From Offshore Oil to Offshore Finance: Shell Companies and Oil Licenses

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2023 WIDER Development Conference
Oslo, September 2023
Corruption in the Extractive Sector

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- NRGI report: offshore shell companies played a role in 8 out of 28 corruption cases.
Does the award of oil/gas licenses create opportunities for corruption?
The Award of Oil/Gas Licenses: a critical moment

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- The awarding of oil licenses occurs via:
  direct negotiation or participation in licensing rounds.

- Ministries/public figures hold a central role: high discretion.
Context: Exploration VS Production licenses

- EXPLORATION license:

  - Right to explore, drill and test for petroleum (zero to five years)

- PRODUCTION license:

  - Right to produce oil for commercial purpose (two to five years)

  - Exploration licenses are often a prerequisite for a production license, thus more lucrative.
Context: Exploration VS Production licenses

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Does the **award of oil/gas licenses** create opportunities for **corruption**?
Measuring corruption: a challenge

+ high RENTS + large DISCRETION of public figures = Risk of CORRUPTION

The central role of SHELL COMPANIES:

1. Politically connected individuals hide behind shell companies, win the permit and re-sell it to established oil companies.
2. Companies participating in the awarding round bribe of public officials via offshore shell companies.
3. Politicians siphon off part of the contract signing bonus from the government’s coffers to their personal accounts.
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Does the award of oil/gas licenses create opportunities for corruption?

*Descriptive Evidence*
Preview of the Results

Does the **award of oil/gas licenses** create opportunities for **corruption**?

The dynamics of shell companies incorporation suggests it does.

In the period around the award of an exploration license:

1. the number of new shell companies increases by 11 percent;

2. this relationship reinforces during oil booms.
Data: Oil Licensing Rounds

- Source: Business Intelligence provider
- 6,300 awards across 131 countries between 1990-2014
- Country / Date / Type (exploration vs production) of the award
Data: Shell Companies Incorporation

- Source: Offshore Leaks Database
- 740 thousand companies between 1990-2014, a third of which we can link to a country
- Country / Date of Incorporation

The leaked files from Panama-based law firm Mossack Fonseca contain nearly 40 years of data and include information about more than 210,000 companies in 21 offshore jurisdictions, from Panama to Hong Kong.

Source: The Panama Papers Read more
Estimation Strategy

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4. We check whether this change (point 3) differs from a country that is not awarding licenses in the same calendar months.
The hypothesis we test

If CORRUPTION occurs, we expect:

- a larger increase in the number of offshore shell companies during the awarding period compared to:
  - a) the same country when is not awarding licenses;
  - b) other countries that are not awarding licenses in the same calendar months;
- to observe an even greater increase in the number of shell companies during an oil boom, when the profitability of oil blocks increases.
Results: shell companies and awards of licenses

- The number of shell companies increases by 11%, in the six months around the award of an exploration license.
- The effect is true only for exploration licenses and not for production licenses.
Shell companies, Licensing during an Oil Boom

**Results**

During an oil boom, the incorporation of shell companies increases even more

<table>
<thead>
<tr>
<th>Number of New Entities (in IHS)</th>
<th>(1)</th>
<th>(2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Around Exploration Award</td>
<td>0.1102***</td>
<td>0.1109***</td>
</tr>
<tr>
<td></td>
<td>(0.0353)</td>
<td>(0.0379)</td>
</tr>
<tr>
<td>Around Exploration Award × Oil Price Change</td>
<td><strong>0.2748</strong></td>
<td>0.2631*</td>
</tr>
<tr>
<td></td>
<td>(0.1309)</td>
<td>(0.1440)</td>
</tr>
</tbody>
</table>

*Fixed-effects*
- Country: Yes
- Month: Yes
- Varying Slopes: Yes
- GDP Per Capita Quartile: Yes

<table>
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<tr>
<th>Observations</th>
<th>35,268</th>
<th>31,320</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean Dep. Var.</td>
<td>0.89</td>
<td>0.90</td>
</tr>
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Conclusion

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- Shell companies, as providers of secrecy, facilitate corruption in the awarding of license permits.
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• Corruption in the extractive industries perpetuates low and unequal growth of resource-rich countries (*Resource Curse*).
• This calls for an urgent response of institutions and policymakers to up their game in detecting corruption.
• Shell companies, as providers of secrecy, facilitate corruption in the awarding of license permits.
• More *transparency* in the awarding procedures and in the names of the ultimate beneficiaries of the shell companies is a first step to curb malfeasance in the extractive sector.
Thank You

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CLEAN - Bocconi University
Policy Suggestions

I) Monitoring of the participants to the auction process:

- Financial and infrastructural capabilities to carry out the investments required;
- Linkages to Politically Exposed Persons.

II) Involvement of International Organizations that are super-partes: through auditing and standardization of the awarding procedures.

III) Disclosure of the ultimate beneficiaries behind shell companies as a requirement to operate in the extractive sector.
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Licenses and Shell Companies (1990-2014)

Figure: License Awards

Figure: Shell Companies