, can disincentivize energy efficiency and widen inequality, as the rich use more energy than the poor and therefore benefit disproportionately. It also risks locking in rising fuel demand and locking out clean technologies and infrastructures.

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<sup>40</sup> Based on the International Institute for Sustainable Development (IISD) Global Subsidies Initiative (GSI) presentation to the Chatham House workshop. Data available at IEA (2020), *Energy subsidies – Tracking the impact of fossil-fuel subsidies*, <https://www.iea.org/topics/energy-subsidies> (accessed 21 May 2020).

<sup>41</sup> See the IMF explainer (2020), 'Energy Subsidies', <https://www.imf.org/en/Topics/Environment/energy-subsidies>, and a supporting study on post-tax subsidies: Coady, D. et al. (2019), *Global Fossil Fuel Subsidies Remain Large: An Update Based on Country-Level Estimates*, IMF Working Paper No. 2019/89, <https://www.elibrary.imf.org/view/IMF001/25712-9781484393178/25712-9781484393178/25712-9781484393178.xml> (both accessed 21 May 2020).



The reform of fossil fuel subsidies features in several areas of national governance, and it is a central pillar of SDG 12 on responsible production and consumption. Commitments to subsidy reform also feature in the NDCs of at least 20 countries, often at subnational level.<sup>42</sup> While subsidy reform can support SDG and NDC delivery, it comes with implications for affected workers and consumers, and thus raises the importance of a ‘just transition’ within countries, as well as between them.

Transparency around the real costs of subsidies and the implications of their removal is crucial, yet beyond the OECD and G20 countries, reporting remains limited. In its input to the G20 Energy Transitions Working Group, the IEA/OECD stated that ‘increasing transparency on the use of scarce public resources is one way to maintain the momentum for fossil-fuel subsidy reform’.<sup>43</sup> EITI could play an important role in reporting data on subsidies across a wider range of countries, and particularly where tax exemptions and opaque forms of support to the sector are concerned. It could also support wider conversations about the net contribution of the extractive sector to the economy over time. The disclosure of ‘unseen’ subsidies including public health and environmental damages may also support the development of natural capital accounting approaches within government, and encourage discussions about the changing value of natural resources over time.

### International governance

National engagement with international discussions can help ensure that international tools and approaches are shared with developing countries, and put into practice where they are needed most. Enhanced awareness of and coordination with international processes could help address the current asymmetry of information between developing countries and their international partners, where the management of the economic impacts of transition is concerned. It could also help support international efforts to deliver an orderly, equitable transition.

### Managing the economic impacts of transition

#### *Climate-related financial risk*

Just as EITI focuses on transparency and disclosure, so do emerging international efforts to manage the economic impacts of climate change and encourage the transition to a decarbonized economy.<sup>44</sup> There are two key mechanisms at work here: the Task Force on Climate-related Financial Disclosures (TCFD) and the Central Banks and Supervisors Network for Greening the Financial System (NGFS).

The TCFD was established in 2016 with the objective of developing a consistent voluntary disclosure mechanism at company level. It now has over 1,000 supporters, with a combined market capitalization of almost \$12 trillion.<sup>45</sup> A shift towards mandatory disclosures looks

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<sup>42</sup> Global Subsidies Initiative (2019), *Raising ambition through fossil fuel subsidy reform: Greenhouse gas emissions modelling results from 26 countries*. Geneva: Global Subsidies Initiative of the International Institute for Sustainable Development, <https://www.iisd.org/sites/default/files/publications/raising-ambition-through-fossil-fuel-subsidy-reform.pdf> (accessed 1 Jun. 2020).

<sup>43</sup> IEA/OECD (2019), *Update on recent progress in reform of inefficient fossil-fuel subsidies that encourage wasteful consumption*, Contribution by the International Energy Agency (IEA) and the Organisation for Economic Co-operation and Development (OECD) to the G20 Energy Transitions Working Group in consultation with: International Energy Forum (IEF), Organization of Petroleum Exporting Countries (OPEC) and the World Bank, 2nd Energy Transitions Working Group Meeting, Toyama, 18–19 April 2019, <https://www.oecd.org/fossil-fuels/publication/OECD-IEA-G20-Fossil-Fuel-Subsidies-Reform-Update-2019.pdf> (accessed 21 May 2020).

<sup>44</sup> ‘Increasing transparency makes markets more efficient, and economies more stable and resilient’ (Michael Bloomberg). See Task Force on Climate-related Financial Disclosures (undated), [www.fsb-tcf.org](http://www.fsb-tcf.org) (accessed 21 May 2020).

<sup>45</sup> TCFD (2020), ‘More than 1,000 Global Organizations Declare Support for the Task Force on Climate-related Financial Disclosures and its Recommendations’, Press Release, 12 February 2020, [https://www.fsb-tcf.org/wp-content/uploads/2020/02/PR-TCFD-1000-Supporters\\_FINAL.pdf](https://www.fsb-tcf.org/wp-content/uploads/2020/02/PR-TCFD-1000-Supporters_FINAL.pdf) (accessed 11 May 2020).

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increasingly likely. The UK's Green Finance Strategy, launched in mid-2019, suggests that all listed companies and major asset owners will have to make TCFD disclosures by 2022, and HM Treasury has established a taskforce to explore how this could be implemented.<sup>46</sup> At present, however, only 15 of 60 EITI-supporting companies are TCFD supporters. The EITI Board could also encourage EITI-supporting companies to support the TCFD and provide links to their disclosure of climate-related financial risks.

The NGFS was established in 2017 with the objective of sharing best practice among central banks and regulators, mainstreaming frameworks to manage climate risks, and supporting an orderly transition towards a sustainable economy. It now has 65 members (consisting of central banks and regulators) and 12 observers (including the major MDBs, the IMF and the OECD).<sup>47</sup> They are working towards the development of data-driven scenarios to help central banks and regulators assess climate risks.

**Emerging and developing economies with a dependence on extractives production and exports are among both the most exposed to the economic impacts of transition, and the least prepared.**

Both the TCFD and the NGFS highlight the need to work with emerging and developing economies to ensure that they too build the capacity to identify and manage climate-related financial risks. Emerging and developing economies with a dependence on extractives production and exports are among both the most exposed to the economic impacts of transition, and the least prepared.<sup>48</sup> Norway's Climate Risk Commission, for example, has stressed the need for full sight of climate-related financial risks and effective management of them, due to Norway's exposure to oil and gas.<sup>49</sup> Raising awareness of these approaches and tools within MSGs could help ensure that governments draw upon international experience and best practice in managing the economic impacts of transition. It could also help create a feedback loop, making these mechanisms relevant to developing economies as well as to emerging and advanced ones.

The TCFD and the NGFS also both highlight gaps in the type of granular, asset-level data that is required across jurisdictions to build an accurate assessment of climate-related financial risk. They are encouraging the relevant government authorities to make such data publicly available. With its focus on project-level data, EITI has the potential to contribute to this effort, with disclosures relating to the viability of projects and the resilience of the revenues they generate, and the full scale of SOE assets and public finance reinvested in the extractive sector, for example. In both cases, the MSGs of EITI-implementing countries that also participate in the NGFS – including Colombia, Germany, Indonesia, Mexico and the UK – would be well placed to explore the opportunities.

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<sup>46</sup> HM Government (2019), *Green Finance Strategy – Transforming Finance for a Greener Future*, July 2019, [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/820284/190716\\_BEIS\\_Green\\_Finance\\_Strategy\\_Accessible\\_Final.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820284/190716_BEIS_Green_Finance_Strategy_Accessible_Final.pdf) (accessed 21 May 2020).

<sup>47</sup> Central Banks and Supervisors Network for Greening the Financial System (NGFS) (2020), *Membership*, 16 April, <https://www.ngfs.net/en/about-us/membership> (accessed 11 May 2020).

<sup>48</sup> Countries in NORAD's Oil for Development programme participated in a scenario analysis exercise, drawing on TCFD/NGFS principles, as part of a climate risk and energy transition capacity-building course led by Chatham House and delivered in partnership with the UN Environment Programme and the Norwegian Environment Agency in Geneva.

<sup>49</sup> Norwegian Climate Risk Commission (2018), *Climate risk and the Norwegian economy*, Official Norwegian Reports NOU 2018: 17 Summary, <https://www.regjeringen.no/contentassets/c5119502a03145278c33b72d9060fbc9/en-gb/pdfs/nou201820180017000engpdfs.pdf> (accessed 11 May 2020).

### Macroeconomic stability

Extractives transparency may also help manage climate-related risks in the global financial system. The IMF has been exploring the role played by macroeconomic and financial policies in mitigating climate change.<sup>50</sup> It is also considering the implications of a rapid energy transition for oil and gas producers.<sup>51</sup> Most recently, questions around debt have returned to the fore, and are being exacerbated by the COVID-19 crisis. Many fossil fuel exporters are already facing severe economic distress, due to the collapse in oil demand and prices, and the rising healthcare and economic costs of the crisis. Like climate change, the impacts of COVID-19 – and the economic stimulus measures being developed in response to it – underscore the importance of timely and accurate data, scenario analysis and public debate around different pathways, including the long-term viability of high-carbon industries and the sustainability of sovereign debt.

Greater transparency around the links between the extractives industries and the wider economy – and the implications of different transition pathways for economic stability, energy systems and industrial development – could help support the integration of scenario analysis in Article IV Consultations and Financial System Stability Assessments, for example. It could also help incorporate transition risks – and national preparedness for them – into sovereign credit ratings and the price of sovereign bonds. EITI already works with the IMF to align accounting standards, and has previously explored the ways in which EITI data might help credit ratings agencies.<sup>52</sup> Disclosures on the resilience of resource revenues and the scale of public finance at risk in the extractive sector could contribute here.

### Accounting standards

Accounting standards boards are considering whether the value of assets, including extractive resources and associated infrastructure, may be prematurely written down due to climate commitments and energy and investment trends. The Australian Accounting Standards Board (AASB) and Auditing and Assurance Standards Board (AUASB) issued a note in 2019 stating that ‘qualitative external factors’ – including the sector in which a company operates, and investor expectations of the company – may present material risks that warrant disclosure in financial statements.<sup>53</sup> The International Accounting Standards Board (IASB) has advanced this argument, highlighting requirements in the International Financial Reporting Standards Foundation’s (IFRS) Standard that could help companies make judgments on the materiality of climate-related financial risks, ranging from impairments to assets, to changes in contingent liabilities.<sup>54</sup> In late 2019, the Spanish oil company Repsol became the first to issue an asset impairment, in line with its commitment to become a net-zero emissions company by 2050.<sup>55</sup>

<sup>50</sup> See for example Krogstrup, S. and Oman, W. (2019), *Macroeconomic and Financial Policies for Climate Change Mitigation: A Review of the Literature*, IMF Working Paper No. 19/185, <https://www.imf.org/en/Publications/WP/Issues/2019/09/04/Macroeconomic-and-Financial-Policies-for-Climate-Change-Mitigation-A-Review-of-the-Literature-48612> (accessed 11 May 2020).

<sup>51</sup> See for example Cherif, R., Hasanov, F. and Pande, A. (2017), *Riding the Energy Transition: Oil Beyond 2040*, IMF Working Paper No. 17/120, <https://www.imf.org/en/Publications/WP/Issues/2017/05/22/Riding-the-Energy-Transition-Oil-Beyond-2040-44932> (accessed 11 May 2020).

<sup>52</sup> EITI and the UN-supported PRI (Principles for Responsible Investment) explored the potential role of EITI disclosures in credit risk assessments in 2015–16, although the issue of climate change was not raised at that time. See EITI International Secretariat (2015), *Quantifying Intangibles – Using the Extractive Industries Transparency Initiative (EITI) in Credit Ratings Assessments*, EITI Brief, Oslo: EITI International Secretariat, [https://eiti.org/files/documents/20150825\\_eiti\\_brief\\_how-to-use-the-eiti-in-credit-rating-assessments.pdf](https://eiti.org/files/documents/20150825_eiti_brief_how-to-use-the-eiti-in-credit-rating-assessments.pdf); also Gordy, A. (2016), *Using the Extractive Industries Transparency Initiative to Enhance Credit Ratings Assessments*, UN PRI & EITI, <https://www.unpri.org/download?ac=202> (both accessed 21 May 2020).

<sup>53</sup> AASB and AUASB (2019), *Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB/IASB Practice Statement 2*, April 2019, [https://www.aasb.gov.au/admin/file/content102/c3/AASB\\_AUASBJointBulletin.pdf](https://www.aasb.gov.au/admin/file/content102/c3/AASB_AUASBJointBulletin.pdf) (accessed 21 May 2020).

<sup>54</sup> IASB (2019), *IFRS Standards and climate-related disclosures*, IFRS In Brief, November 2019, <https://cdn.ifrs.org/-/media/feature/news/2019/november/in-brief-climate-change-nick-anderson.pdf?la=en> (accessed 21 May 2020).

<sup>55</sup> Repsol wrote down its assets by €4.8 billion in 2019. See Repsol (2019), *Repsol will be a net zero emissions company by 2050*, <https://www.repsol.com/en/press-room/press-releases/2019/repsol-will-be-a-net-zero-emissions-company-by-2050.cshml> (accessed 11 May 2020).

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These shifts will almost inevitably affect public accounting standards in time. Where flows such as revenues are concerned, EITI has already worked to align its reporting requirements with the IMF's Government Finance Statistics. Where stocks, or natural assets, are concerned, there is less guidance. While EITI does not require the disclosure of reserves, many countries include them as contextual information in their reporting, and the scale and carbon intensity of these reserves will be of relevance where the assessment of climate risk is concerned. The International Public Sector Accounting Standards Board (IPSASB) is considering the reporting of natural resource revenues and assets under its Strategy and Work Plan for 2019–23.<sup>56</sup> Early coordination with international accounting standards boards and their evolving approaches could help ensure alignment and build country capacity.

### Supporting international climate action

#### *Emissions reporting*

The architecture of the Paris Agreement is based upon voluntary national commitments to emissions reductions within each signatory country's national borders. The integrity of the process is dependent on the transparent reporting of progress towards these commitments. Under the Paris Agreement's Enhanced Transparency Framework (ETF), developed countries will provide updates every two years, including providing greenhouse gas inventories and reporting their progress towards NDCs, which are subject to technical expert review and a multilateral peer review process. These updates support country assessments of progress, and alongside other inputs, contribute to a regular 'global stock take', where collective progress towards the long-term goal of the Paris Agreement is assessed. EITI engagement with emissions reporting could help develop national capacities and support the development of sector-specific commitments within NDCs, for example.

#### *Supply-side policy*

International climate negotiations have traditionally focused on the source of emissions – or the demand-side of fossil fuels. The discussion of supply-side policies with the objective of curbing fossil fuel supply is now beginning to emerge within UNFCCC processes. Proposed measures range from fiscal tools, such as production taxes, to regulatory measures including unilateral moratoriums and multilateral treaties on fossil fuel production.<sup>57</sup> Alongside demand-side initiatives like the Powering Past Coal Alliance (PPCA), they reflect the growth of national policies and international coordination designed to manage the decline of fossil fuel production. At subnational level, transparency around the progress towards these commitments – and the finance and assistance that will be required to deliver them in an equitable way – will be crucial to maintaining societal support for transition. At international level, addressing the question of equity – and particularly which countries should be the first to wind down fossil fuel production – will also be crucial. Transparent data on fossil fuel production could help assess progress towards supply-side commitments within UNFCCC processes, where countries make them. The authors of the *Production Gap* report recommend the reporting of emissions associated with extraction on a voluntary basis under the UNFCCC, following extractive-based accounting methods.<sup>58</sup>

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<sup>56</sup> See IPSASB's Strategy and Work Plan 2019–2023, <https://www.ifac.org/system/files/publications/files/IPSASB-Strategy-and-Work-Plan-2019-2023.pdf> (accessed 21 May 2020).

<sup>57</sup> See for example the Lofoten Declaration, <http://www.lofotendeclaration.org/>; and the Fossil Fuel Non-Proliferation Treaty, <https://www.fossilfueltreaty.org/> (both accessed 21 May 2020).

<sup>58</sup> SEI, IISD, ODI, Climate Analytics, CICERO and UNEP (2019), *The Production Gap: The discrepancy between countries' planned fossil fuel production and global production levels consistent with limiting warming to 1.5°C or 2°C*, <http://productiongap.org/> (accessed 11 May 2020).

## 4. Conclusion

This paper finds that, as the central governance standard for the extractive industries, EITI has an important role to play in the transition to a sustainable, decarbonized world. Calls for better understanding of the implications of transition for the extractive industries are growing louder across government, business and civil society. The economic impacts of the transition away from fossil fuels and carbon-intensive sectors are increasingly clear, as are the opportunities for a domestic energy transition, yet levels of awareness and capacity in producer countries remain low. These countries will face different risks and opportunities, shaped by both their national context and international progress towards transition. While the transition is not currently on track, emissions are now expected to decline in 2020 due to the impact of the COVID-19 pandemic, and the shape of the global recovery will have profound implications for its future trajectory. Producer countries with high levels of economic, energy and industrial dependence on the extractive industries will be among the most vulnerable in a late and disorderly transition, and the least resilient to economic and climate shocks.

**The economic impacts of the transition away from fossil fuels and carbon-intensive sectors are increasingly clear, as are the opportunities for a domestic energy transition, yet levels of awareness and capacity in producer countries remain low.**

Within this wider context, this paper has explored two broad areas of opportunity:

First, the potential for EITI *data, disclosures and dialogues* to help countries assess both their exposure to the economic risks associated with transition, and their progress on energy transition. Better understanding of the issues introduced in this paper – from the resilience of revenues and the commercial viability of projects under different transition scenarios, to the extractive industry’s energy sources and emissions – will be crucial for sound policy development and decision-making. In many cases, existing EITI data and disclosures and publicly available information could support such analysis. In others, additional disclosures could enhance EITI’s relevance and impact.

Second, the potential for EITI to contribute to improved *national and international governance* through transition. Where *national governance* is concerned, EITI is well positioned to provide a forum for informed debate around the risks and opportunities associated with transition. With the right data and guidance, MSGs could help ensure that policies and decisions relating to the extractive industries are aligned with national sustainable development, including energy transition and climate goals. It could highlight economic and energy dependencies on the extractive sector that may increase national exposure to climate-related economic risks or present a barrier to domestic energy transition.

Better coordination with *international governance* mechanisms can help ensure that international best practice is shared with producer countries and put to use, and that EITI data, disclosures and dialogues contribute to international efforts to support an orderly transition. Effective partnerships with international mechanisms that are designed to manage climate-related economic risks, such as the NGFS and TCFD, and those such as the UNFCCC that are designed to guide emissions

reductions, could help avoid the duplication of efforts and encourage these processes to reflect the needs of emerging and developing countries, as well as demonstrating EITI's relevance and impact beyond the extractive industries.

**Without better information and capacities, developing and emerging economies may be exposed to unnecessary economic risks and be left further behind by energy transition.**

Underpinning each of these areas is the imperative to support an equitable and just transition. It has long been accepted that national decision-makers face asymmetries of information and capacity around the extractive industries, compared with international companies and investors in the sector. Indeed, the focus of much donor and MDB assistance to the sector, and of governance standards such as EITI, has been on addressing information gaps and building the institutional and civil society capacity required to ensure the good governance of extractive resources. Similar asymmetries are now emerging around climate risk and energy transition, with an increasingly sophisticated understanding of risks and opportunities at the international level, but few comparable discussions or mechanisms at national level. Without better information and capacities, developing and emerging economies may be exposed to unnecessary economic risks and be left further behind by energy transition.

As an organization, EITI will have to decide how to respond to this changing global context for the extractive industries, while balancing the interests and needs of its stakeholders. Its emphasis on multi-stakeholder engagement means that the process of integrating new issues within the EITI Standard is typically a slow one. At the same time, there is growing interest in energy transition among implementing countries, and some MSGs are already integrating issues related to transition in their EITI processes. As the world responds to the COVID-19 crisis, the need for a transition towards more sustainable, equitable and climate-resilient growth could not be clearer. The impacts of COVID-19 have highlighted the speed with which systemic shocks can affect economic stability, and the need for real-time data and forward-looking analysis to inform sound policy- and decision-making.

There is now a live debate about the extent to which recovery measures might accelerate the transition to a sustainable, low-carbon economy, or reinforce carbon-intensive economic models. Many producer countries are already facing severe economic downturns because of the crisis, and the decisions their governments take now regarding debt, spending and investment will have long-term implications for their resilience to future systemic shocks – including those related to climate change – and their ability both to manage climate-related economic impacts and to make progress on domestic energy transition. As national governments and international development assistance focus on greening economic recovery, EITI's response both to the current crisis and to longer-term climate and energy transition trends will be crucial to its continued relevance. It must now consolidate the progress that it has made on transparency and against corruption, while keeping pace with global developments.

## Recommendations

**Make a high-level policy commitment to mainstreaming transparency on energy transition and climate risk through the next EITI Standard:** This commitment should come from the EITI Board and should recognize both the economic and energy impacts of transition, and their wider implications for the good governance of natural resources and for public financial accountability. EITI's approach should be one of mainstreaming transition requirements through existing data, disclosures and dialogues, and where appropriate, considering additional requirements. It should treat transition as a cross-cutting issue for extractives governance, rather than as an additional area of reporting. Such a commitment would provide a clear strategic direction for EITI's longer-term policy response, and a mandate for EITI's more immediate practical steps towards it.

**Identify practical next steps towards the use of EITI data and disclosures:** There are many opportunities to leverage existing EITI data and disclosures to analyse the implications of transition for producer countries, and for the good governance of extractive resources. There are also a number of challenges, not least the significant time and investment that will be required to build awareness and capacity, especially at national level. The International Secretariat should work in partnership with national secretariats, MSGs and other partners to:

- **Develop analysis of existing data and disclosures** – EITI summary data include disclosures relating to production and revenues, contracts and state participation in the sector, and could already help build a picture of national and aggregate exposure to risks and opportunities, including exposure to certain commodities. EITI reports contain disclosures and contextual information that may help set the wider context for energy transition and provide quick insights into the areas of interest and current levels of reporting across countries. The International Secretariat could explore opportunities for the analysis of EITI summary data, and consider how these data could be structured to support comparative as well as country analysis.
- **Advance national analysis and reporting** – Some EITI-implementing countries are already exploring issues relating to transition, and others have stated their interest. Pilot studies with small groups of volunteer countries could test analytical approaches and reporting in new areas, from the resilience of revenues, the viability of projects and the scale of public finance at risk, to subsidies and emissions reporting. Each area will raise different challenges, including the relevance of existing EITI data and the need for additional information or disclosures, as well as the capacity of key stakeholders to use them. Support for studies and peer dialogue could help accelerate learning.
- **Provide clear guidance and requirements for countries** – Where levels of awareness are low among national secretariats and MSGs, and where data and capacity gaps are identified, there will be value in developing guidance notes and in packaging (or linking to) relevant data. The International Secretariat could develop guidance notes on priority issues such as revenue resilience and project viability (linking to mainstream scenarios and best-available data on the cost of production) and contract analysis (with detail on risky clauses and amendments). These should clearly communicate risks and opportunities, and questions for MSGs to explore.

**Enhance dialogue and coordination at national and international level:** Some of the issues introduced in this paper lie beyond EITI's traditional areas of competency, but they will inevitably affect the extractive industries, and would benefit from enhanced transparency and greater scrutiny.

Doing this without overstressing national secretariats and MSGs – or duplicating efforts elsewhere – will require effective stakeholder engagement and the development of new partnerships at national and international level. EITI’s national and international stakeholders should work to:

- **Integrate transition within the mandate and membership of MSGs** – Effective discussion of the economic and energy implications of transition will require a clear mandate and wider MSG engagement, particularly with departments that have responsibility for energy and climate policy, and with processes such as the development of NDCs. This can be encouraged from the top down, with the EITI Board putting the implications of transition on the agenda for MSGs to discuss as part of their mandate, and from the bottom up, with MSGs integrating transition in their mandates and work plans and widening stakeholder engagement.
- **Share international best practice with producer countries** – Developing links to international governance mechanisms – such as the UNFCCC, where the reporting of emissions is concerned, the TCFD and the NGFS for climate-related economic risks, and the G20 and the OECD for the reporting of fossil fuel subsidies – could help raise national awareness and build the capacities required to apply the principles of such mechanisms in the domestic context. Effective MSG engagement could help ensure that country decision-makers and civil society have full sight of the economic and energy implications of transition, and of national exposure to/readiness for them.
- **Explore EITI’s contribution to international processes** – EITI’s International Secretariat could initiate further studies – in partnership with the relevant international stakeholders and national secretariats – to identify where EITI data could contribute to international processes, and how EITI summary data could be structured to facilitate easier access and wider use. The findings could be presented in time for the UN Climate Change Summit (COP26) in 2021, alongside EITI’s progress in the other areas outlined above. The EITI Board could also encourage supporting companies to support the TCFD and provide links to their disclosure of climate-related financial risks.

**Act fast:** EITI should recognize that political and societal sentiment on climate change and energy transition are evolving rapidly. The EITI Board should explore the potential for ‘quick wins’ that can help support both longer-term policy debates regarding the economic risks associated with transition, and the opportunities for domestic energy transition, in the context of national SDG and climate commitments *and* urgent interventions in response to the COVID-19 pandemic, including borrowing and state support for the extractive industries, and their implications for national climate resilience and energy transition. While a policy commitment to mainstreaming transparency on transition through the next EITI Standard could set the direction here, practical steps towards the use of EITI data and disclosures in priority areas and the integration of transition within MSG mandates and membership could be advanced immediately by interested EITI stakeholders. This could encourage recovery measures that support sustainable economic development and energy transition.



## Appendix: Summary of EITI's Strategy Consultation With Implementing Countries

EITI undertook a strategy consultation with implementing countries between December 2019 and January 2020. The aim of this consultation was to ensure that country contexts and interests were reflected in the themes of the EITI Board Strategy Retreat in February 2020 – energy transition, corruption and measuring impact. A survey was sent to all 52 (at that time) EITI-implementing countries through their national secretariats, and regional calls were held with country managers in Francophone Africa, Anglophone Africa, Latin America and the Caribbean, Central Asia and Southeast Asia. A total of 35 countries participated, with 26 responding to the survey, and 12 participating in regional calls. The anonymized results are presented here.

Most countries agreed that EITI should be involved in discussions relating to energy transition. Of the 26 countries that responded to the survey, 21 agreed, with several noting the urgency of EITI engagement. One major oil exporter stated that involvement in energy transition would be consistent with EITI's 2019 Standard, which includes environmental Requirements, and suggested the need to question how transition will affect the issues and challenges that brought EITI into being. One major minerals exporter noted the potential benefits of transition, with growing demand for strategic minerals presenting economic and employment opportunities. Participants on one regional call similarly agreed that transition would affect the extractive industries, and inevitably EITI, with some countries at risk of stranded assets and others having to rapidly improve their oversight of strategic minerals.

Respondents suggested several potential roles for EITI at country level, including:

- Raising awareness around the concept and importance of energy transition;
- Encouraging greater use of RE, including in extractives, and where it can enhance access to energy;
- Monitoring the energy sources and emissions of companies in the extractive industries; and
- Helping manage the decline of extractives, with commitments to coal phase-out, for example.

Respondents also identified several entry points and next steps, including:

- Linking EITI processes to existing energy policy and power sector reforms;
- Widening dialogue to include those with responsibility for energy and climate policy;
- Reviewing the mandate and work plans of multi-stakeholder groups (MSGs) to incorporate transition; and
- Integrating issues relating to transition in EITI reporting, from contextual information to new data and disclosures.

While the economic risks associated with transition were mentioned by some countries and on the regional calls, the roles and entry points listed above focus largely on domestic energy policy. The implications of transition for economic governance and public financial accountability did not feature prominently in either the survey responses or the regional calls. The suggested roles

for EITI and entry points at country level, for example, focused largely on domestic energy policy and emissions reporting, rather than on economic policy and the analysis of climate-related risks to anticipated revenues and investments. At the Board Strategy Retreat, too, stakeholder-led discussion initially focused on access to energy and domestic energy transition, before considering the economic impacts of transition.

Some respondents also suggested a role for EITI at the regional and international level. One low-income and low-capacity country noted that EITI would be well placed to support peer-to-peer learning on energy transition between implementing countries. One upper-middle-income country highlighted how country dialogues could feed into international processes, and described EITI involvement with energy transition as complementary to its role in the G20 Energy Transitions Working Group, ‘since [EITI] too constitutes a process of dialogue to maintain a balance between sectors with different interests and visions’. Several countries also stated their commitment to sustainable development and to climate action under the UN Framework Convention on Climate Change (UNFCCC), albeit without drawing direct links to EITI.

Respondents identified several policy and practical barriers to EITI involvement. Ministries of oil and gas, energy and/or resources are typically the lead actors for government in EITI processes, and some suggested engagement with RE directorates within these institutions, where they have been established. Other respondents highlighted the need for engagement with ministries and government agencies that have responsibility for aspects of transition, but that are not currently involved in EITI processes, including ministries of climate change. At the same time, however, many respondents cited weak institutions, low levels of capacity and the early stage of policy discussions on transition and its implications for the extractive industry as barriers to engagement, and stressed the need to consolidate EITI’s progress in-country as a foundation. However, while some felt that MSGs would have to wait for government to identify priorities, others saw opportunities to encourage and shape policy.

There were differing opinions on the appropriate scope of EITI engagement. Several respondents noted that their EITI processes and reports were already considering issues relating to energy transition. One suggested that future versions of the EITI Standard should be amended to require the disclosure of information on national plans or policies linked to transition and emissions mitigation, and another suggested that in countries where MSGs could provide a central forum for debates on energy transition, EITI reports could contain recommendations for implementation. Others remained more cautious about mandatory requirements relating to energy transition due to the technical nature of some parts of the discussion and the potential to overstretch EITI. One respondent noted EITI’s responsibility to ensure that engagement does ‘not undermine or neglect current progress being made in extractives governance and transparency, and its continued importance in economic development’.

Only three countries stated that EITI should not be involved in current energy transition debates at all. They include one advanced economy with fossil fuel production, which did not cite a reason, and one developing country with well-established fossil fuel production, which stated that there were already ‘sufficient organizations’ to do this. One further developing country with emerging fossil fuel production questioned EITI engagement on the practical basis that it would already take some time to develop country ownership of new EITI reporting requirements for gender and environment; however, it did reiterate its commitment to international action on climate change and sustainable development, and suggested the need for a study on the role that EITI can play in transition. Three further countries submitted separate and conflicting responses, with civil society typically supporting involvement, industry opposing it, and governments’ positions varying from country to country.

## Acronyms

DEITI	Deutschland Extractive Industries Transparency Initiative
EITI	Extractive Industries Transparency Initiative
ETS	emissions trading system
GHG	greenhouse gas
IEA	International Energy Agency
I-EITI	Indonesia Extractive Industries Transparency Initiative
IMF	International Monetary Fund
IOCs	international oil companies
IRENA	International Renewable Energy Agency
MDB(s)	multilateral development bank(s)
MSG(s)	multi-stakeholder group(s)
NDC(s)	Nationally Determined Contribution(s)
NEITI	Nigeria Extractive Industries Transparency Initiative
NFGS	Network for Greening the Financial System
NOC(s)	national oil company (companies)
NRGI	Natural Resource Governance Institute
OECD	Organisation for Economic Co-operation and Development
RE	renewable energy
SDG(s)	Sustainable Development Goal(s)
SOE(s)	state-owned enterprise(s)
TCFD	Task Force on Climate-related Financial Disclosures
TTEITI	Trinidad and Tobago Extractive Industries Transparency Initiative
UNFCCC	United Nations Framework Convention on Climate Change

## About the Author

**Siân Bradley** is a senior research fellow in the Energy, Environment and Resources Programme at Chatham House.

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For further information on EITI, see <https://eti.org/who-we-are>.

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Cover image: Supply boats towing an oil drilling rig, São Tomé and Príncipe.

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