



QUANTIFYING INTANGIBLES

USING THE EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (EITI) IN CREDIT RATINGS ASSESSMENTS

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“A growing body of empirical research has highlighted the positive relationship between the degree of fiscal transparency and measures of fiscal sustainability (such as government deficits and debts), with a stronger correlation among low and middle income countries than among high income countries.”

International Monetary Fund, 2012¹.

EXECUTIVE SUMMARY

The EITI is a global standard that promotes the open and accountable management of natural resources, through the disclosure and reconciliation of data on the oil, gas and mining industries. As of August 2015, the EITI is implemented in 48 countries, with more countries preparing to join. Credit rating analysts (CRAs) can use the EITI to deepen their analysis and make more accurate assessments.

The ‘big three’ CRAs (Standard & Poor’s, Moody’s and Fitch) use governance and transparency as a marker in their ratings methodologies, both directly in their own qualitative judgements and indirectly through third-party rankings. Rating agencies may benefit from more closely tracking EITI implementation. In more opaque frontier economies, EITI Reports provide information of relevance to ratings assessments both of governments and companies. In emerging and middle-income economies, the EITI process provides a mechanism through which to gauge institutional reform both in the extractive industries and in broader fiscal revenue management. Data

disclosed through the EITI are increasingly quoted in frontier markets’ sovereign bond prospectuses, commodity producers’ share offerings² and fundraising brochures for private equity and investment funds.

The EITI offers credible insights into institutional strength and governance. For investors more broadly, the information required under the EITI Standard can be compared to the market intelligence provided by private-sector consultancies and raise the bar for information providers. This Brief introduces the EITI Standard, examines the value of its information for frontier markets and emerging economies, and reflects on the common interests of EITI stakeholders and the broader investment community. Examples of concrete actions credit rating agencies could undertake are also included.

The EITI International Secretariat would welcome feedback on how to strengthen the relationship between the EITI and CRAs.

WHAT IS THE EITI?

The EITI is a global standard designed to strengthen governance, ensure revenue transparency and inform public debate in the mining and petroleum sectors. Implemented by 48 countries ranging from Indonesia to the United States, it is supported by over 90 of the world’s largest extractive companies (including BHP, Chevron, ExxonMobil, Glencore, Rio Tinto, Shell, Total and Trafigura), as well as state-owned enterprises (such as Pemex, Petrobras and Statoil), development finance institutions (like the African Development Bank, Asian Development Bank and

the World Bank Group) and institutional investors (including Allianz, Goldman Sachs AM, Schroders and UBS Global AM) with over USD 19 trillion in combined assets under management.

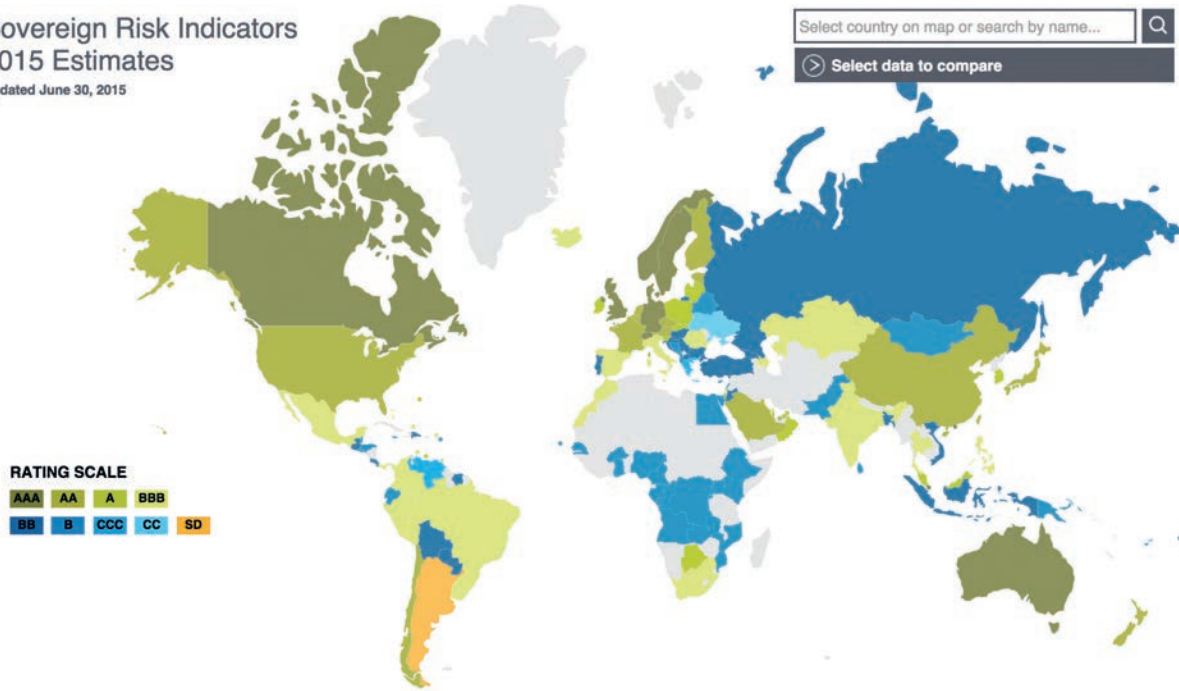
Government, industry and civil society organisations cooperate through a EITI national multi-stakeholder group (MSG) in each country to implement the EITI Standard. Their annual EITI Reports reconcile payments from companies in the sector to government, but also include comprehensive market information

1 IMF (7 August 2012), “Fiscal Transparency, Accountability and Risk”, <http://www.imf.org/external/np/pp/eng/2012/080712.pdf>

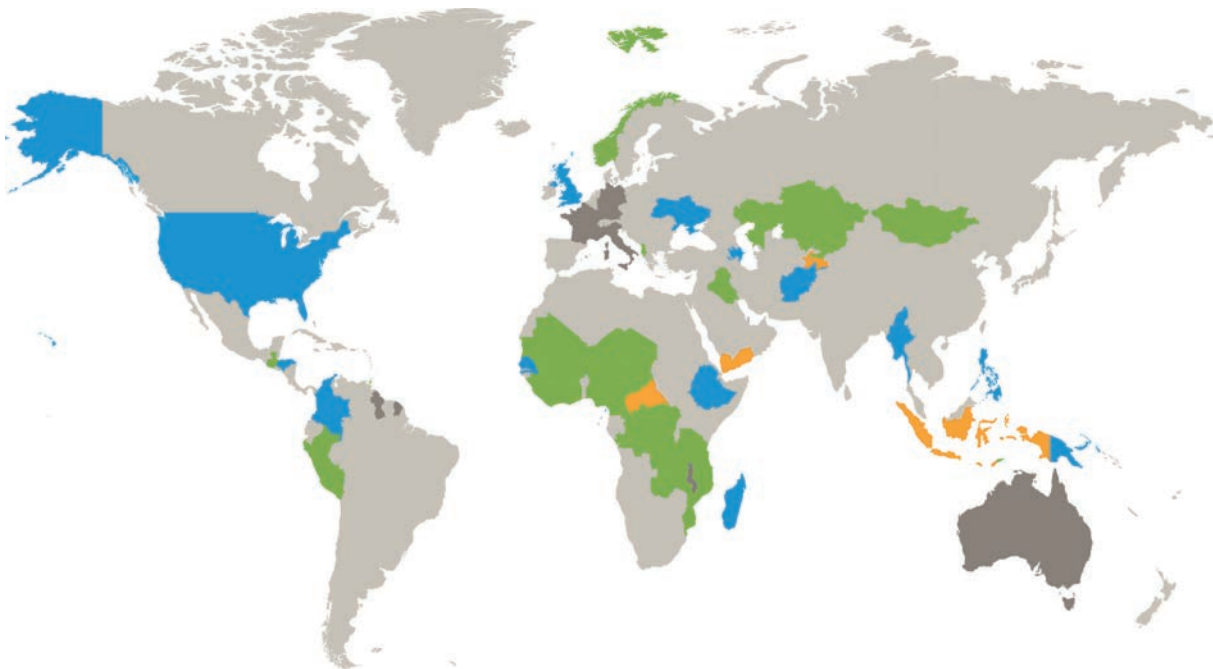
2 For instance PA Resources here, Haranga Resources here, Caracal Energy here

3 <https://register.standardandpoors.com/sri/>

Sovereign Risk Indicators
2015 Estimates
 Updated June 30, 2015



Credit rating agencies (CRA) evaluate countries' ability and likelihood to pay back debt and the likelihood of default. The higher the rating, the better the borrowing conditions (such as lower interest rates) a country will have on the international market. The image above is a screenshot of Standard & Poor's country ratings as of June 2015³. EITI Reports include a range of information relevant when evaluating a country's credit rating. Many EITI implementing countries (see map on opposite) are rated below investment grade (image: <https://register.standardandpoors.com/sri/>).



Member countries of the EITI are coloured according to their progress in implementing the EITI Requirements. Green indicates countries that have been validated as compliant with the requirements. Blue countries are candidates, and in the process of implementing the requirements. Countries in amber are currently suspended from the EITI, as they have missed deadlines or have been suspended due to political instability or conflict.

on licensing, production, revenue collection, revenue allocation and the role of state-owned enterprises. More credible than any unilateral declarations by any one stakeholder group, these disclosures are the product of collaboration by the three constituencies. The engagement of an Independent Administrator (such as Deloitte, EY, KPMG, PwC and others) ensures an authoritative assessment of data quality and a comprehensive

reconciliation of payments. Implementing countries are validated against the EITI Standard every three years.

Below we highlight three common features in EITI Reporting of interest to CRAs: market information, a financial assessment of payments to government, and data on government expenditure.

Box 1: Key facts and outputs of the EITI



The EITI is a global standard designed to strengthen governance and inform public debate in the mining and petroleum sectors.

The EITI Standard sets out seven requirements on disclosures in the extractives sector, including information on tax payments, licenses, contracts, production and other key elements around resource extraction. Countries are validated against the Standard every three years.

As of 1 August 2015, 48 countries are implementing the EITI Standard.

39 of these have published reports, covering a total 246 fiscal years and disclosing over USD 1.6 trillion in government revenues.

Key EITI outputs per country:

- **EITI Reports**, produced annually and available on national EITI websites (e.g.: www.ph-eiti.org) and on eiti.org.
- **EITI Workplans and Annual Activity Reports**, which track progress against EITI Requirements, objectives and progress in following recommendations of EITI Reports.
- **EITI Validation Reports**, every three years, evaluating EITI Reports against the EITI Standard.



Market information

The EITI Standard requires that countries publish information on licensing, production, state ownership, the structure of state-owned enterprises, transfers to local governments and social and infrastructure investments. It encourages contract transparency and disclosure of beneficial ownership of extractive industry companies. Countries that implement the EITI are required to disclose the financial structure of state-owned enterprises, including loans and

guarantees provided by central government, their quasi-fiscal expenditures and their role in the extractive industries. EITI Reports cover subnational payments by companies, and subnational transfers from central government, as well as the institutional relationship between central and subnational governments. They also contain an assessment of quality assurance and auditing procedures for both government and companies.

Box 2: Market information of greatest relevance to credit ratings from the EITI process

EITI Reports include a wealth of market information of relevance for analysts, including:

- Overview of the **institutional and regulatory framework**. Mongolia's 2013 EITI Report details how mining regulations are applied in practice. See www.eitimongolia.mn/en.
- Extractive industries' **direct and indirect contributions to the economy**. Indonesia's 2010-2011 EITI Report tracks the economic contributions of mining, oil and gas by location. See www.eiti.ekon.go.id.
- **License allocation** procedures, including technical and financial criteria for assessment. The Philippines' 2012 EITI Report explains the process for allocating licenses and how these are applied in practice. See www.ph-eiti.org.
- Description of **state's participation** in extractive industries, including relations between government agencies and state-owned enterprises. Iraq's 2012 EITI Report details the structure of state ownership of oil and gas assets, including how proceeds from these stakes are remitted to the national treasury. See www.ieiti.org.iq.
- Overview of loans and **loan guarantees by government** to state-owned enterprises and their quasi-fiscal expenditures. Ghana's 2012-2013 EITI Report provides an overview of the structure of Ghana National Petroleum Corp.'s equity financing. See www.gheiti.org.gh.
- Information on **mineral and petroleum sales** by state-owned enterprises. Cargo-by-cargo oil sales are reconciled in the Republic of the Congo by KPMG. See www.itie-congo.org.
- Disclosure of **production and export figures**.
- **In-kind transfers and barter** agreements. DRC's EITI Reports from 2010 to 2013 have disclosed the terms of the Sicomine agreement between Cohydro, CREC and Gecamine. See www.itierdc.com.
- Links to information sources with **delineation of mining and petroleum licenses**, including geospatial coordinates. Sierra Leone's GoSL Online Repository contains an overview of all active indexed on a map. See <http://sierraleone.revenuesystems.org/login/auth>
- Description of **subnational revenue allocation** formulas and actual transfers. According to the 2013 EITI Report of Peru, 50% of total revenues were transferred to the regions. The report contains detailed information on the allocation of funds to municipalities, regions and universities and the formula this is based on. See <http://eitiperu.minem.gob.pe/>
- Clarification of **government policy** on contract disclosure and beneficial ownership. In a growing number of cases work on EITI Reports leads to publication of mining, oil and gas contracts. See the Philippines' contracts dashboard on www.data.gov.ph/infographics/eiti-dashboard.
- Assessment of **quality assurance and timeliness** (including the quality of audit procedures) of public sector and corporate financial reporting. Indonesia's 2010-2011 EITI Report provides a comprehensive overview of prevailing auditing practices for both government agencies and companies. See www.eiti.ekon.go.id.

Financial information

The most detailed information produced through the EITI is the reconciliation of payments by companies to government (and state-owned enterprises where applicable). The reconciliation is conducted by a third-party consultant, an independent administrator, commonly an auditing company, but final publication is agreed by the MSG. This financial information includes company payments by type (revenue

stream), and the identification of discrepancies between company and government records. The EITI also requires publication of summary data templates, which aggregate information disclosed through the EITI in a consistent IMF GFS (Government Finance Statistics) format. Key data points in these summary data templates include payments by category, state equity dividends and social contributions, on a per company basis.

2 Government revenues from extractive companies, per revenue stream		C. Companies	
3 This worksheet covers (A) identification of whether a revenue stream is included in the EITI Report, (B) listing the revenue streams according to their corresponding classification, (C) listing the companies that are reporting, (D) recording the payments per revenue stream and company, and (E) any notes to explain the information provided.		Enter companies included in the EITI Report. Add columns as necessary.	
		Adnama Mining Resources Incorporated Apex Mining Company Inc. Benguet Corp. Nickel Mines, Inc.	
		Commodities mining mining mining	
A. GFS classification of revenue streams		B. Revenue streams	
Indicate if revenue stream is "included", "not applicable" or "not included" in the EITI Report. If "included", enter the revenue streams in the box above "Revenue streams". The letter E in the GFS codes means that these are the codes used for the revenues from extractive companies. The digits to the left of an E are actual GFS codes. The digits to the right of an E are subcategories created exclusively for revenues from extractive companies.		Enter revenue streams included in EITI Report. If more than one revenue streams fall under the same GFS classification, copy the row and paste it as a new row. Only payments to governments from companies on their own behalf are to be included. Payments to governments from companies on behalf of their employees	
GFS codes of revenue streams from extractive companies		D. Payments per revenue stream and company	
Included in EITI Report		Name of revenue stream in country	Receiving government agency
11E Taxes			Subtotals
111E Taxes on income, profits and capital gains			97,367,375
1112E1 Ordinary taxes on income, profits and capital gains	Included	Corporate Income tax	BIR
1112E2 Ordinary taxes on income, profits and capital gains	Included	Withholding tax - Foreign shareholder dividends	BIR
1112E3 Ordinary taxes on income, profits and capital gains	Included	Withholding tax - Profit remittance to principal	BIR
1112E4 Extraordinary taxes on income, profits and capital gains	not applicable		
112E Taxes on payroll and workforce	not included		
113E Taxes on property	Included	Real property tax - Basic	LGU
113E Taxes on property	Included	Real property tax - SEF	LGU
114E Taxes on goods and services			
1141E General taxes on goods and services (VAT, sales tax, turnover tax)	not included		
1142E Excise taxes	Included	Excise tax on minerals	BIR
1143E Profits of natural resource fiscal monopolies	not applicable		
1145E Taxes on use of goods/permission to use goods or perform activities			
114521E Licence fees	Included	Local business tax	LGU
114522E Licence fees	Included	Mayor's permit	LGU
114523E Licence fees	Included	Environmental fees	LGU
114524E Licence fees	Included	Extraction fees	LGU
114525E Licence fees	Included	Mine wastes & tailing fees	LGU
114526E Licence fees	Included	Occupation fees	LGU
114527E Licence fees	Included	Registration fee	LGU
114528E Licence fees	Included	Regulatory/Administrative fees	LGU

The Philippines' 2012 EITI Summary Data Template provides key data points in a machine-readable format, for ease of cross-country and multi-year comparisons. You can download the data sheet at <http://www.ph-eiti.org/#/EITI-Report/First-Country-Report>

Box 3: Financial information of greatest relevance to credit ratings from the EITI process

- **Corporate income tax** information.
- Information on **royalties and fees** (including application fees, land-use fees, etc.).
- **Signature bonuses.** For instance Burkina-Faso's 2012 EITI Report highlighted how a USD 10 million signature bonus was diverted in 2012. See www.itie-bf.gov.bf.
- **Withholding tax** information.
- **In-kind payments** including cost- and profit-minerals, infrastructure development and barter agreements.
- **Advance payments** to government. Chad's 2013 EITI Report will disclose the terms of Glencore's advance payments to the Chad government for future delivery of oil.
- Equity distributions and dividend payments by state-owned enterprises. The 2012 Nigeria EITI oil and gas report alleged that between 2008 and 2012, USD 11.6 billion in dividends were withheld by the state owned Nigerian National Petroleum Corporation.

Expenditure information

The EITI also covers some information on expenditure, most notably on government income earmarked for specific allocations. EITI Reports provide key insights into subnational revenue allocation, quasi-fiscal expenditure by

state-owned enterprises and the budgeting process more broadly. While not an instrument for a comprehensive diagnostic of public financial management, the EITI opens up key information on expenditures connected to revenue from extractive industries.

Box 4: Expenditure information of greatest relevance to credit ratings from the EITI process

- Description of system **for distribution of revenues**.
- Assessment of **subnational transfers** and any **earmarked expenditure** tied to specific revenue streams. Indonesia's 2010-2011 EITI Report details the system for allocating extractive industry revenues to subnational (provincial and district) governments. See www.eiti.ekon.go.id.
- Quantification of **state-owned enterprises' quasi-fiscal expenditures**. For instance Kazakhstan's 2013 EITI Report details quasi-fiscal spending by Samruk-Kazyna NWF in the Shchuchinsk Borovoye Golf Club. See www.geology.gov.kz/en.
- Assessment and quantification of mandatory **social expenditures** by companies, with scope for including voluntary social payments. The Philippines' 2012 EITI Report includes information on companies' five-year Social Development and Management Programs. See www.ph-eiti.org.
- Additional information on budgeting, commodity price assumptions, fiscal sustainability, revenue forecasting, etc.

EITI: THIRD-PARTY SOURCE FOR CREDIT RATING AGENCIES

Rating agencies track several proxies for institutional strength, governance and efforts to curb corruption, with different weights in their respective methodologies. All three main CRAs rely primarily on third-party indicators to make such qualitative judgements. *"While we have our own impressions from our interactions with the government to help us judge institutional strength, we also look at third-party assessments,"* says Moody's Christian de Guzman. These include World Bank's annual Doing Business (DB) and Worldwide Governance Indicators (WGI) reports, the United Nations Development Programme's Human Development Indicators (HDI), Transparency International's Corruption Perception Index (TI's CPI) and the IMF and World Bank's Reports on the Observance of Standards and Codes (ROSC)⁴. While S&P assigns a set 25% weight to its "Political Score", which includes transparency improvements, Moody's and Fitch assess such factors on a rolling scale with no fixed weight.

EITI Reports provide information that can enable CRAs to make more comprehensive and reliable assessments of the outlook for government revenues from this sector and to more accurately assess the government's long term ability to make timely interest payments. Specifically:

1. The EITI helps governments ensure that the income from the extractive industries is correctly accounted for (and channelled to the treasury where it can be invested to promote growth and directed toward debt repayment).
2. The EITI guards against misappropriation (which over time will impede a borrower's ability to make timely interest payments).
3. Where countries have weak public financial management (and questionable official statistics), EITI implementation improves disclosure and is being used to strengthen government audit and assurance systems.
4. The EITI also helps to ensure that there is a robust national debate about whether the country has an effective and competitive tax system, again enhancing the government's long-term ability to make timely interest payments and reducing the likelihood of default.
5. As the EITI moves toward project-by-project reporting, data disclosed become even more granular, enabling CRAs to examine specific projects that are likely to have a major impact on the government's fiscal position (e.g., Jubilee project in Ghana, Oyu Tolgoi in Mongolia, PNG LNG in PNG, Bayu-Undan in Timor Leste).

4 See respective methodologies of the main three credit rating agencies (Standard & Poor's, Moody's and Fitch).

Diagnostics: a gauge of reform

“There are certainly challenges in quantifying transparency improvements, but we tend to look at everything available on the topic.”

Craig Michaels, associate director of sovereign and international public finance ratings at Standard & Poor’s (S&P).

In frontier markets and even emerging economies where other information may already be available, the EITI provides a useful gauge for tracking reforms in extractive industries. The EITI information provides an agreed, reliable and timely basis for public debate. It also identifies potential improvements in the data collection system and wider reforms. For example, the Philippines’ first EITI Report covering 2012 includes recommendations such as more efficient financial transfers between central government agencies and local government units, enhanced visibility of the effectiveness of subnational transfers, disaggregation of reporting by individual company rather than by consortium, and amendments to the National Internal Revenue

Code to lift the prohibition on tax information disclosures. The process also highlighted the difference in accounting procedures between companies (accrual-based) and government (cash-based).

Tracking EITI implementation is not as straightforward as following a ranking or index. Yet EITI Reports, and countries’ other EITI outputs (including annual activity reports, Validations, and secretariat assessments) provide insight into the nature of debates, key recommendations and the blockages to meaningful reform. Ratings agencies could benefit from the quantitative and qualitative information in EITI Reports, to complement other third-party sources of information.

Box 5: Institutionalising reform in the Philippines

The primary driver of 20 sovereign credit rating upgrades for the Philippines over 2010-2015 has been macroeconomic (improved GDP growth and external position), political stability, efforts to curb corruption and fiscal reforms have been secondary drivers according to Moody’s, S&P and Fitch’s respective credit rating upgrades. Yet while secondary, these factors were central to the Aquino administration’s reform agenda. “Governance reform has been the centre-piece of the Aquino administration’s policy efforts,” notes Fitch in its March 2014 affirmation of the Philippines’ rating.

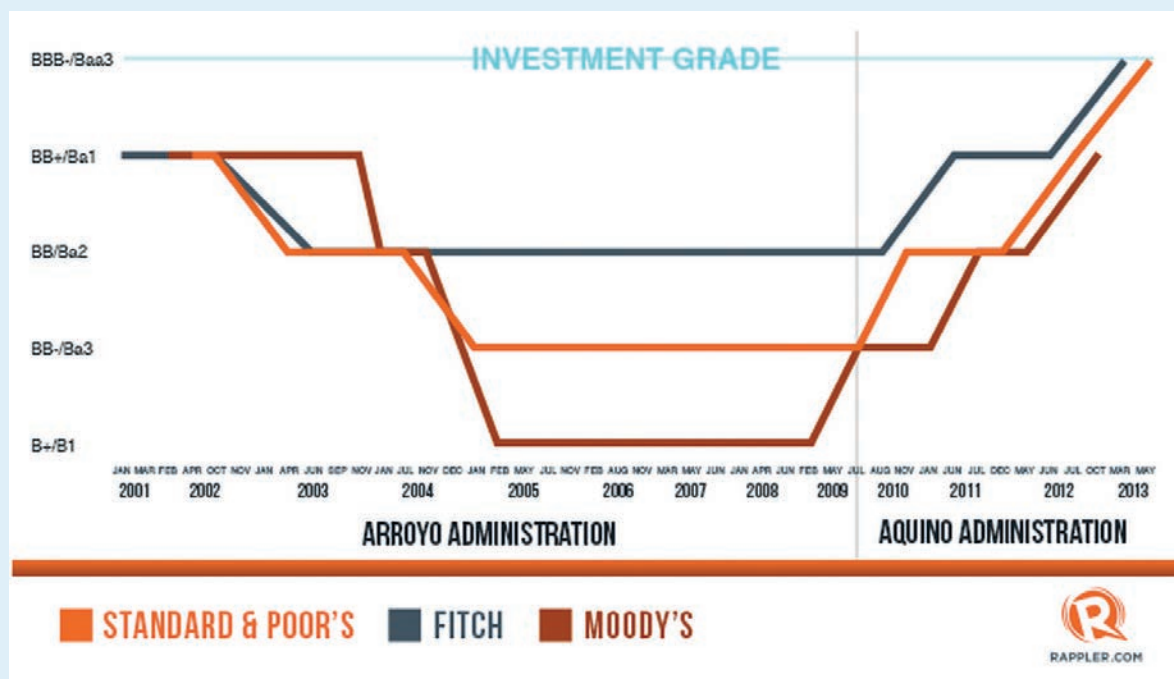
“The reforms affecting fiscal revenue under the Aquino administration have mainly been administrative rather than legislative, focusing mostly on improving compliance and widening the tax base,” says Moody’s primary ratings analyst on Papua New Guinea and the Philippines Christian de Guzman. This focus on enforcement and collection, a key rationale for implementing the EITI, has raised fiscal revenues significantly, albeit from a low base.

EITI implementation in the Philippines is driven by efforts to improve revenue collection but also drive broader reforms. As such, it is proving a useful **gauge of broader reforms and a means of institutionalising reforms**, a particularly important variable for medium-term credit rating prospects. Thus EITI implementation provides more grounds for optimism for the continuation of reforms beyond political change in power. Once a country implements the EITI, it commits itself to a structure (the MSG) to drive reform efforts, with strong reputational lock-in effects. “Even though a change of administration after the presidential elections in 2016 represents some uncertainty for reforms, the risks have shifted toward maintaining the impetus and direction of the process, away from a potential reversal or abandonment of advances achieved to date,” S&P noted in its May 2014 sovereign credit rating upgrade.

The EITI is a process, not merely a series of reports. As part of preparing the first PH-EITI Report, some 30 mining and 6 oil and gas **contracts were published**, providing information of use for modelling financial revenue flows. Some of the key **recommendations of the first PH-EITI Report** being implemented include rationalisation of subnational transfers to local government units, clarification of tax incentives extended by the Board of Investment, revisions to the National Inland Revenue Code, improved oversight of the payments to indigenous peoples and social development and management projects. It has also

served to highlight the discrepancies inherent in reconciling companies' accrual-based accounting with the government's cash-based accounting system.

"EITI is a concrete step towards enshrining transparency in governance. While it may only be for the extractive industry, the number of government agencies involved is substantial and includes the major revenue and licensing agencies of government. It is a statement as to how committed government is about up-scaling transparency in government operations and procedures. This can only be a positive as far as credit ratings is concerned, since a more transparent government bureaucracy lends itself to greater efficiency and effectiveness." – Maria Teresa S. Habitan, Assistant Secretary of Finance, the Philippines.



Change in political power, subsequent reforms and higher growth have improved the Philippines' country rating from the "big three". Implementation of international initiatives like the EITI serves as bellwethers of the success of reform efforts. (Image source: Rappler.com) The commitment to the EITI occurred in July 2012, coinciding with improving sovereign credit ratings. Implementation of efforts like the EITI is an example of such reforms and may have been reflected in credit ratings improvements illustrated above.

Visibility on states' fiscal positions

The value of the EITI process for CRAs clearly varies from country to country. In more opaque frontier markets, disclosures under the EITI provide crucial new information not usually accessible to CRAs. As Moody's notes in its assessment of Papua New Guinea's sovereign risk, "Transparency surrounding off-budget and public-sector enterprise borrowing is lacking."⁵ In such resource dependent frontier markets, the EITI requires disclosures of key interest

to CRAs, including assessments of the quality of public data, clarification of regulatory oversight in extractive industries and, perhaps most crucially, the financial guarantees to state-owned enterprises in these sectors. In some cases, improved visibility on these SOEs becomes even more important in a depressed global commodity-price environment.

Data disclosed through the EITI are increasingly quoted in frontier markets' sovereign bond prospectuses⁶, commodity producers' share

5 Moody's, in its reaffirmation of PNG's Ba2 Stable rating, June 2014

6 For instance Nigeria (\$500m Eurobond in January 2011), Gabon (\$1.5bn Eurobond in December 2013) and Azerbaijan (\$1.25bn Eurobond in March 2014)

offerings⁷ and fundraising brochures for private equity and investment funds.

For investors more broadly, the information required under the EITI Standard can be compared to the

market intelligence provided by private-sector consultancies and raise the bar for information providers.

Box 6: Opening up fiscal information in Papua New Guinea (PNG)

“The quality and dissemination of national accounts and external payments statistics are poor and subject to a considerable lag. Transparency surrounding off-budget and public-sector enterprise borrowing is lacking.”

Moody’s, Sovereign Rating of the State of PNG (Ba2 Stable), June 2014

Admitted as an EITI candidate in March 2014, PNG is working to produce its first EITI Report, covering 2013 financial data, by the end of 2015. Disclosures in the PNG-EITI Report will be the first covering the mining, oil and gas sectors agreed upon by the three stakeholder groups, thereby providing an independent and credible data set.

Significant disclosures are required of the state-owned enterprises in the extractive industries including Petromin, Mineral Resources Development Company and National Petroleum Company PNG.

Disclosure of the **financial relations between government and these SOEs**, alongside their social (non-commercial) expenditures, will clarify the structure of their state support and will support government efforts to restructure all SOEs into a single public asset-management vehicle, the Kumul Trust. This improved oversight of SOEs becomes even more significant during global commodity price downturns.

Clarification of the regulatory framework and licensing procedures, including financial and technical criteria for license awards, will be included in the EITI report, and is an important gauge of the practical implementation of the government’s statutory oversight. Even before publication of the first PNG-EITI Report, the MSG is undertaking assessments of the **quality of public-sector data**, of use for analysts tracking the PNG Government’s disclosures.

As part of preparing the PNG-EITI Report, the MSG is further working to **publish at least some contracts** in the mining sector, which would prove a significant resource for analysts seeking to model public-sector revenue flows from specific projects.

Relationship between transparency and market credibility

Particularly since the global financial crisis, the factors influencing qualitative judgments in credit ratings, such as those on institutional strength and governance, are facing more rigorous scrutiny. CRAs would thus benefit from tracking the EITI more closely.

The IMF provides a useful description of transparency in 1998, which clearly

relates to the scope of EITI. “It involves ready access to reliable, comprehensive, timely, understandable, and internationally comparable information on government activities so that the electorate and financial markets can accurately assess the government’s financial position and the true costs and benefits of government activities, including their present and future economic and social implications.”⁸

7 For instance PA Resources [here](#), Haranga Resources [here](#), Caracal Energy [here](#)

8 Koptis, George and Jon Craig, (1998), ‘Transparency in Government Operations’, IMF Occasional Paper n.158, p1, as related to in <http://www.lse.ac.uk/IPA/images/Documents/PublicSphere/2013/8-fiscal-transparency-spreads-20121.pdf>

Quantifying transparency remains challenging. Yet, a growing body of literature links improvements in fiscal transparency with credit ratings and sovereign borrowing costs.

A study by the Central Bank of Ireland's Laura Moretti on sovereign bond spreads in 18 emerging markets found that "more transparent countries enjoy lower spreads."⁹ The London School of Economics' Jules Tilly studied the link between fiscal transparency, as measured by the Open Budget Index, and five-year credit default swaps in 36 countries from 2007 to 2011¹⁰. The study found that, while transparency had little impact on the cost of funding before the crisis, this has now changed. "In the post-2008 era, the relationship between fiscal transparency and investor perceptions has strengthened considerably."

The IMF has studied the impacts of improvements of fiscal transparency, as measured through the Report on Observance of Standards and Codes (ROSC). It finds that more transparency reduces the uncertainty over a country's finances. This improvement is more pronounced in emerging economies, according to a June 2012 paper¹¹. In developed markets more fiscal transparency improves fiscal policies and outcomes.

Over time, both of these influence the primary fiscal balance and lead to a reduction of gross debt.

A separate IMF paper from August 2012 makes a similar point. "A growing body of empirical research has highlighted the positive relationship between the degree of fiscal transparency and measures of fiscal sustainability (such as government deficits and debts), with a stronger correlation among low and middle income countries than among high-income countries."¹² For higher-income countries, the evidence points towards a positive relationship between fiscal transparency and market perceptions of fiscal solvency. This is expressed in the credit default swap spreads on sovereign debt, credit ratings and foreign portfolio investment. The more transparent governments are on their fiscal position, the better their borrowing position.

Thus as the research indicates, there are clear advantages for CRAs to use EITI Reports, as these contain valuable information on a country's fiscal and performance related to extractive industries. More disclosure could in the mid-term improve a country's borrowing conditions.

Box 7: Relationship between fiscal transparency to government debt and CDS spreads

Improvements in fiscal transparency could improve a country's rating, and as such improve its lending conditions. EITI implementation is one type of improvement in fiscal transparency. Implementing the EITI provides a signal to the market of a government's reform efforts and can thus prove a useful gauge of the pace of reforms.

Image source: IMF (7 August 2012), "Fiscal Transparency, Accountability and Risk", p. 6

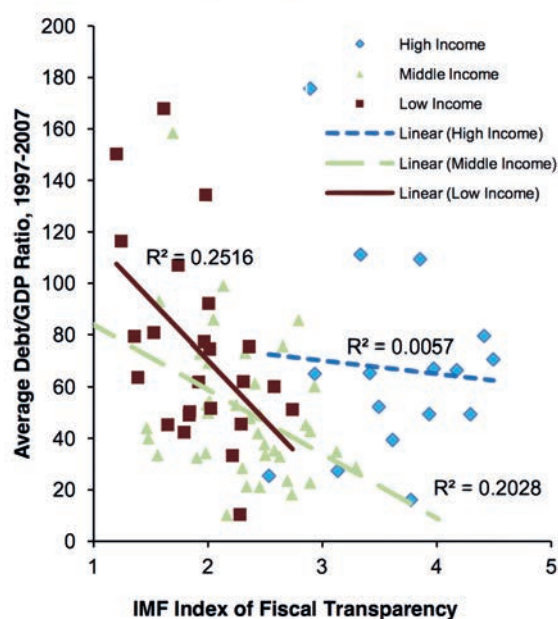
9 Laura Moretti (June 2012), "Transparency and Emerging Market Bond Spreads", <http://www2.unine.ch/files/content/sites/irene/files/shared/documents/s%C3%A9minaires/Moretti.pdf>

10 Jules Tilly (August 2013), "Fiscal Transparency and Sustainability of Public Debts in Times of Crisis: How to Strengthen Investor Confidence?", <http://www.lse.ac.uk/IPA/images/Documents/PublicSphere/2013/8-fiscal-transparency-spreads-20121.pdf>

11 IMF (June 2012), "Fiscal Transparency, Fiscal Performance and Credit Ratings", <https://www.imf.org/external/pubs/ft/wp/2012/wp12156.pdf>

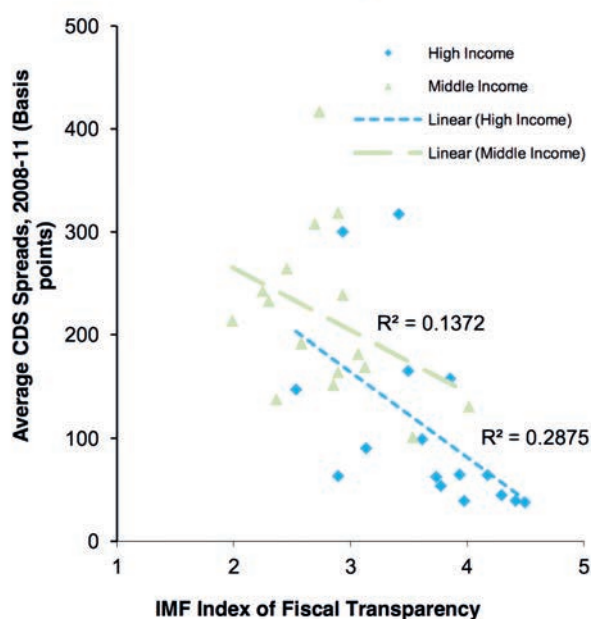
12 IMF (7 August 2012), "Fiscal Transparency, Accountability and Risk", <http://www.imf.org/external/np/pp/eng/2012/080712.pdf>

a. Fiscal Transparency & Government Debt



Sources: World Economic Outlook (Debt to GDP); Staff estimates (Fiscal Transparency Index).¹⁷

b. Fiscal Transparency & CDS Spreads



Source: Markit Five Year CDS (credit default swap)
Note: Four outliers with very high average CDS spreads (Argentina, Greece, Pakistan, and Ukraine) are excluded.

Left: The IMF paper found that particularly in low-income countries, improved fiscal transparency correlated to lower indebtedness levels. A lower debt/GDP level indicates a country's better likelihood of repaying its debt.

Right: The CDS spread is an indicator of the likelihood of a country to default on its debt obligations. The IMF study shows a strong correlation between better fiscal transparency and a lower CDS spread for higher and middle-income countries.

PRACTICAL INTERACTION WITH THE EITI

With a clear overlap of interests between credit rating assessments and information disclosed through the EITI, analysts can use the EITI process in a number of concrete ways. Analysts can use EITI information for their sovereign rating assessments, due diligence on listed companies and interact

with the MSG to support the EITI reporting process. Credit rating agencies can play a key role in helping EITI implementing countries overcome the significant data challenges of emerging economies, while demonstrating the business case for EITI to governments.

Box 8: How credit rating agencies can use EITI information

The following is a preliminary list of ways that credit rating analysts may consider using the EITI:

- **Analyse existing EITI information** for countries covered: the financial information contained can add to visibility on government operations in frontier economies, while the recommendations contained provide a useful gauge of reform in more established emerging economies.

- Assess information from the EITI on **institutional capacity, political risk and governance**. If appropriate, source information from EITI reporting in sovereign ratings reports.
- **Interact with members of the national EITI process (the national council and the national secretariat)** to identify data and information points that would be of greatest interest to the investor community, and provide input to data visualisation.
- **Liase with the EITI International Secretariat** to provide feedback on the EITI process in specific countries and identify data points and other information of highest interest.
- **Join EITI supporting institutional investor calls** and meetings to represent credit rating agencies' perspectives as EITI Supporting Companies. Feed proposals for refinements in the Standard to the EITI Board through the Institutional Investor constituency members.

Box 9: Sections of Moody's and S&P's rating methodologies where EITI data is relevant

MOODY'S SOVEREIGN BOND RATINGS				
	<i>Broad Rating Factors</i>	<i>Rating Sub-Factor</i>	<i>Sub-factor Weighting (towards Factor)</i>	
Government Bond Rating Range Government Financial Strength Economic Resiliency	Factor 1: Economic Strength	Growth Dynamics	50%	
		Scale of the Economy	25%	
		National Income	25%	
		Adjustment Factors	1-6 scores	
	Factor 2: Institutional Strength	Institutional Framework and Effectiveness		75%
		Policy Credibility and Effectiveness		25%
		Adjustment Factor	1 - 6 scores	
	Factor 3: Fiscal Strength	Debt Burden	50%1	
		Debt Affordability	50%1	
		Adjustment Factors	1 - 6 scores	
		Political Risk	Max. Function ₂	
	Factor 4: Susceptibility to Event Risk	Government Liquidity Risk	Max. Function ₂	
		Banking Sector Risk	Max. Function ₂	
		External Vulnerability Risk	Max. Function ₂	

The table is from Moody's (2013) "Sovereign Bond Ratings". <https://www.moody.com/researchandratings/>

Figures and information in EITI reports can specifically influence Moody's Institutional Strength indicators

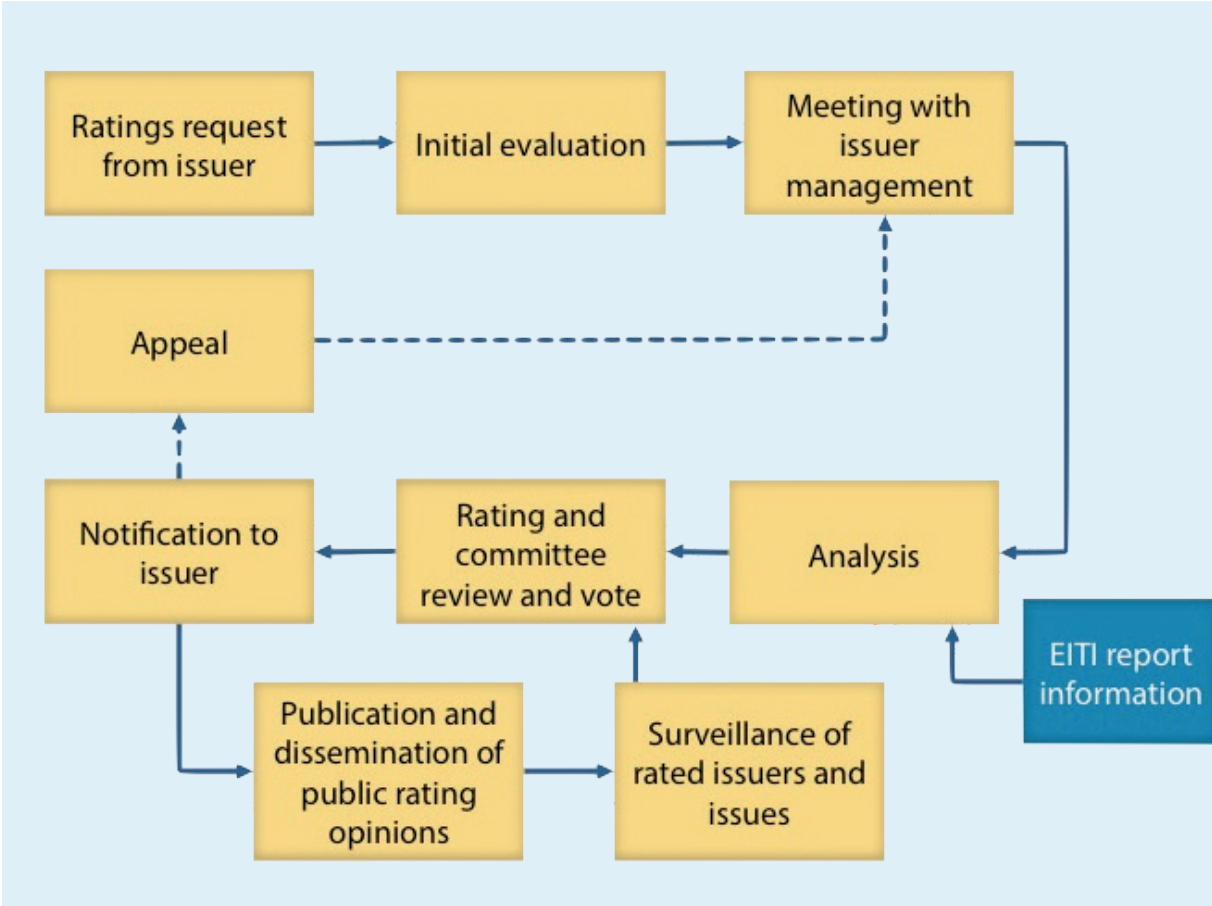
S&P's SOVEREIGN GOVERNMENT RATING METHODOLOGY AND ASSUMPTIONS

<i>Broad Rating Factors</i>	<i>Rating Sub-Factor</i>	<i>Sub-factor Rating</i>	<i>Sub-Factor Indicators</i>
Institutional and governance effectiveness and economic profile	1-6 score	Institutional and governance effectiveness score	Effectiveness, stability, and predictability of policymaking and political institutions (primary factor)
			Transparency and accountability of institutions, data, and processes(secondary factor)
			Debt payment culture (potential adjustment factor)
			External security risks (potential adjustment factor)
1-6 score	Economic score	Income levels	
		Growth prospects	
		Economic diversity and volatility	
		Currency status in international transactions	
Flexibility and performance profile	1-6 score	External score	External liquidity
			External indebtedness
			Adjustments for the trend and funding composition of the balance of payments
			Specific considerations for members of monetary unions
	1-6 score	Fiscal score	Sovereigns with limited external data
			Fiscal performance and flexibility
			Debt burden
			A sovereign's ability to use monetary policy and the exchange rate regime
1-6 score	Monetary score	Monetary policy's credibility and effectiveness and inflation trends	
		Development level of financial system and capital markets	
		Negative adjustments to the initial monetary score	
		Sovereigns in monetary unions	

This table is based on the information found in S&P's (2013) Sovereign Government Rating Methodology and Assumptions. https://www.standardandpoors.com/en_US/web/guest/ratings/ratings-criteria/-/articles/criteria/governments/filter/sovereigns

Figures and information in EITI reports can specifically influence S&P's institutional and governance effectiveness indicator.

Box 10: EITI data in the credit rating process



Standard & Poor's rating process (source: Standard & Poor's website, EITI addition by the International Secretariat). EITI reporting information is a source of rich information for the analysis phase.

The EITI (Extractive Industries Transparency Initiative) is a global standard that improves transparency and accountable governance of oil, gas and mineral resources. The standard is implemented by governments, in collaboration with companies and civil society.

Countries implementing the EITI disclose information on issues such as tax payments, licenses, contracts, production and national oil companies.

