

THIRTEENTH PLENARY MEETING OF THE POLICY DIALOGUE ON NATURAL RESOURCE-BASED DEVELOPMENT

25-26 November 2019

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

Under the co-chairmanship of Kazakhstan, Liberia, Norway, and Switzerland, 22 government delegations from Africa, Asia, Europe, Latin America and the Caribbean, as well as representatives from 6 partner international organisations and institutions, and 41 major firms, industry associations, civil society organisations, academia, law firms and think tanks, convened at the OECD on 25-26 November 2019 for the Thirteenth Plenary Meeting of the Policy Dialogue on Natural Resource-based Development. International organisations and institutions represented included the Commonwealth Secretariat, the European Commission, the Extractive Industries Transparency Initiative (EITI), the International Energy Agency (IEA), the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF), and the United Nations. The Director of the Development Centre welcomed participants and the Chair of the Development Centre's Governing Board delivered welcoming remarks.

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. Besides the OECD Development Centre, the OECD Environment Directorate, the Centre for Tax Policy and Administration (CTPA), the Directorate for Financial and Enterprise Affairs (DAF) and the Development Co-operation Directorate (DCD) were also represented.

The first day (25 November 2019) began with a session on BEPS in mining. The IGF presented a Zero Draft Practice note on tax treaties and the mining sector in order to receive early feedback from participants. CTPA presented a framework for mineral products valuation, with a specific focus on bauxite. The second session of the day focused on the role of Sovereign Wealth Funds (SWFs) and Strategic Investment funds (SIFs) in the low-carbon transition. The afternoon featured a session on decarbonising fossil fuels through technological innovation, mainly focusing on carbon capture and storage, followed by a session to discuss new examples for decarbonising fossil fuels, for possible inclusion in the on-line [Compendium of Practices](#).

The second day 26 November 2019 (only morning), featured two sessions to advance work in respect of the Thematic Dialogue on Commodity Trading Transparency.

II. Summary of the Discussion and Conclusions

Under *Work Stream 1 – Shared Value Creation and Local Development*, participants acknowledged that despite on-going efforts to phase out fossil fuels as part of the global low-carbon transition agenda, demand for fossil fuels is projected to grow over the next decades. Therefore, it is of crucial importance to consider the question of decarbonising the fossil fuel sector through technological innovation to enable a sustainable transition to a low-carbon future. Representatives from the industry highlighted their diversification portfolio approach, intending to reduce the carbon intensity of their products and activities. Participants discussed several cost-effective, mature technological options available for the decarbonisation of the sector including the use of energy efficiency technology, the integration of renewables in upstream operations to reduce carbon intensity, fuel switching (from coal to gas) and abating methane emissions in upstream operations by avoiding flaring and venting. Carbon Capture, Utilisation and Storage technology (CCUS) can also help decarbonise the fossil fuel sector, if enabled by policy incentives and deployed at larger scale. Where possible, the adoption of a life-cycle approach would be desirable, linking heavy and extractive industries to positive climate impact, whereby CO₂ is captured from coal-fired power plants or steel processing or even cement plants, then transported and used for Enhanced Oil Recovery (EOR) or stored in suitable geological locations. In order for this to happen, governments should put in place adequate transport infrastructure, put a price on carbon emissions (as in Norway) or introduce regulations setting performance emission standards (as in Canada); adopt regulations on transboundary transport of carbon dioxide (where necessary); and create demand for CO₂ use and storage through a trading mechanism. While creating efficiency gains, this would also help create a revenue generating mechanism that would facilitate the uptake of this technology in resource-rich developing and emerging economies where it is not yet utilised.

Participants validated three new examples for inclusion in the [Compendium of Practices](#), which helps operationalise the [Framework for Extractive Projects on Collaborative Strategies for In-Country Shared Value Creation](#). The examples discussed refer to STEP 4 and highlight the successful deployment of technological innovation for emission reduction. The Canadian example shows how to decarbonise coal-fired power plants through the deployment of CCS, supported by an enabling policy framework. The second example comes from China and demonstrates the successful use of CO₂ for Enhanced Oil Recovery (EOR), reducing emissions and increasing efficiency in oil production. The CO₂-EOR is also being used to replace the use of the water flooding technology in arid fossil fuel producing regions of China. The third validated example illustrates the successful application of Carbon Capture and Storage (CCS) in Norway showing that a CO₂ tax can make flaring and venting uneconomic and drive industry behaviour towards decarbonisation.

Under *Work Stream 2 – Revenue Management and Spending*, participants acknowledged that financing the low-carbon transition remains a major challenge for resource-rich countries. Participants discussed how natural resource revenues could contribute to closing infrastructure gaps and facilitating the transition without putting additional pressures on often-constrained public budgets. Given their size, Sovereign Wealth Funds (SWFs) could play a very important role in climate finance, but they are not doing so, yet. Moreover, few SWFs take account of climate risk to their portfolios – which should be part of their fiduciary responsibility to their citizens and government. SWFs could invest more in low-carbon assets without compromising their role as commercial investors, and at the same time reduce climate-related risks to their portfolios. For SWFs to play a larger role, governments would need to provide mandates and resources for SWFs to increase their capacity to align their operations with the low-carbon transition. Contrary to SWFs, Strategic Investment Funds (SIFs), already have many of the characteristics required to play a significant role in the low-carbon transition. Therefore, there is an important potential for collaboration between SWFs and SIFs, where SWFs could deploy capital for low-carbon infrastructure through SIFs. The experience of the Nigeria Infrastructure Fund, and of Infra Credit, demonstrates that it is possible to mobilise capital from

institutional investors for low-carbon infrastructure, and that the challenges related to the quality, efficiency and integrity of the investment process can be addressed through strong governance structures.

Under *Work Stream 4 – Domestic Resource Mobilisation (tackling corruption in commodity trading and BEPS in mining)*, participants welcomed the practical progress taken by the EITI toward the development of a common reporting framework, and provided feedback on the EITI’s draft working document on “*Developing reporting guidelines for companies buying oil, gas and minerals from governments*”. Participants acknowledged the commercial confidentiality risks that disclosures can create and the consequential importance of providing legal certainty to companies that are making payment disclosures. Participants emphasised the importance of establishing a consistent and level playing field that is globally applicable across different jurisdictions, different companies, and different commodities, regardless of EITI’s membership. Participants acknowledged the challenges in identifying whether the counterparty to the transaction is state-owned and welcomed the future development of an OECD On-line Mapping Tool of SOEs. Participants acknowledged the importance of improving understanding around existing anti-corruption and transparency requirements in global commodity trading hubs, and welcomed the opportunity to learn from the experience of commodity trading regulation in Belgium, China and Dubai. Participants noted the challenges that smaller commodity trading companies face when meeting complex regulatory requirements and how industry organisations can provide guidance and support in order to meet applicable requirements. The integration of the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas into the compliance requirements by the Dubai Multi Commodities Centre and the London Metal Exchange can provide a useful model for how commodity trading transparency requirements can be operationalised.

As part of the IGF-OECD joint programme on BEPS in mining, the IGF presented a practice note on tax treaty design and the mining sector. Participants suggested that the practice note should include notable trends in tax treaties, as well as lessons learned from the hydrocarbons sector. A revised and expanded version of the practice note will be available in February 2020. The OECD Centre for Tax and Policy Administration outlined a new framework for approaching mineral pricing for transfer pricing purposes, with bauxite used as a practical example. Participants discussed the reliability of using indices to price minerals, whether there could be the opportunity to develop price formulas derived from publicly quoted prices where a market price does not exist or is hard to determine, as in the case of lithium. Participants recommended government testing of mineral quality and collaboration between governments to share knowledge on mineral pricing to reduce asymmetry of information. Given that host governments often lack the financial means and expertise needed to set up testing facilities, the [IGF-OECD practice note on Monitoring the Value of Mineral Exports](#) offers a number of alternative policy options for consideration.

Work Stream 1 – Shared Value Creation and Local Development (session 3)

Session 3 was chaired by Hon. Emmanuel O. Sherman, Deputy Minister for Operations, Ministry of Lands, Mines and Energy, Republic of Liberia and Professor Petter Nore, Senior Consultant at the Norwegian Agency for Development Cooperation.

The first part of Session 3 addressed the question of decarbonising fossil fuels through technological innovation, which is of crucial importance for a sustainable low-carbon transition in resource-rich economies. In the second part of the session, three more examples for the [Compendium of Practices](#) were validated, as a means to operationalise STEP 4 of the [Framework for Extractive Projects on Collaborative Strategies for In-Country Shared Value Creation](#).

According to the projections of the International Energy Agency (IEA), several cost effective technological solutions can be adopted, such as enhancing energy efficiency, deploying renewable power, switching from coal to gas, and using Carbon Capture, Use and Storage technology (CCUS). The IEA projections suggest an increase followed by a stabilisation of demand for oil and coal by 2030 with very substantial growth of demand for gas. In a sustainable development scenario, natural gas is likely to replace

coal in the mid-20s and oil in the mid-30s. Participants highlighted that CCUS technology has reached momentum with 19 projects (mostly in the United States, Canada, Australia and Europe, but also China and Qatar) worldwide and a growing potential for the future. Policy incentives and economic and environmental benefits of CO₂-Enhanced Oil Recovery have been key drivers. However, despite such a momentum, the deployment of CCUS is still not sufficient to meet the goals of the Paris Agreement. Tackling indirect emissions in the upstream part of the oil and gas supply chain and integrating renewable energy can also have a high emission savings potential.

Industry representatives highlighted that they want to be part of the global decarbonisation effort, following a portfolio approach, which means reducing the carbon intensity of the products they sell. They stressed that they would like to reduce the carbon intensity of their products by 50 per cent over the next 30 years, tackling at the same time methane emissions and phasing out routine flaring as part of the World Bank's "Zero Routine Flaring Initiative". The Northern Lights project in Norway was mentioned, in which CO₂ is going to be captured from on-shore industrial sources and then shipped and injected into North Sea reservoirs, thus creating an additional source of revenue for Norway, which uses its seabed for the safe storage of CO₂ coming from industrial sources from within and outside Norway

The deployment of CCS/CCUS technology can be accelerated with the increased use of the technology, bringing costs down, as it has been the case with renewable energy technology. CCS/CCUS is particularly interesting for oil producing countries, as it can help maintain market access for the next decades and increase the economic value of resource endowments. Furthermore, taxing coal production in coal-producing countries, rather than taxing coal use in importing countries, could support the deployment of low carbon technology that supports economic diversification away from fossil fuel export dependence in resource-rich countries.

Supply-side policies that could support the decarbonisation of fossil fuel producing countries, targeting the upstream part of the oil and gas value chain include offsetting by companies and countries. A carbon offset is a reduction in emissions of carbon dioxide or other greenhouse gases produced in order to compensate for emissions made elsewhere. This could involve a voluntary pledge to increase the supply of decarbonised fuel as a means to promoting GHG removal activities. Currently all major oil companies take responsibility for reducing their direct emissions from ventures under their operational control. In light of shareholders' pressure, there is an emerging movement among oil producers towards extended product responsibility. Not only companies but also countries could use offsets. They could do this through their Nationally Determined Contribution under the Paris Agreement, as Saudi Arabia does. A second supply-side policy could be low-carbon portfolio standards for fuels as an economic instrument that target an emission rate for well-to-wheel emissions of a portfolio of fuels supplied into a specific market. The metric is the average GHG intensity of the fuel consumed at the pump. They are in operation in the United States, European Union and Canada. Most of them are by design technology neutral but if an explicit role would be given to CCS, the deployment of the technology could be accelerated and complementary to biofuels, electricity and hydrogen.

Participants highlighted that current climate policies do not sufficiently value the role of CCS as an option for CO₂ reduction. Cooperation at a global scale would be essential if CCS is to move forward by managing financial and economic risks for public and private investors. The Paris Agreement provides a framework for enabling multilateral cooperation on CCS. An alliance of supply-side countries could pool financial and technical resources in order to accelerate the deployment of CCS as part of their climate mitigation strategy. The Riyadh-based think tank King Abdullah Petroleum Studies and Research Center (KAPSARC) suggests the creation of a new CCS-specific mechanism to incentivise the uptake of this technology in the form of a carbon storage unit – a tradeable, non-tangible commodity that represents a proof that a ton of CO₂ has been stored safely in geological formations. Such a unit would have no intrinsic emission reduction value but would provide a verified record of geological storage. While conventional carbon pricing uses penalties to achieve emission reductions, a carbon storage unit would provide an upstream incentive for undertaking CCS. A carbon storage unit would be similar to a renewable energy

certificate, also known as a green energy certificate, providing a proof that energy has been sourced from renewables such as solar or wind power.

Participants concluded that there is a number of mature and cost-effective technological solutions available for the decarbonisation of the fossil fuel sector. Some other low hanging fruits not requiring high capital investments in developing countries include the achievement of optimal operation or improving existing operations. Industrial stakeholders emphasised that they would be in favour of a price on carbon.

Participants underlined that for over 20 years, the example of Norway has been demonstrating that CO₂ can be captured and stored safely. For the acceleration of CCS deployment, the CO₂ tax introduced in 1991 has been an important policy driver and economic incentive. Drawing on existing knowledge, the country intends to adopt a full chain demonstration project led by fossil fuel industry actors and supported financially by the government. The project consists of three component: capturing CO₂ from industrial sources (cement production and waste incineration), transport (mostly shipping and transport via pipelines) and offshore storage. Besides the CO₂ tax and participation in the EU Emission Trading System, Norway has adopted the EU CCS Directive as a cost effective policy measure, which is based on a permitting system, prescribing requirements on liability and environmentally safe storage. Participants highlighted that in October 2019 parties to the London Protocol agreed on transboundary carbon capture and storage, which will enable Norway to import CO₂ for storage in the Norwegian seabed. Based on the discussion over the Norwegian case, participants concluded that while collecting geological data for storage is necessary, the lack of geological information does not explain why African countries are lagging behind in deploying CCUS. Government support in the form of enabling policies and funding are critical factors. In developing countries with restricted public funding possibilities, market-based policies could be helpful.

Participants validated one example for the Compendium from Norway on designing smart carbon taxation policies in support of CCS deployment in natural gas production. In 1990, during the planning phase of the Sleipner project, located in the Norwegian part of the North Sea, it became clear that the natural gas contained about 9% of CO₂, exceeding customers' specifications of a maximum 2.5% share. Therefore, the CO₂ content needed to be reduced before natural gas could be sold. Rather than venting the separated CO₂, Equinor, the operator of the field, decided to invest in CCUS technology. In 1991, the Norwegian government introduced an offshore CO₂ tax as an effort to reduce emissions. This tax would have applied to any CO₂ that was released from gas extracted from Sleipner. The CO₂ tax was one of the triggers for Statoil's plans to separate CO₂ offshore and inject it into deeper geological layers. Due to the Norwegian CO₂ emissions tax, it became more economical to store the CO₂ once captured than venting it. Had this process not been adopted, and the CO₂ produced been allowed to escape to the atmosphere, the licensees of the Sleipner West field would have had to pay NOK 1 million/day in Norwegian CO₂ taxes.

The second validated example shows how the economic and environmental benefits of the CO₂-Enhanced Oil Recovery have led to the successful deployment of this technology in China, which is gradually replacing water flooding and increasing oil production in a series of mature oil fields in the Ordos Basin. Compared to water flooding, CO₂-EOR was regarded as a more sustainable solution, from both an environmental and economic perspective, addressing the double challenge of emission reduction and water consumption in an arid region. Government support and international collaboration for financial and technical support have been critical. Yet, for a larger-scale deployment of CCUS technology, a comprehensive and predictable policy framework is needed.

The third validated example shows how to decarbonise coal-fired power plants in Canada. In conventional coal-fired electricity generation, large amounts of CO₂ are produced during combustion of the fuel in the air, but only as a small fraction of the flue gas stream. Separating CO₂ from the other flue gases after combustion of the fuel is more expensive. The first large-scale project in which CO₂ was separated from power station flue gases is the Boundary Dam Carbon Capture and Storage project in Saskatchewan, Canada, which commenced operations in 2014. The Boundary Dam CCS Project rebuilt a 115-megawatt coal-fired generation unit with carbon capture technology capable of reducing GHG emissions by up to 1Mtpa of CO₂ each year. By way of comparison, a conventional lignite coal plant emits around 1100 tons of

CO₂ per Gigawatt hours while conventional natural gas plants emit between 550-500 tons. New natural gas plants emit at around 375-400 tons of CO₂ per Gigawatt hours and plants powered by wind energy with gas turbines emit between 175-325 tons of CO₂ per Gigawatt hours. Boundary Dam Unit 3 with a CCS facility emits between 120-140 tons of CO₂ per Gigawatt hours, which is well below Canadian regulations on coal-fired power plants requiring not to exceed 420 tons of CO₂ per Gigawatt hours. The captured CO₂ is sold and transported by pipeline to nearby oil fields in southern Saskatchewan where it is used for enhanced oil recovery. CO₂ not used for enhanced oil recovery is stored in the Aquistore project, a research and monitoring project, which analyses the effects of storing CO₂ deep underground in a layer of brine-filled sandstone. Canada was among the first countries to make laws on emission reduction from coal-fired power plants. In 2011, the federal government announced strict performance standards for new coal-fired units and units that have reached the end of their useful life. The capture technology enabled the project operator, SaskPower, to meet these standards, while selling CO₂ for enhanced oil recovery providing a revenue stream to help offset the added cost involved in carbon capture.

Work Stream 2 – Revenue Management and Spending (session 2)

Session 2 was chaired by Mr Dastan Umirbayev, Director of Macroeconomic Analysis and Forecasting Department, Ministry of National Economy, Republic of Kazakhstan

The session sought to elucidate how natural resource revenues can contribute to closing infrastructure gaps and facilitate the low-carbon transition, while minimising additional pressures on often-constrained public budgets. This work builds on the key policy recommendations resulting from the lessons learned and analysis carried out by the Policy Dialogue over the period 2015-2018, as reflected in the publication on [“Using Extractive Revenues for Sustainable Development: Policy Guidance for Resource-Rich Countries”](#). The OECD Development Centre’s work recognises that non-renewable natural resource revenues can make an important contribution to harnessing inclusive growth and sustainable development, including the low-carbon transition, if resource revenues are appropriately managed to smooth revenue flows throughout the price cycle and effectively spent domestically to transform natural resource revenues into productive development gains.

The focus of the session was on the role that sovereign wealth funds (SWFs) and strategic investment funds (SIFs) could play in the low-carbon transition of resource-rich countries.

To achieve low-carbon and climate resilient development on a global scale, \$6.9 trillion of investments per year will be needed, of which \$3.9 trillion is required in developing countries. The investment gap for developing countries, or difference with the current level of around \$1.4 trillion, is estimated at 2.5 trillion USD per year. By comparison, total official overseas development assistance in 2018 amounted to 153 billion USD, or about six percent of the investment gap for developing countries.

Since many governments are fiscally constrained, it is clear that the majority of this investment will need to come from other sources. However, transition-related government expenditures will need to be balanced with the allocation of resource revenues to other development objectives.

The OECD Development Centre’s paper *Investing in the low-carbon transition: the role of Sovereign Wealth Funds and Strategic Investment Funds* argues that SWFs could become essential contributors to the low-carbon transition, without compromising their role as commercial investors. SWFs hold nearly 8 trillion USD of assets under management. The magnitude of the capital held by SWFs means that their action or inaction on climate finance are of crucial importance to the world’s ability to mitigate climate change.

As emphasised by participants, there are three main reasons that climate change matters to SWFs. First, climate change will affect the risk to SWF portfolios. Second, systemic risks associated with climate change, and the financial stability issues that could result from such systemic risks, would affect SWF portfolios. Third, the transition to a net-zero carbon economy is the most capital-intensive transition in human history, and represents huge opportunities for asset owners such as SWFs.

Participants observed that a number of large institutional investors have managed to generate attractive investment opportunities from climate change. This includes Canadian and Danish pension funds, as well as Abu Dhabi's SWF, Mubadala Investment Corporation - through its subsidiary Masdar. Participants noted that evidence from the literature indicates that more sustainable companies are more profitable.

In spite of this, SWFs currently play a very small role in climate finance. As highlighted by participants, SWFs allocate less than one percent of their capital to low-carbon solutions. Very few SWFs disclose information about their climate policies and strategies, and only a few have adopted climate-focused ownership policies to reduce the carbon footprints of their portfolios. Furthermore, few SWFs are comprehensively assessing climate risk to their own portfolios, although taking full account of climate risk in their operations this should be part of their fiduciary duty to their citizens and government.

Participants highlighted the changing role of SWFs, resulting from domestic investment needs and climate change. Whereas governments originally established SWFs to save resource revenues abroad, and provide fiscal stabilisation, the urgency of the low-carbon transition calls into question the exclusive focus on foreign investment. Where high-quality investment management capacity is available, and investment decisions can be implemented free from political influence, within strong corporate governance frameworks, this shift in attitudes has opened up opportunities for the domestic investment of resource revenues through SIFs.

SIFs, contrary to SWFs, already have many of the characteristics required to play a significant role in the low-carbon transition. SIFs are mainly direct investors in infrastructure, rather than investors in financial securities; and they have investment criteria and processes to protect investment decisions from political interference. Participants discussed the example of Nigeria's SIF, the Nigeria Infrastructure Fund (NIF), managed by the Nigeria Sovereign Investment Authority (NSIA), which seeks to safeguard its mandate as a commercial, yet policy-driven investor. To this end, projects are eligible for NIF financing only if they comply with four defined criteria for selection. Projects need to i) have a nationwide strategic impact; ii) exhibit commercial returns that satisfy the NIF's return benchmarks; iii) be attractive to co-investors – including institutional investors and multilateral finance institutions; and iv) be implemented in sectors that have a sufficiently mature regulatory environment.

Participants discussed the governance structures needed for SIFs to resist political influence on investment decisions, and corruption. In the case of the NSIA, these include its establishment as an independent public authority, at arms'-length from government. NSIA independence is strengthened by the composition of its board, consisting of very senior private-sector executives "with high integrity and a reputation to protect"; and by NSIA senior management consisting of senior financial sector professionals recruited from the private sector – including diaspora members.

Participants observed that, whereas some governments have established SIFs to invest in domestic infrastructure, it is a question whether there will now be another shift, where not only SIFs but also SWFs become climate finance institutions. For now, SWFs are starting to take account of climate risk, with less attention yet to climate impact. SWFs' incipient attention to climate change is reflected by the establishment of the One Planet SWF Working Group, an initiative of French President Emmanuel Macron. The Group consists of six SWFs, which collectively hold more than 3 trillion USD worth of assets. The One Planet Sovereign Wealth Fund Framework is based on three principles:

- Principle 1: Alignment – This principle refers to the alignment of SWF portfolios with the Paris Agreement. This includes building climate change considerations into SWF decision-making, and the integration of climate considerations into SWF investment beliefs and investment framework.
- Principle 2: Ownership – The second principle refers to SWFs' relationship to their portfolio companies. SWFs should be active owners with regard to climate-related issues, and should formulate climate-related expectations towards investee companies.

- Principle 3: Integration – The principle of integration refers to the consideration of climate-related risks and opportunities in risk management, portfolio management, and asset valuation. SWFs should integrate climate change into investment mandates for external managers, as well as internally in their own organizations.

Participants emphasised that a challenge to the deployment of low-carbon infrastructure is the lack of early-stage investment capital, for the project development and construction stages. Participants noted that this challenge could be addressed by closer collaboration between the energy industry and large investment funds.

Participants considered that the main challenge to SWFs' climate engagement is capacity building. To achieve higher allocations to low-carbon assets, SWFs would need to undertake major investments in capacity building to engage with portfolio companies on climate-related issues; and to select and monitor asset managers based on their climate-related performance

Participants concluded that since SWFs receive their mandates from their governments, these funds are unlikely to take climate-related action on their own. Participants noted that for SWFs to become climate-aligned investors, their governments need to provide them with the mandates and budgets required to implement the necessary reforms. Governments need to establish strategies for this transformation, with concrete plans for implementation.

Participants noted that SIFs are very small compared to SWFs, and would need far larger amounts of capital to contribute meaningfully to the low-carbon transition. However, SWFs and SIFs are complementary in several ways, with a potential for synergies. Participants concluded that there is an important potential for SWFs to deploy capital for low-carbon objectives through SIFs.

Work Stream 4 – Domestic Resource Mobilisation (tackling BEPS, corruption and commodity trading transparency) (Sessions 1, 4 and 5)

Thematic Dialogue on Commodity Trading Transparency

Sessions 4 and 5 of the Thirteenth Plenary Meeting were chaired by Mr Jürg Vollenweider, Program Manager, Federal Department of Economic Affairs, State Secretariat for Economic Affairs (SECO), Switzerland, and provided an opportunity to advance the outputs of the Thematic Dialogue – through a discussion on the role of key commodity trading hubs in the global economy, and to receive an update on complementary work being undertaken by the EITI.

Session 4 provided an opportunity to consider the progress made by the EITI to develop reporting guidelines for buying companies on their oil purchases from resource-rich countries. These guidelines are intended to help inform implementation of Requirement 4.2 in the 2019 EITI Standard, which encourages disclosures by buyers on payments to governments in EITI countries, and can help guide voluntary disclosures by buying companies in their annual reporting. They can also support host and home governments considering whether to encourage or require disclosure of information by buyers.

Participants recalled that the EITI and the OECD have been co-operating on the topic of payments to governments' disclosure and that both organisations share the ambition to develop a standard that can be globally scalable. At this point, the process is being undertaken in two parallel but interacting streams. The EITI is taking the lead on developing the guidance and the Policy Dialogue on Natural Resource-based Development will serve as a platform for feedback and discussion with a broad set of stakeholders. . In the short-medium term, the development of the EITI guidelines will offer an opportunity to consider how additional elements, such as the use of corporate vehicles, conflicts of interest, beneficial ownership, politically exposed persons (PEPs), could be incorporated.

To situate the draft EITI guidelines in context, the broad objectives and history of the guidelines were recalled. The intention of the guidelines is to assist citizens in understanding how their governments receive

revenue from the sale of their publicly owned commodities, to help other stakeholders understand the transactions involved (not just the public), and to complement other relevant data that is already in the public domain. In 2011, Iraq, through its national oil company SOMO, began to publish the payments it received from companies buying Iraqi crude oil. This was a very significant step forward in the area of transparency at the time. Since then, the EITI has carried out pilot disclosures with certain countries and has undergone extensive consultations with a wide variety of stakeholders – including through the EITI Commodity Trading Working Group and the OECD Policy Dialogue on Natural Resource-based Development.

Key risks were identified during recent pilot disclosures and it was noted how increased transparency could help in addressing and mitigating those risks. For example, it was recognised that there is significant sensitivity around the selection of buyers and further scrutiny is warranted here. Recent pilot disclosures in Nigeria and the Republic of the Congo (Brazzaville) demonstrated that there is a big variation in reporting practices across different jurisdictions, and that a common reporting standard could help in developing a global level of consistency. Alongside the governments undertaking pilot disclosures, a number of commodity trading companies have also been leading efforts to disclose payments at a global level. Notably, Glencore, Trafigura and Gunvor who have all disclosed information in respect to their payments to governments. As the process matures, there has been greater granularity in respect of the information disclosed but there are still challenges remaining on the consistency and commonality of the data, and that the data is not always timely or comprehensive.

In terms of the applicability and scope of the guidelines, participants strongly recommended that all interested parties work toward the development of globally applicable guidelines, as opposed to guidelines that apply to just a select number of countries or companies in EITI implementing countries. It was noted that commodity trading companies operate on a global scale (as evidenced from their annual disclosures), and that in order to create an equal playing field for all market participants, the guidance should apply across both EITI and non-EITI countries in order to avoid creating a two-tier system (for EITI vs non-EITI). In terms of the scope of the government entities to be covered, the guidelines should seek to apply to any government agency that is engaged in selling publicly owned oil, gas or minerals, not just SOEs. Similarly, in respect of the buyers that should be covered by the scope of the guidelines, alongside independent commodity trading companies, international oil companies (IOCs) are also encouraged to participate in order to create a truly equal playing field. Lastly, on the subject of which commodities should be covered by the scope of the guidelines, participants noted how the draft EITI guidelines focus on the state's share of production, and not on equity oil sales. Consequently, participants recommended the inclusion of equity oil in the scope of the disclosures as the majority of the disclosures to date have been in respect of payments made for equity oil.

The guidelines set out five practical steps for reporting entities to prepare their disclosures: commodities, buying companies, selling entities, period, and materiality. Each step sets out a number of elements that are 'core' and those that are 'additional'. The core elements are based on the EITI Standard and on current disclosure practice – what is straightforward to disclose and unlikely to be subject to legal challenge. The additional elements are not directly referenced in the EITI Standard or observed through current practice but set out information that can add value to the transparency and accountability process if disclosed.

Participants discussed the challenges encountered by the EITI in the development of the draft guidelines, including how to identify entities that are majority owned and sell on behalf of government. These entities may be marketing agents appointed by the government or SOE, but it is important that the scope of the guidelines is broad enough to capture these sales structures as well.

A further challenge relates to how confidentiality clauses can be addressed in the general terms and conditions of sales contracts. It was noted that one SOE (the Iraqi SOE, SOMO) includes provisions in the general terms and conditions of its crude oil sales agreements with buyers that enable payment disclosures. Requirements concerning future disclosures could be included in sales contracts. This has been seen in contracts in the upstream oil & gas sector and provides legal certainty to companies that are undertaking these disclosures. It was noted that companies might be more willing to disclose payments to governments

if there was an enabling law in their home jurisdiction, as this would give them increased legal certainty wherever they operate. However, these enabling laws may pose companies in conflictual obligations if the host government contractual practice or host government legislation prohibits disclosures. It was further noted that these upstream contracts often have a provision allowing disclosure, if there is a specific stock market rule that stipulates that disclosures must be made.

In jurisdictions where SOEs do not have disclosure provisions written into their general terms and conditions, companies can take steps to communicate their intention to disclose payments in the future. Participants noted that one independent commodity trading company has formulated a sales disclosure policy to communicate these expectations on a wide basis.

In terms of the reporting of the data, the draft EITI guidelines encourage buying companies to incorporate the payment disclosures in their regular reporting (annual report, payment to government's reports, online reporting), and that the data should be presented in an open data format. It was noted that some companies might have been reluctant to make disclosures in their annual reporting cycles, as they may have preferred to make disclosures as part of the EITI reporting cycle. In this case, there will be a much larger delay between the payments for the commodities and the subsequent disclosure of the payment, and as a result, the data will be less useable by stakeholders.

Participants also discussed the levels of disaggregation of the information to be disclosed. There is a connection between level of granularity of the data and the timeliness of the disclosure. Under a longer timeframe, more granular data can be made available. Some companies participating in the EITIs pilot disclosure projects have disclosed information on a cargo-by-cargo basis but this may not be feasible for all companies.

The EITI will incorporate the feedback received during the session and circulate updated draft guidelines to the EITI Commodity Trading Working Group in January 2020. Smaller working groups may need to be established to explore specific issues – such as disclosures related to resource-backed loans.

Session 5 provided an opportunity for participants to better understand the structure of global commodity trading and existing transparency requirements in those jurisdictions. The majority of global commodity trading transactions take place in a handful of jurisdictions, known as “trading hubs”. Many commodity-trading companies are located in these hubs, as are important support services, including banks that specialise in the financing of commodities trading, companies providing inspection services, shipping companies, insurance companies, law firms and consultants.

Participants recognised the previous participation of Switzerland and the United Kingdom and noted the importance of having additional trading hubs at the table. Participants continued the peer learning and knowledge sharing process by discussing the existing transparency requirements in three jurisdictions: China, the UAE (Dubai) and Belgium. These commodity-trading hubs have quite an advanced framework for compliance and due diligence although their regulatory framework is more focused on domestic rather than international activities.

China is the world's largest industrial manufacturing country. It is the world's largest importer of crude oil and natural gas and the world's second largest importer of coal. China has several major international energy trading hubs: the Shanghai International Energy Exchange and the Hainan International Energy Exchange, as well as the Dalian Commodity Exchange.

China's trade regulation system can be divided into two dimensions. The top-down public policy area – composed of the laws, regulations and standards of the specific government departments. This includes licensing, tariffs, import, and export down payment management, trade remedies, foreign trade operator management, and inspection and quarantine system. The second dimension is the bottom-up internal compliance program (ICP) undertaken by companies.

China's Ministry of Commerce is mainly responsible for trade regulations and sensitive items and technology. Other ministries are responsible for implementing multi-department consultations and licencing systems.

In terms of trade transparency, China focuses on four main areas of policy action: open access to information, open decision-making processes, fair review of the investment decision, and combatting corruption and bribery. Anti-corruption and anti-bribery are among the most important indicators of trade transparency. Corruption can lead to information asymmetry, rent seeking behaviour, discretionary behaviour and protectionism. All of which have the result of reducing resource allocation efficiency.

In terms of specific laws, China's foreign trade laws stipulate that for companies engaging in foreign trade, unfair competition such as selling goods at an unreasonably low price and engaging in bribery are prohibited. China has enacted a large amount of laws in this area but does not have a legal equivalent of the United States' Foreign Corrupt Practices Act.

Participants also had an opportunity to learn about the specific experience of commodity trading carried out in Dubai. The Dubai Multi Commodities Centre (DMCC). The DMCC was created in 2003 and is owned by government of Dubai, one of the seven emirates of the United Arab Emirates (UAE). DMCC covers companies licenced in the DMCC free zone. In order to facilitate trading in Dubai, the DMCC has built an infrastructure of refineries, a specific exchange – the Dubai Gold and Commodities Exchange, and provides access to dealers, vaults, banks, and retailers. Since creation in 2003, markets have grown, and trading now takes place with entities from across the globe including China, Hong Kong, Italy, Switzerland, and the United Kingdom.

The DMCC adopted the *OECD Due Diligence Guidance for Responsible Mineral Supply Chains from Conflict-Affected and High-Risk Areas* in 2011. Subsequently, the DMCC converted its responsible sourcing guidelines into rules, thereby making it mandatory for all DMCC licenced traders to follow these rules. The DMCC is also seeking to align its rules with relevant European Union standards.

In addition to these specific DMCC requirements, the UAE also has federal level anti-money laundering (AML) regulations, which have been updated recently, and there are additional specific requirements for the gold and jewellery sector. This is in addition to the usual know-your-customer (KYC) norms, which include details on the ultimate beneficial owner.

Lastly, the UAE Cabinet has announced its intention to develop a federal gold policy to be structured around three key pillars: governance, sustainability and innovation. This will include the creation of a platform for tracking sources of gold, which will allow for a complete audit of the trade.

Participants noted that while some commodity trading hubs deal with the sales of many different commodities, other hubs may specialise in a specific commodity. In this regard, participants discussed the anti-corruption and transparency requirements applicable to diamond traders in Belgium, and considered whether any lessons could be learned from this experience that could apply more generally to promoting transparency and combatting corruption in the oil and gas and mining sectors.

The city of Antwerp is the world's most important diamond centre. Each day approximately 550 shipments of diamonds pass through Antwerp, which total approximately USD 220 million. Diamonds are not mined in Belgium. However, Antwerp is in middle of diamond value chain, and approximately 80% of all rough diamonds will arrive in Antwerp. The diamonds are traded there, and then shipped to India for polishing, before arriving back in Antwerp to be traded again and shipped off to various jewellery hubs.

The Antwerp World Diamond Centre (AWDC) is a not-for-profit sector body that represents 1600 diamond companies in Antwerp. The AWDC works with diamond trading companies and the government to enhance the understanding of the regulatory framework and to promote compliance.

In terms of diamond specific legislation, the supervising authority – the Ministry of Commerce regulates access to the trade. A trader must have a registration number in order to participate in the diamond trade. A

potential trader must apply to the Ministry of Commerce and must provide: information in respect of the ultimate beneficial owner, shareholder structure, a clean criminal record and information about previous mandates for each director, a justification for why they want to access the diamond trade. Once registered, each trader must complete a compulsory AML course within 6 months of registration. The Ministry of Commerce retains the right to suspend or delete a trader registration.

In terms of the value of the diamond shipments, the AWDC provides experts to the Ministry of Commerce to monitor the shipments. If the experts see any irregularity in the value of the diamond shipments, this information is passed to the government. Diamonds traded through Antwerp must also comply with the *Kimberley Process Certification Scheme* to ensure that diamond purchases are not financing conflict and rebel movements seeking to undermine legitimate governments. Participants noted the value of the Kimberley Process but also its limited scope of application.

In addition to diamond specific legislation, AML legislation applies across all sectors. It was reported that in Belgium, the AML legislation goes beyond what is required under Financial Action Task Force (FATF) guidelines and European Union regulations. For each transaction, traders have to identify their clients, undertake due diligence, conduct a risk assessment, notify any suspicious activity, and report to the Belgium Financial Intelligence Unit.

Participants noted that know-your-customer requirements are generally focused on the existence of any AML elements in a transaction, rather than the source (original location) of the commodities. It was noted that there is no legislation in Belgium that requires traders to report if they make payments to governments. However, traders have to report annually on their AML compliance to the Ministry of Commerce, and there may be scope to include an additional requirement here on the identification of state-owned suppliers.

Participants noted how regulatory requirements can be complex and in some situations may be burdensome for trading companies – particularly smaller companies with less capacity. AWDC support smaller companies in their compliance through the following measures:

- Software tools – developed with Bureau van Dijk where traders can use to screen customers for PEPs, sanctions etc.
- Workshops – AML, best practice, sanctions compliance;
- Risk assessment on money laundering – developed in coordination with the government and banks. This risk assessment is now used by all parties; and
- A help-line.

These measures have resulted in much better compliance and understanding by diamond trading companies. These companies recognise that it is now less costly to comply with the regulatory environment.

AWDC have also developed a number of self-regulatory initiatives on behalf of the diamond trading industry in Belgium. These initiatives focus on human rights, child labour, money laundering, and corruption in the value chain. In this regard, AWDC has introduced due diligence measures in accordance with the *OECD Due Diligence Guidance for Responsible Mineral Supply Chains 5 Step Framework*. This has resulted in the creation of more awareness of these risks in the value chain among the diamond trading industry, and consequently, action is now being taken to address those risks.

Alongside regulation in Belgium, participants noted how the London Metal Exchange (LME) is now requiring that listed brands comply with the *OECD Due Diligence Guidance for Responsible Mineral Supply Chains* to make sure that the commodities are responsibly sourced. The LME is also requiring producers to use a newly developed ‘red flag template’ that will include a disclosure of potential financial crime and corruption risk under the EITI Standard.

The implementation of the *OECD Due Diligence Guidance* by the DMCC, AWDC and the LME offers an interesting model to build on for how to operationalise transparency requirements that can be adopted by trading hubs, and proactive initiatives that can be taken by exchanges or commodity trading centres in order to improve transparency in commodity trading.

BEPS in Mining

Session 1 provided the opportunity for the IGF and the OECD Centre for Tax and Policy Administration to present the results of the year's work on international tax treaties research in relation to mining and developing countries. The IGF and the International Senior Lawyers Project (ISLP) tabled for discussion a zero draft practice note on tax treaties and the mining sector in order to receive early feedback from participants. The OECD Centre for Tax Policy and Administration presented a framework for mineral valuation and its application to bauxite. This work complements the existing OECD studies on mineral product pricing for gold, copper, thermal coal and iron ore, published by the Platform for Collaboration on Tax in 2017 as a supplement to the Toolkit Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses.

The main purpose of the on-going research on tax treaty design in relation to mining and developing countries is to investigate the language used in tax treaties to protect the right to tax mining income in resource-rich countries. The research was based on the review of OECD, UN and ATAF Model Tax Conventions and Double Taxation Agreements. The treaty practice of resource-rich countries such as Australia, Canada, Chile was also undertaken to understand whether and how these countries have modified and adapted their tax treaties in order to protect their right to tax mining income. The analysis is also looking at the interaction between tax treaties and contractual fiscal terms and bilateral investment agreements, which might freeze certain aspects of the tax treaty or offer a more generous treatment than a treaty. Because of the prevalence of project specific agreements containing fiscal terms, incentives might be more important than tax treaties in influencing mining investment decisions than in other sectors.

Key issues that resource-rich countries should consider when entering into tax treaties include permanent establishment; immovable property, royalty payments for intellectual property; and indirect transfers.

Whether there is a permanent establishment in a country determines whether a tax obligation or liability exists. While for a producing mine, a fixed based of business is deemed to exist for permanent establishment purposes, the case of exploration is less certain. For this reason, many countries have tried to avoid any ambiguity, by deeming permanent establishment to arise when an exploration project is in place. When the license holder outsources the extraction activities to subcontractors, it is also important to ensure that subcontractors give rise to a permanent establishment for resource taxation purposes. Oil producing countries will generally have specific provisions allowing them to tax offshore activities, but permanent establishment will only arise after a certain period. Unlike a mine, which will constitute a permanent establishment irrespective of the duration, activities performed by a subcontractor may only give rise to a permanent establishment after a certain period of time (six months and 12 months for the UN and OECD Model Tax Conventions respectively). Subcontractors may enter a country for a period just less than the period required to trigger a permanent establishment to avoid paying taxes. Following the experience from the oil and gas sector, it was recommended that states with the potential for deep sea mining should (1) establish a domestic right to tax non-resident companies operating offshore; (2) ensure that the Continental Shelf is explicitly in scope of Double Tax Agreements; and (3) deem a permanent establishment for offshore activities relating to deep-sea mining that exceed 30 days in aggregate. Some countries, like Australia, have extended permanent establishment to include the use of substantial equipment (e.g. drilling rig) in relation to exploration or exploitation of natural resources.

Where income from immovable property is not derived through a permanent establishment, Article 6 of the OECD and UN Model Tax Conventions secures the right of the source state to tax income from immovable property where the assets are located. Many treaties will consider the license granting the right to mine as satisfying the definition of immovable property, but many countries have chosen to include the right to explore as well to deal with the situation in which the exploration license

is sold to another party. In fact, unless it qualifies as immovable property, the income derived by a non-resident from exploration activities would not be subject to tax in the source state, including the capital gains from a future sale of an exploration license.

Retaining the right to tax outbound interest expenses in tax treaties when mining projects are financed through debt from a related party is also crucial to counter risks of transfer pricing or tax planning. Automation is rapidly increasing in the mining sector, which is leading to a growth in new technologies. These technologies are being licensed out to mines for limited use, in return for remuneration i.e. royalty payments. These technological developments may mean that royalties become a larger component of outbound payments in the mining sector. With this comes the risk of profit shifting as intangible assets such as patents, trademarks, and intellectual property, are more easily relocated to countries with lower rates of withholding tax and they are harder for tax authorities to value. Consequently, retaining the right to tax royalties in Double Tax Agreements may become an important source of mining revenues, as well as a deterrent against profit shifting. Canada and Chile have adopted specific provisions, mirroring the UN Model Tax Convention.

Establishing a domestic right to tax indirect transfers is also important. Indirect transfers occur when the shares of the domestic subsidiary, the shares of the foreign company with a branch in the country, or the shares of the holding company are sold, instead of the right to a mining or exploration assets itself. Resource-rich countries should retain the right to tax the capital gains from these sales, in particular when the interests in company that owns the mine changes hands offshore.

Participants also discussed the challenge of tackling the valuation of minerals from a corporate taxation perspective, with a particular focus on bauxite. The Centre for Tax and Policy Administration presented a framework for mineral valuation applicable to all minerals. The recommended starting point is the commercial valuation of the mineral or metal, followed by downward adjustments for undesirable physical properties in the ore and upward adjustments for desirable physical properties or other valuable by-products. Optional steps relate to additional adjustments that might be made to account for specific economic circumstances. The challenge developing countries are facing is linked to the fact that they usually do not sell finished products for which commercial prices are available, but they sell the raw ore or intermediate products for which reference prices are more difficult to establish.

Tax administrations can obtain pricing information from three sources: 1) price reporting agencies (such as Platts, Asian Metals, London Metals Exchange); 2) information collected from tax payers through documentation required by law or through audit activities undertaken by the tax administration; 3) equity sales where the state as an equity interest in the mine and it is making sales into the market.

Participants discussed the advantages and disadvantages associated with each of these approaches. They questioned the reliability of price indexes, which largely depends on their maturity and volumes of transactions from which prices are derived, the degree of their exposure to external influence and how transparent they are in terms of methods they are using. Newly established indexes rely on less data and the information they provide may be less accurate. The advantage of using price indexes is that they provide an unambiguous and practical reference point based on real commercial data collected from spot and short-term sales, with the possibility to make any necessary adjustments to account for comparability differences. For example, the CBIX index can be used for determining the price of bauxite, based on key economic metrics reflecting qualitative considerations (such as total alumina, silica content and moisture), and subject to shipping costs adjustments. The downside is that the databases that collect this information can be too expensive for tax administrations to afford. One possible solution is to establish regional centres where tax administrations collaborate and share the costs of using price indexes as a default position, subject to any

necessary adjustments. For example, prices for longer-term agreements can diverge from price indexes as they might have specific features that might provide either a discount or a premium to the market index. Using wrong indexes (for example for LNG prices there at least three different regional indexes) or making inaccurate adjustments may result in a material tax gap for tax administrations.

Collecting data from taxpayers is in principle the most accurate way to determine mineral pricing as long as the sales price is directly related to the value of the minerals. This requires strong information gathering power within tax administrations. Most of them do not have such power to request information from taxpayers and where they happen to have this power, they often deal with subsidiaries that do not have access to the sales agreements entered into by parent companies. This means that the government would need to issue either an information request offshore, which the offshore parent entity may not comply with or a request for an exchange of information, which requires a cooperation agreement or tax treaty between different jurisdictions. Developing countries may not have the legislative tools or tax treaty networks in place to obtain this information. Although this is the preferable method for determining mineral prices, it is often not a feasible option. Behavioural changes from multinationals would also be necessary as they need to cooperate, but may be reluctant to share sales price information that they consider commercially sensitive and that can reveal their commercial position to their competitors unless this information safely stored. Vertically integrated supply chains where raw and intermediary products are sold to related parties present an additional challenge for using this method, given the absence of a third party agreement.

Equity sales offer an alternative approach as they can be used as a proxy to determine mineral prices. In principle, this method is administratively easy and provides an opportunity for tax administrations to build knowledge on how the market works. However, it requires that governments have equity interests in projects, which presupposes the availability of the necessary funding. Governments may also be inefficient in making resource sales, as they may not have the skillsets to sell into the market and set either a too low price, leaving on the table a tax gap, or a too high price, hurting foreign investments by imposing taxes on income that is not able to be earned by taxpayers.

Participants discussed an additional approach for mineral valuation for bauxite, which consists of setting price formulas linked to the price of aluminium. It was observed that linking the price of bauxite to aluminium was historically a good approach. However, there has recently been a separation between bauxite, alumina and aluminium markets because aluminium has evolved into its own market with a secondary market for recycling. It is now cheaper to recycle aluminium than to produce it from bauxite. Bauxite has also diverted from alumina, as alumina producers are located in different jurisdictions with their own supply and demand dynamics (such as sanctions and refineries' disruptions) that can make alumina prices increase significantly while aluminium prices stay the same. Participants considered the challenge to determine the price for lithium, for which a market reference price does not exist. It was noted that the two main producers of lithium, Australia and Chile, produce different forms of lithium, with refining capacity concentrated in China. There appears to be a price for finished products for lithium in raw form. The price for lithium could be derived from the market price of finished products, by discounting the cost of refining which is not easy to obtain.