FOURTH MEETING OF THE POLICY DIALOGUE ON NATURAL RESOURCE-BASED DEVELOPMENT

29-30 June 2015

Summary Report

The meeting was conducted under Chatham House Rule: "When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed."

I. Meeting objectives and structure

Building on the outcomes and conclusions of the Third Meeting (held on 17-18 November 2014), the Fourth Meeting of the Policy Dialogue on Natural Resource-based Development, held on 29-30 June 2015 at the OECD Conference Centre in Paris, afforded opportunities to review and advance the work under the four Streams of Work: **(i) Shared Value Creation and Local Development; (ii) Revenue Spending and Stabilization Funds; (iii) Getting Better Deals; (iv) Detecting Corruption Risks in Extractives.**

Austria, Chile, Finland, France, Germany, Ghana, Guinea, Kazakhstan, Korea, Liberia, Malaysia, Mongolia, Netherlands, Oman, Peru, Russian Federation, Senegal, South Africa, Sweden, Switzerland, Tanzania, Zambia were in attendance. Country delegations were joined by representatives of partner organisations, i.e. the African Development Bank, the African Union Commission, the Commonwealth Secretariat, the European Union, the UN Conference on Trade and Development, the UN Economic Commission for Africa, the UN Economic Commission for Latin America and the World Bank. Twenty-seven multinational mining, oil & gas companies, industry associations and civil society organisations also joined the multi-stakeholder consultation on 29 June. H.E. Mrs. Fatima Haram Acyl, Commissioner for Trade and Industry, African Union Commission, delivered a keynote address on “Using natural resources for shared value creation in Africa”.

Besides the OECD Development Centre, the Centre for Tax Policy and Administration, the Development Co-operation Directorate, the Directorate for Legal Affairs, the Environment Directorate and the Trade and Agriculture Directorate were also represented.

The meeting departed from the traditional conference format distinguishing between speakers and audience. Every participant played a role as both a knowledge holder and knowledge recipient and actively engaged in a thought-provoking, frank and constructive discussion. The OECD Development Centre, acting as a neutral knowledge broker, contributed to framing the broad thematic areas and specific issues for discussion, as outlined in the background documents distributed to all participants in advance of the meeting.

The dialogue was structured around 7 sessions. The first day (29 June) was dedicated to a multi-stakeholder consultation on Work Stream 1 (Shared Value Creation and Local Development), 3 (Getting Better Deals) and 4 (Detecting Corruption Risks in the Extractive Sector), gathering representatives of governments, international organisations, extractive industry and civil society. Session 1 focused on

reviewing the advanced draft of the Operational Framework on Public-Private Collaboration for Shared Resource-based Value Creation (developed by the Multi-stakeholder Drafting Committee chaired by Liberia and Norway during the period January – May 2015) and on discussing trade-offs and implications associated with specific policy instruments to unlock the potential for shared value creation and local development. Session 2 offered the opportunity to assess progress made with the G7 CONNEX Initiative and discuss how the Policy Dialogue could be linked and support the objectives of this international initiative. Session 3 was dedicated to reviewing the Typology Study of Corruption Risks in Extractives developed by the OECD Development Centre with the support of the Multi-Stakeholder Working Group set up for this purpose.

The second day (30 June) featured intergovernmental sessions with the participation of delegates from Partner International Organisations. Session 4 focused on comparing the results of the surveys and analysis on the performance of stabilisation and other resource-based funds and public investment options. Session 5 was dedicated to reviewing OECD and non-OECD methods for verifying mineral product prices in transactions between related parties. In Session 6, financial and administrative aspects related to participation in the Policy Dialogue initiative were presented. The meeting concluded with Session 7 on the role of commodities in the relationships between China and Latin America.

II. Summary of the Discussion and Conclusions

Mr Kang-Hyeon Yun, Vice-Chair of the Governing Board of the OECD Development Centre and Deputy Permanent Representative, Delegation of the Republic of Korea to the OECD opened the Plenary meeting, welcoming the continuous engagement of governments, international organisations, the extractive industry, think tanks and civil society. The Policy Dialogue was described as offering the opportunity to effectively contribute to the achievement of the Post-2015 development agenda, by fostering integrated policy making and leveraging multi-stakeholder partnerships that share knowledge and act upon identified workable approaches around shared resource-based value creation. Meeting the SDGs by 2030 will require unprecedented cooperation and collaboration among governments, non-governmental organisations, development partners, the private sector, and communities. Therefore, the SDGs will call upon all stakeholders to incorporate them into their own practices and operations. It was emphasised that integrated policy making and partnerships are the founding pillars of the Policy Dialogue and its outputs.

In her keynote address on "Using natural resources for shared value creation in Africa", H. E. Mrs. Fatima Haram Acyl, Commissioner for Trade and Industry, further recognised the central role of dialogue and partnerships in devising balanced and mutually beneficial solutions in order to harness natural resources for Africa’s structural transformation. Africa will continue to build the critical infrastructure to support the exploitation and beneficiation of its vast natural resource wealth, the development of skills and the adoption of climate resilient technology in line with the objectives laid down in Agenda 2063, currently operationalised through the African Mining Vision and the African Commodity Strategy. The Commissioner highlighted how structural transformation is not just about collecting revenues, but building downstream, upstream and horizontal linkages that can unlock the potential for shared resource-based value creation in line with the programme of work of the Policy Dialogue Initiative. The engagement of the private sector and the involvement of partners that are destination markets of Africa’s natural resource wealth were also considered critical to achieve the desired objectives. The Commissioner also clarified that all stakeholders have to play a role. Working together to create shared value is not about "doing the right thing" or for business to be charitable, but rather doing good business that creates shared benefits, saving costs for industry and boosting the competitiveness of local economies in the continent. The key challenge is how to strike the right balance, and that’s where the notion of shared value is critical in framing the dialogue and collectively shaping workable approaches. Industry acknowledged that there is pressure to show benefits and showed willingness to contribute to shaping balanced solutions.

Work Stream 1 - Shared Value Creation and Local Development (Session 1)

Session 1 was chaired by Hon. Deputy Minister of Operations Sam G. Russ, Ministry of Mines, Lands and Energy, Republic of Liberia. The session was dedicated to an in-depth review of the advanced draft of the Operational Framework for Public-Private Collaboration for Shared Resource-based Value Creation, produced though a multi-stakeholder drafting process chaired by Liberia and Norway. The Framework is an operational tool offering guidance on proposed actionable steps for harnessing non-renewable natural resources to build competitive, diversified and sustainable economies in a transformative and scalable manner. It is addressed to governments and industry, clearly articulating their respective roles for improved collaboration, mutual respect and accountability. The Framework transcends sectoral boundaries and looks at integrated approaches to build synergies and inter-linkages across sectors and different policy areas. Dimensions of value considered in the document include local employment, local procurement, shared used of infrastructure, power, transport and innovation, with a view to fully exploiting the potential for unlocking lasting and shared benefits directly or indirectly linked to resource exploitation. The Framework was regarded by participants as a robust and practical tool to clarify how governments and industry can work together to achieve the desired objectives.

The Framework articulates the roles of governments and industry and how to jointly identify and evaluate opportunities for local development that outlive the life-cycle of extractives. Participants identified the following common success factors, as reflected in the Framework.

The articulation of a common long-term vision and systemic approach for shared value creation by all parties involved to define how the extractive sector can fit into and contribute to broader national and regional development strategies. Finland provides an example of how the role of the mining sector and its contribution to the economy was defined through an inclusive process, led by the Prime Minister and involving ministries of environment, employment and economy with the support of ten expert working groups. This process resulted in the Action Plan for making Finland a leader in the sustainable extractive industry, looking at the extractive sector as one participant in the development process.

Developing a common understanding of the opportunities arising within as well as around the extractive value chain was considered essential. Beneficiation is an important component of Finland's mineral strategy. In Finland, benefits from mining do not come from royalties or taxes on mining, but from the indirect benefits generated through ancillary activities (metals industry and companies providing machinery and equipment and technological services), corporate taxes and income taxes of workers. The experience of Sweden further shows how competitiveness could build through sustainable innovative solutions, both along the mining value chain (ranging from the development of innovative deep prospect techniques, safe environmental processing of extraction of minerals and remediation methods to increase energy efficiency) and across sectors (maximising synergies between mining and reindeer herding and tourism).

The International Council on Mining and Metals (ICMM)'s mapping tool on local employment, procurement opportunities and indirect/induced benefits along the lifecycle of mining projects, reinforces this point. The mapping exercise shows that although modern mining is not a direct large scale employer, it can be absolutely transformative in terms of the large scale capital investment and the potential for indirect benefits by access to linked opportunities for enterprise development. While it was recognised that firms can make much greater efforts to generate local employment and procurement of goods and services along the mining life-cycle, it was clarified that these opportunities are time-bound, dependent on country contexts and commodity specific. There is also a risk of dependence and imbalances (including concentration of wealth) when taking a too narrow project-based approach. Reference was made to the experience of Ghana, where the partnership between the IFC, the Ghana Minerals Commission and the Chamber of Mines is developing a co-ordinated collaborative approach to promote industrial development through linkages. Yet, the point was made that ten to fifteen additional target goods could be localised if there were a concerted and coordinated effort within the private sector, well beyond mining, and between

the private sector and the government as whole. The adoption of a systemic approach thus requires genuine and unprecedented coordinated efforts to align multiple investments decisions across sectors to support market development and public service provisions.

An up-to-date collective understanding of the underlying context by both the government at the central and local level and the private sector (including but not limited to the extractive sector), with a common understanding of opportunities, gaps and resources to bring transformational change to scale. Countries need first of all to understand where to position themselves in global value chains and how to advance their competitive advantage. Participants agreed that getting to a globally competitive position should be the common goal across governments and industry. The long timescale involved in extractive projects presents both challenges and opportunities, tempering expectations about the pace at which employment and local procurement can be generated, but at the same time creating space for building local capacity. Matching skills with projected demand is a long-term endeavour, requiring the involvement of the private sector from the very outset. Establishing information-sharing platforms to guarantee a permanent flow of information was considered important to unlock multiplier effects. It was recommended to identify segments of local supply and service provision that can be developed to global standards.

In Chad, there was no local capacity when oil was first discovered. More than three decades elapsed between oil discovery and commencement of production. Twelve years after the beginning of production, it was reported that the workforce has been heavily localised (88%) and operating at global safety standards, despite declining levels of production. The oil project has contributed 3.5 million USD to local suppliers, and the government of Chad has acquired a 25% stake in the project after developing the capacity to become a fully-fledged partner. In Western Australia, four roundtables were established with the participation of communities, operators and the education sector to look into opportunities for integrating aboriginals into the extractive value chain. The operators provided a five years outlook as well as a twenty five-year outlook identifying service maintenance requirements and highlighting the need to realign education so that vocational training and programmes could be developed to build the capacity needed. Pakistan offers another example of the initial lack of local skills. One participant reported that Pakistan allocated a certain amount of oil revenues to develop local skills through programmes and schools run by local NGOs, given the weak capacity of local institutions. Namibia provides another example of joint efforts between governments and the private sector to develop the necessary capacity. The Petroleum Training and Education Fund was established in 1993 to help build capacity in the petroleum industry. The 1991 Petroleum Act obliges companies that have been granted licences agreements to contribute to the fund. Part of the fund is also used to encourage students to undertake internships programs in the mining industry and develop knowledge on the country reserves. The experience of Morocco and Sweden also shows the importance of the triangulation among industry, universities/centres of excellence and authorities to maximise synergies and drive innovation. Attention was also drawn to the need to get the fundamentals right to develop appropriate responses. For example, while Brazil and Malaysia have adopted similar strategies, working through national oil companies and planned interventions with local content requirements to develop local capacity, the number and composition of the workforce in these two countries differ significantly. This suggests that some adjustments may be required to adapt solutions to less dynamic environments with high unemployment rates and skilled workforce close to retirement.

Besides capacity constraints, other participants identified complex procurement processes, tenders, and bids and access to finance as barriers to the integration of local Small and Medium Enterprises (SMEs) into extractives supply chains. SMEs need guaranteed loans and market liquidity to run their own business, allowing them to pay for their staff and goods before they get paid by big multinationals' tier 1 or 2 suppliers. A participant reported that in Nigeria, a partnership was created with five regional banks to overcome the barriers to indigenous SMEs suppliers' access to credit. Within the existing legal framework, the objective was to improve information-sharing between the operators generating the purchase order, the bank disbursing the loan and the local suppliers who can obtain a loan against the purchase order. An information-sharing platform was created to allow banks to check the existence of the purchase order as well as the list of pre-qualified local suppliers through a clear and transparent process. The loan is

disbursed only once the purchase order has been issued and only up to the amount corresponding to the purchase order, thus bringing down exposure to risk for banks. Four billion dollars have been made available by banks to small enterprises, with improved processing time for the loan request, with simplified access to small credit at competitive interest rates. In Qatar, the Qatar Development Bank provided coaching and training to local SMEs to support their capacity to create a business plan and apply for a loan. 150 Qatari SMEs have now access to the oil and gas supply chain and were awarded contracts through normal bidding process.

Roads, railways, ports and access to power and water were also considered as basic requirements and enablers for resource-based development. Assessing the aggregate demand for power, transport and water infrastructure and developing solutions for shared use were regarded as key elements for unlocking benefits and opportunities linked to extractives. Natural resource projects both require and can drive the creation of infrastructure. One participant described Africa as a continent holding a vast untapped potential for power generation, both from traditional hydro, coal, and natural gas, as well as renewable technologies. World Bank's research shows that beyond South Africa, only Ghana and Zambia have mines that are connected to the grid. Current power demand is led by aluminium, copper, platinum, chromium, and gold, with smelting accounting for ¾ of the demand. In many countries, including Guinea, Liberia, Mozambique, the mining demand vastly exceeds the non-mining demand. By 2020 it is estimated that energy demand in Africa will triple, if planned mining investments are implemented. The majority of mines in Africa currently generate their own power, a practice that, while expensive, =remains the most cost-efficient solution in terms of reliability, a key pre-requisite for industry operations. The assumption is that mines can help harness the untapped energy resources as both anchor customers and energy generators. Between 2000 and 2012 mines generated 1519 megawatts at a cost of 1.3 billion. Looking at the growing demand, the cost of self-supplied power will no longer be sustainable. The World Bank estimates that in Guinea the cost of self-generation is five times as much as if the mines jointly developed hydro resources which could generate wider benefits well beyond the mines. Energy demand must reflect individual projects needs as well as broader developmental goals. There are clear gains associated with joint infrastructure planning: for companies cost savings and quality of infrastructure and for governments know-how and improved socio-economic outcomes. It can also promote innovation - at an extractive project in a remote areas of Chile, solar power plants were constructed to generate power (otherwise not affordable using conventional sources), with excess power sold on the spot market without subsidisation.

Within the context of infrastructure planning, shared use of water was recognised as a critical element, necessary for many aspects of extractives but also for development as a whole. The recommendations drawn from the 2015 OECD report *Water Resources Allocation: Sharing Risks and Opportunities* have informed the recommendations in the advanced draft Framework to help governments allocate water effectively, sustainably and equitably for the greatest benefit. The importance of adopting an integrated approach involving all stakeholders was emphasised to address competition and equity issues. For example, trading of water rights, as done in Australia, has reduced water consumption during periods of draught, allocating water to the highest values without reducing economic output. Charging full price for water services, recognising the true value of water, is needed. This includes putting a price on treatment, delivery, environmental cost of pollution and infrastructure costs of maintenance and replacement. Alternatives to freshwater use should also be considered to manage water security and improve efficiency. Rainwater collection, sea water, waste water and desalination offer possible alternative options. Industry and governments can work together to reduce the water footprint. For example, industry can construct water treatment facilities with wider capacity to also serve the needs of local communities and governments may provide the delivery of water services and the collection of tariffs. It was suggested that the Framework should recognise that some water resources are non-renewables and address management of water quality.

As one participant noted, the extractive sector is a global industry that does not stop at the border of any one country. Often, the best solutions to infrastructural issues are regional rather than national. This may require taking a broader approach, considering the context of other projects operating in the same region,

in order to benefit from economies of scale with regard to infrastructure development and workforce and supplier capacity development. This approach depends on a high degree of coordination across countries, both between the public and the private sector and between different companies operating within the region.

The state has a fundamental role to play to enable and foster local development, while the involvement of the private sector is key to inform evidence-based and long-term policy making. Participants reiterated that local content policy does not equal local content requirements. Local content policies should mandate that governments and industry jointly and fully evaluate the potential for local participation and value creation and collaboratively figure out workable approaches adapted to specific circumstances. Public-private coordinated responses were considered vital to effectively overcome structural obstacles and develop targeted and mutually beneficial solutions. In this respect, the Framework was considered a useful tool, laying out the process and actionable steps to devise collaborative solutions and translate them into practice. Australia, Canada and Oman were cited as examples where local content policies focus on process as opposed to targets and penalties and on giving full and fair opportunities for local participation, while working towards mutually beneficial solutions. Participants discussed trade-offs, implications and impact associated with the choice of policy instruments, such as local content requirements and export restrictions. The point was made that trade policy is rarely an optimal instrument to address domestic market objectives, because it is untargeted and has negative side effects. OECD analysis shows that downstream industries would benefit from removal of export taxes – even in countries that have export taxes on raw materials, given that the lowering of prices of raw materials would increase general welfare. With regard to local content requirements, it was observed that host governments do realise that such measures are not compatible with WTO TRIMS provisions. Yet, since they are under political pressure to show that the exploitation of their finite natural wealth will deliver tangible and durable benefits, they may decide to resort to such measures. The point was made that the cost associated to the implementation of local content requirements may be off-set by certainty around the expected contributions, thus ensuring that project operators work towards the desired goals. Other participants noted that legislation does not necessarily lead to success, as it introduces elements of rigidity. In a high-risk market and in project environments often subject to shifting conditions, flexibility in implementation is extremely beneficial. Enshrining targets in laws means that if a target becomes obsolete, either the law must be changed or the target must still be met. This means that targets can act as an impediment to move in the desired direction, prompting companies to shift the lens through which local development is viewed: rather than an opportunity to maximise mutual value, it can become a requirement which must be met at as minimal a cost as possible. On the other hand, it was noted that concrete results may not always be achieved if left to best-effort endeavours. It was clarified that while the challenges are common the concrete tools to overcome structural obstacles that are holding back development may vary and require different types of policies, not necessarily local content requirements. In this regard, the Framework offers a tool to make collaboration work in practice and develop workable approaches adapted to specific circumstances. The importance of piloting concerted approaches at country-level was considered vital to avoid that policy makers simply revert to policy options they feel more comfortable with.

Participants discussed the opportunity to develop metrics and indicators to measure progress practice. The wide variety of opinions on indicators discussed demonstrated that there was no "silver bullet" approach that was applicable in every situation, aside from understanding the baseline situation before indicators are developed and ensuring proper interpretation of the data once gathered. It was suggested that impact should be measured at the country level against the strategic objectives set out in regional and national plans to assess how the extractive sector is contributing towards the transformative drivers for growth. Experience shows that dramatic changes in commodity prices may easily override efforts by governments to promote the sustainable development of the mining industry. Participants from both the private sector and government raised the importance of ensuring that indicators are cost-effective, efficient, and straightforward to implement. Data collection and assessment is important, but cost and complexity must also be taken into account in their design to ensure that they are manageable, in particular for SMEs. Participants emphasised the importance of establishing cost-efficient, effective, and dynamic mechanisms

for regular monitoring and reporting. The government of Western Australia, for example, tracks progress in the implementation of the local content policy, by issuing regular reports on funding for education, supplier capacity initiatives, bids for local procurement and global trends in commodity prices.

Work Stream 2 – Revenue Spending and Stabilisation Funds (Session 4)

The session was co-chaired by Mr Francisco Vergara, Head of the Sovereign Wealth Fund Unit, Ministry of Finance of the Republic of Chile and Mr Muhamed Izbastin, Director of Management of State Obligations and Development of the Financial Sector Policy Department, Ministry of National Economy of the Republic of Kazakhstan. Participants welcomed the inception report on the performance of stabilisation funds and investment options as providing a common knowledge base for knowledge sharing and peer-learning, by contrasting and comparing experiences across OECD and non-OECD countries with stabilisation funds in place. The report builds on responses received from Chile, Kazakhstan, Mexico, Mongolia to a questionnaire distributed in the aftermaths of the Third Meeting of the Policy Dialogue held on 17-18 November 2014. It also reflects comments received from the OECD Economics Department. Chile acted as a Knowledge Peer to distil lessons. Participants welcomed the key lessons drawn from the cross-country comparative analysis on the performance of stabilisation funds and public investment options and highlighted the trade-offs related to the management of resource revenues.

Over recent years it has become quite fashionable for resource rich countries to establish or consider establishing resource funds to fulfil a stabilisation function and/or to save for future generation, with the expectation that positive development outcomes will result. Unfortunately, this is easier said than done, as there is no one off-the-shelf model that works seamlessly and effectively in all places at all times. Country contexts matter. However, as shown in the inception report, there is much to learn from past and present experiences, allowing to draw out the fundamental drivers of natural resource fund performance as well as principles and practices that support policy and operation effectiveness that have relevance in most places and most times. Indeed, the report showed that natural resource funds can only be effective and sustainable over time as part of a coherent and disciplined fiscal policy framework. In this regard, natural resource funds should be integrated with the budget through deposit and withdrawal rules and procedures, which are rigorously articulated and defined in the legislative mandate. Long term value creation is contingent on the management of risk and uncertainty, which in turn depends on the policy objectives set for natural resource funds. There must be coherence between the fund's policy objectives, such as stabilisation or saving for the future, and its investment function. For example, stabilisation funds by design should typically have an investment policy that limits investment to low risk and highly liquid fixed income securities and cash. In addition, the degree of allowable investment risk and the scope of allowable investments must match the organisational and human resources capabilities available to the fund as an institutional investor. For example, the level of expertise of a conventional central bank may be appropriate and sufficient for managing and/or delegating to third party asset managers a portfolio of low risk fixed income securities and cash, but may be insufficient for a portfolio with broader range of asset classes and risk profiles. The fund should also be insulated from short political cycles.

During the discussion, participants highlighted that the policy objectives of natural resource funds may differ from one country to the other depending on their development stage and their current and future development priorities. It was recommended to get the stabilisation function right first in order to ensure sustainable streams of revenues over time and enable effective planning and budgetary decisions, regardless of minerals and oil price fluctuations. It was further recommended to keep different funds serving different objectives separate. Ghana's Petroleum Funds are illustrative in this respect, with the Heritage Fund saving for future generations and the Stabilisation Fund smoothing the effects of commodity price volatility and sustaining public expenditure in periods of revenue shortfalls. The remaining share is channelled through the national budget and shall serve for spending and investment in priority sectors such as agriculture, education, health and infrastructure. The question of the appropriate time for setting up a fund was raised. Ghana set up its Petroleum Funds before the exploitation of the Jubilee field came into operation, to get ahead of risks of corruption and Dutch Disease. In Papua New Guinea, the fund was

established when the final investment decision by the investor on a major oil and gas project was made and construction was underway.

Participants discussed trade-offs between investing in the domestic economy (thus mobilising resources to invest in value creation and replacement of resources that are getting exhausted) or abroad, saving for future generations. Norway is often referred to as an example to look at. While there is much to learn from the Norwegian experience, finding suitable comparables for informing developing countries' decisions is challenging, given their different contexts and levels of development. It was suggested that after stabilising the budget, it may be more appropriate for developing countries to spend through the budget to meet development priorities and diversify the economy out of extractives. It was clarified that allocation of capital should be a decision of parliament. Natural resource funds should not act as a substitute for democratic processes. In fact, investment managers don't have the capability to invest and identify opportunities for domestic investment. Other specialised vehicles, such as development banks or public investment funds, can be used for this purpose. The point was made that in any case both international and domestic portfolios must compete on risk adjusted returns. In this respect, it was noted that Brazil expects to receive 6 dollars in return for every dollar spent on geological surveys. In Nigeria, spending on domestic investment should always be supported by an economic case for it. Even if good investment opportunities exist in developing economies, issues around capabilities to determine what a good investment is and execute selected projects may arise. In such contexts, saving for future generation can be a prudent option, while the necessary capabilities are built up.

An additional challenge facing countries with stabilisation funds in place is the reputational risk associated with the low returns on investment made in currencies that have depreciated and how to report on the performance of the funds in similar situations, exposing governments to public scrutiny and potential criticism for pursuing a conservative investment policy. In this respect, transparency was referred to as an important tool, not just to report on performance, but more importantly to educate the public and stakeholders on what and why conservative investment policies have been put in place. The New Zealand Superannuation Fund makes public education and communication a core element of its strategy, given that 70 per cent of its investment portfolio is equity, thus subject to great volatility. The experience of Chile which opted for a conservative policy shows how trust has been built and maintained among citizens and investors over time through transparent communication around the key objective of the stabilisation fund which is not to maximise returns, but rather hedge fiscal revenues against fluctuation of the copper price.

Participants discussed further risks associated with domestic investment, namely inflationary pressure linked to the limited absorptive capacity of the local economy. It was reported that even Australia experienced rising prices for highways, after deciding in 2007 to massively invest in local infrastructure projects. There are limits to the aggregate demand that an economy can handle to avoid the appreciation of the exchange rate and negative spill overs on employment and non-tradable sectors, which in most developing countries is agriculture. On participant referred to cash transfers used in Alaska as a possible alternative, also useful to build accountability structures as a key element of good governance. It was observed that the Alaska model proved successful in a very rich country with the necessary institutions and banking system in place to make the cash transfers operate. The replicability of the model in least developed countries was questioned, given that most of the time the required infrastructure is not in place. It is important to note that in the case of Alaska, dividends comes from the financial performance of the Alaska's Permanent Fund, flowing from a savings fund of 60 billion dollars which has been invested for 37 years. Mongolia offers interesting lessons on cash transfers based on volatile mineral revenues that are relevant for developing countries. It was explained how Mongolia experienced rising inflation following the introduction of a large cash transfer programme providing for the disbursement of 1,000 dollars to each individual citizen. As a result, prices increased. This prompted the central bank to react, leading to an appreciation of the exchange rate, with huge negative impact on non-mining sectors. State-owned enterprises borrowed a lot of money to make the cash transfers and are still using revenues from exports of raw materials to repay the debt.

Participants recognised the need to establish as part of the Policy Dialogue Work Stream 2 a space where natural resource funds from developing countries can exchange experiences and learn from each other on how to achieve their development objectives. It was clarified that this endeavour would not overlap with the mandate of the International Forum of Sovereign Wealth Funds, which is primarily a grouping of large sovereign wealth funds created for a different purpose, namely to address concerns related to their influence on financial markets and increase transparency of their operations, including through best practices reflected in the Santiago Principles. A forum where natural resource funds can discuss ways to stabilise resource revenues and put them to use to leave future generation with a stronger economy does not yet exist. Participants agreed to fill this gap, by bringing together and share the experience of other major natural resource funds, leveraging the partnership with the African Union Commission and coordinating with the International Sovereign Wealth Fund Forum. This would allow addressing specific concerns relevant to developing countries.

Work Stream 3 – Getting Better Deals (Sessions 2 & 5)

Session 2 was chaired by Hon. Deputy Minister of Operations Sam G. Russ, Ministry of Mines, Lands and Energy, Republic of Liberia and Session 5 was chaired by Mr Kang-Hyeon Yun, Vice-Chair of the Governing Board of the OECD Development Centre and Deputy Permanent Representative, Delegation of the Republic of Korea to the OECD.

Supporting complex contract negotiations (Session 2)

At the last meeting on 17-18 November, government delegations received an update on the G7 Initiative on Strengthening Assistance for Complex Contract Negotiations (CONNEX) aimed at strengthening assistance to developing countries for complex contract negotiation, focusing initially on the extractives sector. The initiative was launched in June 2014 at the Brussels G7 Summit with a view to "providing developing country partners with extended and concrete expertise for negotiating complex commercial contracts, focusing initially on the extractives sector". CONNEX is articulated around three pillars: 1) a resource hub that provides resources, contacts, and guidance on contracts and negotiations, 2) independent and high quality advice provided by a multidisciplinary team governed by a code of conduct; and 3) long-term capacity building amongst stakeholders.

In their 2015 Declaration, G7 Leaders reaffirmed their commitment to the CONNEX Initiative, aimed at providing multi-disciplinary expertise in developing countries for negotiating complex investment agreements. They endorsed the Code of Conduct for multi-disciplinary advisory services and encouraged support providers and other relevant stakeholders to incorporate the Code as a set of binding principles into their contracts worldwide. They encouraged pilot projects to be undertaken under the banner of the CONNEX initiative in collaboration with support providers, such as the African Legal Support Facility. G7 Leaders welcomed further coordination on mechanisms for knowledge sharing and peer-learning on the subject of negotiation support.

Participants welcomed the G7 CONNEX Initiative as a useful means to reduce asymmetry of power and information between governments and investors and to ensure that contracts produce mutually beneficial outcomes for all parties. In order to achieve this objective, participants considered that governments should know what their resources are worth before they enter into contract negotiations. Governments also need to develop a clear vision of what they want to achieve with their resource wealth which should be reflected in negotiating positions, based on financial modelling to quantify the risks and returns associated with different contractual options. Reference was made to the African Mining Vision as the basis for achieving development objectives through resource contracts in the continent. Finally, well equipped teams should be put in place with clear directions on the desired outcomes. One participating country shared its experience on the voluntary renegotiation of specific aspects of contracts led by an inter-ministerial committee, assisted by five law firms with the financial support of the African Legal Support Facility, hosted by the

African Development Bank. It was reported that the revision of seven agreements was completed; six are at an advanced stage, while the remaining are stalled mainly due to delays in finding the necessary financial resources. An assessment of the impact of the negotiation support provided will be possible once the process is completed by end of 2015. While recognising the importance of negotiation support, emphasis was put on the need to strengthen the capacity of the government negotiating teams and to better structure deals at the outset. To this end, emphasis was put on the importance of long-term capacity building, which is the third pillar of CONNEX. Some caution was expressed on the modalities selection of countries benefitting from CONNEX and its implications, should ODA conditionality be used.

Participants discussed the opportunity for the Policy Dialogue's Work Stream 3 to host a Negotiation Support Forum to share knowledge on how to achieve mutually beneficial deals and balance risks and returns across governments, investors and society at large, supporting the second pillar of the G7 CONNEX initiative. Participants agreed on the merit to take this idea forward. Participants recognised the usefulness to establish such a negotiation support forum to improve knowledge sharing and peer-learning among support providers and between support providers and Partner countries to transform (existing) experiences into a common knowledge base, discuss further improvements to negotiation support and foster cooperation between Support Providers, including improving understanding on what a good deal actually is. Multi-stakeholder dialogues hosted by the Policy Dialogue could help identify the key factors for achieving a good deal and monitor progress with implementation and impact. In line with the scope of the Policy Dialogue, it was recommended that the negotiation support forum should cover both mining and oil & gas, because the demand is moving very rapidly towards the latter sector, where countries will need much more assistance to negotiate enduring agreements.

Verifying mineral product prices in transaction between related parties

Session 5 provided the opportunity to update delegates on on-going work on verifying mineral product prices in transaction between related parties which is being developed with the strong support and engagement of the Policy Dialogue as part of a broader toolkit currently being developed for the G20 Development Working Group, in addition to G20/BEPS actions aimed at preventing base erosion and profit-shifting (BEPS) in commodity transactions.

The OECD's Tax and Development Taskforce Secretariat introduced the Session, outlining the risks of tax base erosion involving the sale and purchase of mineral products between related parties, which can reduce revenue from company income taxes and other revenue instruments that are based on product prices. Product price manipulation in transactions between related parties can be difficult for revenue authorities to detect and mitigate, because it requires considerable information on transactions between unrelated parties for a comparable product under comparable conditions. This information can be challenging to obtain, if it exists at all. In addition, authorities may not know what data might assist them, or may be impeded by a lack of resources to research particular product value chains or markets, or may be unsure where to focus scarce research efforts.

At the request of participants in the Policy Dialogue meeting, the Secretariat shared the preliminary methodology for studying arm's length mineral pricing practices, to assist developing country revenue authorities to improve their understanding of mineral product value chains and product pricing. The Secretariat surveyed OECD and non-OECD tax authorities to share the approaches used to understand and verify mineral product prices. The methodology begins by mapping mineral transformation chains to identify mineral products that are commonly traded. It then focuses on identifying key factors that commonly determine prices (such as the physical attributes of the product) and the data sources that are available to compare a transaction between related parties with a transaction between unrelated parties occurring for a comparable product under comparable circumstances. The Secretariat has applied that methodology to examine the pricing practices for copper, gold and iron ore products that are commonly exported by developing countries (for example, copper concentrates). The case studies emphasise the

importance of building sector-specific understanding in tax authorities, and building local, regional and international networks to strengthen understanding of common industry practices.

Participants welcomed the progress made since the Third Policy Dialogue meeting and considered the work directly relevant to the challenges facing many developing countries. Some participants noted the challenges in understanding mineral product pricing are particularly acute where developing countries do not know the identity of the final mineral product purchasers overseas or the final sales terms. In this regard, participants shared knowledge on complementary approaches to fill this gap. Performing comprehensive due diligence to understand the counterpart, including affiliates was recommended. In one case, the functional analysis performed to verify prices for minerals for which a public price does not exist resulted in improved revenue collection through a more accurate evaluation of the functions/activities, assets and risks associated with the transaction between the related parties. The Policy Dialogue on Natural Resources offers a space where such complementary approaches used in non-OECD countries could be discussed. Participants saw potential for the methodology and OECD research to be extended in several productive directions. For example, it could be extended to inform policy considerations to understand where opportunities for employment creation lie in regional value chains, and/or to minerals for which no quoted prices exist and for which comparable prices are not readily available (e.g. some rare earth elements).

Participants encouraged the Secretariat to continue to refine the work and present the final results at the next meeting, working closely with willing countries, organisations and others to further improve the stock of knowledge available to developing countries on these issues.

Work Stream 4 - Detecting corruption risks in extractives (Session 3)

The session was co-chaired by Mr Fuad Khoury Zarzar, Comptroller General, Republic of Peru and Mr Nicola Bonucci, Director for Legal Affairs and Representative to the G20 Anticorruption Working Group, OECD. Participants reviewed and discussed the Typology Study on Corruption Risks in Extractives prepared by the OECD Development Centre with the support of a Multi-Stakeholder Working Group composed of Guinea, Indonesia, Papua New Guinea, Peru, Philippines, Eni, Natural Resource Governance Institute, Oxfam France, Sherpa France, and Transparency International. The Typology study further benefitted from input and comments received from the OECD Anti-Corruption Division of the Directorate for Financial and Enterprise Affairs.

Participants welcomed the Typology study as an innovative tool and a key milestone in the fight against corruption, offering the first systematic mapping of corruption risks all along the value chain of extractives, also covering emerging risk areas so far overlooked and moving beyond the usual focus on revenue streams. In this respect, it was observed that the Typology should be regarded as a living document open to additional contributions to reflect the permanently evolving and changing nature of corruption, so as to ensure its future continuous relevance. Asymmetry of information, lack of transparency and high-level of discretion (e.g. in the selection of joint venture’s partners, in the hiring of local staff and application of pre-qualification criteria for the selection of suppliers in bidding rounds) were identified as common risk factors along the value chain. Loopholes in regulatory systems were put forward as a major impediment to the effective prevention and mitigation of corruption. For example, commodity flows that are illegally acquired or mispriced (undervalued) are not covered by existing anti-money laundering laws which focus on financial flows. It was emphasised that this gap makes the commodity trading sector particularly vulnerable to new patterns of corruption, with diversion of funds and significant revenue leakages for producing countries. While the commodities are resold in the international market, often through a series of intermediaries and opaque structures, the final purchaser pays the market price and deposits the money into a bank account, with no illicit financial flows involved in the transaction. Practices developed to launder oil illegally acquired in countries subject to U.N. or U.S. sanctions provided another illustration of the increasingly complex schemes and adaptive strategies put in place in the commodity trading sector to circumvent existing requirements at the national or international level. Far from stigmatising any specific

policy, conduct or actor, the Typology, maps out risks to increase awareness and improve understanding around the complexity of evolving corruption patterns and help identify loopholes that increase exposure to corruption risk for improved policy making. Participants considered the document as a milestone in effectively fighting corruption. Participants emphasised that the comprehensive and practical analysis provided by the Typology will provide an excellent basis for stakeholders to join up forces to address identified risks and develop solutions to counter adaptive strategies and inform better policy making. In that respect, the continuous involvement of government, industry, civil society, local communities will be necessary. Companies, in particular, were urged to further engage in the next steps of this exercise, given the incidence of corruption cases involving corporate senior management, as shown by the OECD Foreign Bribery Report.

The proposal to complement the typology with mitigation measures and incentives to prevent and reduce corruption risks in the extractive sector received unanimous support from participants. Participants started sketching out possible responses to address identified corruption risks, stressing the importance of putting the issue in context and looking into the creation of opportunities for creating local value as part of the solution.

Participants further noted that this work could support the G20 Anti-Corruption Working Group's efforts advance work on corruption in high risk area. The Typology was briefly introduced to the G20 Anti-Corruption Working Group on 16-17 June in Washington DC and may be tabled for further discussion at the upcoming October meeting in Paris.

Special session on the impact of China's commodity demand and Latin America's management of natural resources and development strategies (Session 7)

The session was moderated by Mr Angel Melguizo, Head of Unit, Latin America and the Caribbean, OECD Development Centre.

This session offered the opportunity to explore how the evolving role of China in the global economy is affecting prospects for development in Latin American countries, especially those most reliant on commodity exports. China has become the third export destination for commodities originating from most countries in the region. Moreover, Chinese Foreign Direct Investment (FDI) has intensified in the last four years representing over the period 2010-2013 more than USD 10 billion per year in absolute terms and 5 to 6% of total inflows to Latin America in relative terms. Chinese FDI inflows to Latin America have concentrated mainly in three countries (Brazil, Peru and Argentina) and consisted of the acquisition of stakes by Chinese state-owned enterprises in large oil and mining projects. It was observed that as part of its "going out" strategy, China has scaled up multilateral engagement with Latin America with the main objective to boost trade in commodities. Although South America has overall benefitted from the commodity-boom and China's demand for raw materials, the limited composition of the export basket remains a source of concern for many Latin American countries. Compared to other natural resource OECD producing countries, South American countries present little diversification and differentiation of exported products. This increases exposure to volatility and external shocks. Moreover, Latin American countries largely failed to capitalise on the huge resource rents to foster structural transformation. Resource windfalls were mostly used to subsidise consumption and social assistance. Latin America countries present only have a few cases of world class innovators in natural resource-based activities, while Chinese FDIs have not led to the expected positive spill overs, due to the lack of creation of linkages with the local economy. While mining investments in general have generated over time social conflicts and environmental degradation across Latin American countries, the point was made that social and environmental performance of Chinese firms is uneven, with some operating at high and others at low standards, with negative impacts of large extractive projects largely depending on the lack of law enforcement by local authorities. It was reported that Chinese private companies, in particular, are still on a learning curve trying to understand how to best interact with local NGOs that closely scrutinise the activities of their overseas operations.

China is already shifting from an investment to a consumption-driven economy, with a slowdown in the demand for inputs, a process that is already affecting Latin American and African countries highly dependent on commodity exports. This partly explains the fall in commodity prices, in particular for iron and aluminium. It was noted that China's transition into a new normal, with emphasis put more on quality than quantity growth, is also likely to intensify competition for investments and put pressure on the preservation of environmental safeguards for big projects.

Beyond the direct effects on demand and prices, the discussion highlighted the pivotal role that China is playing, including through the conclusion of a number of cooperation agreements, in financing mega infrastructure projects in Latin America, as illustrated by the transcontinental railway connecting Brazil and Peru through the Amazon forest area. It is worth noting that in some cases it is no longer the China Development Bank or Exim Bank that are funding these mega-projects, but ICBC, the Industrial and Commercial Bank of China, with the backing of the Chinese government. As part of the new normal, China is also heavily investing on developing new comparative advantages through massive investments in national education. This will probably enable China to capture many of the high value-added segments of global value chains, as well as produce more sophisticated and innovative goods and services. Having missed the opportunity to use resource rents to bring about structural transformation, Latin American countries may find it difficult to compete with China in these areas, with the potential risk of being confined to lower value-added segments of production.

In this scenario, it was submitted that if China pursues domestic stimulation policies, the role of U.S. and other emerging economies, like India, will need to be further investigated, also bearing in mind the relationship between the US dollar and the price of commodities. But most importantly, the key challenge for Latin American countries remains the articulation a long-term strategy for their relationship with China, as cooperation so far has been largely driven by short-term or opportunistic considerations with little consideration of long-term implications and impact.