The meeting was conducted under Chatham House Rules: "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

On 22-23 June 2016, under the co-chairmanship of Liberia, Norway, Kazakhstan, Chile, Germany and Guinea, twenty government delegations from Africa, Asia, Europe, and Latin America, as well as representatives from nine partner organisations and international institutions, and twenty-four major firms, industry associations, civil society organisations, academia, law firms and think tanks convened at the OECD for the Sixth Plenary Meeting of the Policy Dialogue on Natural Resource Development. Partner organisations in attendance included African Development Bank’s Legal Support Facility, the African Mineral Development Centre, the Commonwealth Secretariat, the European Commission, the International Institute for Sustainable Development, the Islamic Development Bank Group, the New Partnership for Africa’s Development (NEPAD), the UN Conference on Trade and Development (UNCTAD), and the World Bank. High-level participants included H.E. Mr Kazuo Kodama, Ambassador and Permanent Representative of Japan to the OECD; Mr Günter Nooke, Personal Representative of the German Chancellor for Africa, Federal Ministry for Economic Cooperation and Development (BMZ); and H.E. Mr Abdoulaye Magassouba, Minister of Mines and Geology, Republic of Guinea. The Chair of the Governing Board of the OECD Development Centre, H.E. Ambassador Pierre Duquesne, welcomed participants on both days of the Plenary Meeting.

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 Centre for Tax Policy and Administration, the Directorate for Financial and Enterprise Affairs, the Directorate for Legal Affairs, the Directorate for Public Governance and Territorial Development, the Directorate for Trade and Agriculture were also represented.

The two day meeting was structured around six sessions. The first day (22 June) was dedicated to advancing Work Stream 1 (Shared Value Creation and Local Development) and Work Stream 2 (Stabilisation Funds and Revenue Spending). The second day was dedicated to the Negotiation Support Forum, a joint initiative of the OECD Policy Dialogue and the G7 CONNEX Initiative, undertaken as part of Work Stream 3 (Getting Better Deals).
II. Summary of the Discussion and Conclusions

Participants commended the collaborative spirit, high quality analytics and public-private partnership underpinning the Policy Dialogue. Under Work Stream 1, participants welcomed the publication of the Framework on Collaborative Strategies for In-Country Shared Value Creation, and noted its complementarity to the implementation of Country Mining Visions in Africa. Participants emphasised the need to direct collective efforts into action at the country level and to use the Framework as a blueprint to develop strategies on shared value creation, and as a means to align existing initiatives and guidelines across government and industry. Participants further agreed two practical ways to achieve this – pursuing efforts for the creation of an online Compendium of Practices and support from the OECD Development Centre to develop strategies for resource-based value creation as a contribution to the 2030 Sustainable Development Agenda.

Under Work Stream 2 – Revenue Spending and Natural Resource Funds, participants discussed the merits of adopting stabilisation funds to stabilise revenue flows and ensure the consistency of spending, and they considered the means by which host governments can manage the trade-offs between saving and spending. Participants further agreed a Roadmap for 2016-2018 to move this work forward and endorsed a draft questionnaire designed to elicit information on four investment and spending instruments: subnational revenue sharing, special purpose investment vehicles, ear-marking practices and direct distribution and cash transfers.

Under Work Stream 3 – Getting Better Deals, participants discussed the drivers for renegotiating long-term extractive contracts and identified two underlying challenges: striking a balance between contractual flexibility to respond to changing circumstances while at the same time maintaining predictability and stability for long-term investments; and the tensions between national development goals and the global corporate practice of structuring extractive operations to capture windfall profits in one operation, to offset those gains against losses elsewhere. As part of the next steps, participants agreed to work towards a common understanding of key attributes for contract stability, learn from contemporary global contractual practice (including stabilisation, renegotiation and periodic review clauses). Participants further endorsed the proposal to develop a matrix reflecting a common baseline and criteria for building a dynamic equilibrium in extractive contracts between 2016 and 2018.

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

Session 1 was co-chaired by Hon. Deputy Minister of Operations Sam G. Russ, Ministry of Mines, Lands and Energy, Republic of Liberia, and Mr Pål Arne Davidsen, Senior Adviser, Private Sector Development, Department for Economic Development, Gender and Governance, Norwegian Agency for Development Cooperation (NORAD), Norway. Since the Fifth Plenary Meeting, held on 2-4 December 2015, the Framework on Collaborative Strategies for In-Country Shared Value Creation (henceforth the Framework) has been finalised and published. As part of next steps, participants emphasised the need to direct collective efforts into action at a country level by using the Framework as a blueprint to develop strategies on shared value creation to use natural resources to achieve SDGs, and as a means to align existing initiatives and guidelines across government and industry. The Framework is the product of a participatory drafting process including representatives from government, industry, and civil society. Indeed, the Drafting Committee established in January 2015 met eight times via conference call to discuss revisions, with progressive drafts submitted and discussed during the Fourth (29 June 2015) and Fifth (2 December 2015) Plenary Meetings. Participants commended the solid and inclusive process established to develop the Framework, which reflects the inclusive nature of the Policy Dialogue itself. They further noted that there is no “one-size fits all” approach to the implementation of the Framework. Rather, it is flexible enough to “fit for purpose”, amendable to be tailored to different contexts, and useful “to bring the right questions to the table” to understand how to leverage public-private coordination to maximise
benefits from extractive projects. The Framework helps understand the complementary roles of
governments and industry to achieve the desired results and do things differently, moving from
compliance/penalty-based systems to collaborative efforts for true value creation from extractive projects.
The Framework further helps to foster accountability for all stakeholders, providing a practical guide and
easy steps that enable governments, industry and civil society to work collaboratively, strategically and on
commercial terms. If public-private coordination works, benefits can be maximised.

To operationalise the Framework, participants heard the first set of examples for inclusion in the on-line
Compendium of Practices (‘the Compendium’) and agreed on the merits of pursuing efforts to model the
means by which the Framework could be operationalised. Participants further agreed to continue to
undertake country-level analysis to support the development of strategies for resource-based value
creation, in order to support the implementation of the 2030 Sustainable Development Agenda. Highlights
from the first set of Compendium practices included the integrated approach in Norway, involving targeted
regulations, collaborative partnerships with industry and investments in skill and technology development.
This strengthened the competitiveness of local firms and enabled Norway to develop world class oil-field
services and equipment with global companies working around the world (in line with Step 1 of the
Framework, ‘Shared Vision for a Competitive and Diversified Economy and In-Country Shared Value
Creation). Key success factors of the Norwegian approach include an incremental approach based on the
evolving industry and local capacities, a focus on developing a supply base competitive on quality, service
delivery and price, support for both large and small companies, and a fiscal framework that incentivised
sectoral diversification. Two other examples were discussed: a joint initiative between the Canadian
Government and Vale to provide training and skills development, enabling the formation of a ‘ready-made’
workforce to support Vale’s Voisey Bay operations (as per Step 3 of the Framework, ‘Unlocking
Opportunities for Shared Value Creation’); and Chile’s experience in which mining firms responded to high
energy costs by leveraging solar photovoltaic and wind turbines, to power their mining operations and
provide power back to the Chilean grid (Step 4, Support Innovation for New Products and Services). The
examples of Norway, Chile and Canada illustrate the fundamental role that governments play in creating
the enabling environment for facilitating, rather than hampering trade and investment.

Several partner organisations – including the Africa Minerals Development Centre (AMDC), UNCTAD,
and the World Bank – offered to contribute to the development of the Compendium by sharing resources
and knowledge. Participants further discussed the role of academia in contributing examples, and queried
the proposed on-line format for the Compendium. Participants were particularly supportive of ensuring a
functional interface between existing databases so as to leverage information that is available elsewhere,
for example, through the World Bank’s GOXI platform. Participants further agreed that the success of the
Compendium rests on honest and forthright contributions from Policy Dialogue participants, and from
academics and practitioners outside of the Policy Dialogue network. In the spirit of that approach, the
OECD Development Centre’s Secretariat will convene a Compendium Working Group with focal points
tasked to collect input from a wider set of stakeholders, to enable a multi-disciplinary, interactive approach
to Compendium development.

Key findings on Opportunities for Value Creation in Kazakhstan’s Copper Value Chain were presented by
the OECD Development Centre’s Secretariat. The extractive sector is an important component of
Kazakhstan’s economy, and the government supports the modernisation of the copper value chain through
the development of new mines, better environmental performance, and increased capacity to produce
different copper products with more value added. Copper industry participants noted that market dynamics,
in particular China’s overcapacity, created challenges for increasing Kazakhstan’s level of value added in
copper manufacturing. They suggested that government and industry efforts on employment and local
capacity development needed to be aligned, and that local suppliers would benefit from better access to
finance. Participants discussed the study’s findings, and noted the potential for additional research and the
benefits of conducting further field work for assessing the feasibility of the identified potential.
Participants agreed that the Country Reviews presented an opportunity to operationalise and gather country level experiences of the Framework, and to support synergies with other initiatives. Several opportunities for the Framework to interact with existing initiatives were discussed. Complementarities between the Framework and Country Mining Visions as part of Africa Mining Vision Process (AMV) will be leveraged by working collaboratively with partner countries in the design of strategies for value creation. Participants noted that the AMV interacts with and reflects the Framework at several key junctures, including on: Pillar One – Linkages, investment and diversification; Pillar Three – Fiscal regimes and revenue management; Pillar Five – Building human and institutional capacity; and Pillar Seven – Environment and social issues. Like the Framework, the AMV is not a static top-down approach but is intended to respond to different national and regional contexts through multi-stakeholder and interactive engagement.

Based on the Framework’s adaptability to different national contexts, the potential for the Framework to support stakeholder coordination in Senegal’s nascent petroleum sector was discussed. The structured approach of the Framework, embodied in both its step by step structure as well as its divisions of responsibilities, may be helpful in aligning the interests of stakeholders.

Participants also discussed the prospect of engaging the Islamic Development Bank (IDB) and its member states through its “Reverse Linkages Program”, which facilitates technical cooperation between countries and could be leveraged for the involvement of Knowledge Peers in the process.

Aspects of the Framework are also reflected in IPIECA’s recently released second edition Local Content Guidelines for Oil and Gas. In particular, IPIECA guidance echoes Step 1 of the Framework in emphasising the need to adopt long-term strategies around legal and regulatory frameworks to support the development of local content; Step 2 in detailing how to conduct baseline studies and gap analysis (Annex); Step 3 in offering options for unlocking employment and procurement opportunities, including through education and skills development. The potential to unbundle capital investments to support innovation by local suppliers as recommended in Step 4 is also being explored. In line with Step 5, the Guidelines establish indicators that are suited to a collaborative approach, and include an appendix on how to establish an appropriate organisational structure for monitoring and evaluation. The synergies between the Framework and IPIECA’s Local Content Guidelines reflect deliberate efforts on IPIECA’s part to harmonise the approach between the two documents, focussing on shifting to action and implementation.

In identifying opportunities for shared value creation, participants gave particular emphasis to education and skills development. Specifically, it was noted that not every country needs an oil and gas university, and not every country can act as an educational hub. There is also a need to coordinate education efforts with the actual demand for skills, and to consider what those skills should be – what kinds of jobs are most prevalent in the industry. Low skill employment presents opportunities to employ local staff quickly and without lengthy training; and yet, medium and high-skill jobs offer more opportunities for earnings and mobility in the long term. One participant noted that training a potential engineer in the oil and gas sector requires, on average, 3 years of education followed by 2 years on-the-job training.

Participants discussed the necessity of coordinating skills development efforts on a regional basis. In East Africa, for example, the GIZ-implemented Skills for Oil and Gas (SOGA) programme works with partner governments, industry, and training providers to help support the development local capacity in jobs related to the oil and gas sector. SOGA entails close cooperation with the private sector to ensure that the training provided meets the skills requirements of the industry. Participants noted the need for careful scaling and regional coordination of efforts to avoid subsidising overcapacity, as well as a multi-sectoral approach to promote skills mobility.

BGR’s research on the opportunities for local procurement in Southern Africa provided the basis for identifying other barriers to shared value creation. Among those barriers, participants identified: reluctance...
on the part of companies to transfer technology, unless mandated by law; and the difficulty of ensuring local suppliers adhere to certification and transparency requirements, as required by many investors. Participants also noted that local manufacturing and production require large markets to support it, which suggests there is some merit in building regional value chains in order to leverage economies of scale. Although potentially beneficial, supplier development programs are often located around the mining site enabling only low-skill inputs such as catering, transportation and security; investors rarely support the development of middle and high tech companies, where greater value can be added. Participants agreed that more needs to be done to support the capacity of local suppliers to provide the quantity and quality of inputs needed and to improve their access to finance. Currently, the expansion of local inputs is hampered by technological capacity gaps, inadequate access to financing, lack of reputation and the use of closed tenders by major mining companies, and incoherent policies. Participants further emphasised the importance of considering the broad socio-economic dimensions of shared value creation to maximise their benefits and contributions to development, and with a view to using natural resources to achieve the SDGs.

In light of the different issues around shared value creation that were raised by participants, it was agreed that there was a need for a greater understanding of initial demand and supply or capacity; and for coordination and cooperation between the public and private sectors. Participants also signalled the need for a degree of pragmatism because, as mining becomes more advanced and achieves greater automation, there will be fewer opportunities for direct employment and new challenges to understand where shared value creation can be created. Already, in many operations, the principal inputs of local content were labour and fuel, more than anything else.

Planned work to support the development of strategies on value creation and the Compendium of Practices are two concrete means by which to operationalise the Framework. These efforts can also help to crystallise new thinking and approaches to the issues discussed by participants, and will further enrich the Framework and inform possible future revisions.

**Work Stream 2 – Revenue Spending and Stabilisation Funds**

The session was co-chaired by Mr Rodrigo Monardes, Counsellor on Trade and Investment, Permanent Mission of Chile to the OECD, Republic of Chile and Mr Dastan Umirbayev, Executive Director of Macroeconomic Analysis and Forecasting Department, Ministry of National Economy, Republic of Kazakhstan. The objectives of this session were three-fold, to: (a) identify good policy and operational practices for managing the trade-offs between investment and spending, including in this instance, through subnational revenue sharing; (b) agree the milestones and thematic dialogues under a Roadmap for 2016-2018, including on sub-national revenue sharing, special purpose investment vehicles, direct distribution and ear-marking practices; (b) review and validate a questionnaire designed to collect data on the performance of four investment and spending tools.

Two principal concerns underlie the challenge of effectively managing resource revenues: managing the counter-cyclical nature of resource revenue flows to ensure that there is a consistent level of resources available for spending; and ensuring productive gains from the funds that are spent, in-line with the 2030 Sustainable Development Agenda. Drawing on lessons learned from the *Comparative Analysis on the Performance of Stabilisation Funds and Investment Options*, participants reiterated the merits of stabilisation funds as a possible means for smoothing revenue flows throughout the commodity price cycle, capturing windfalls and countering Dutch disease. It was reiterated that stabilisation funds are also not necessarily long-term savings instruments, nor are these a panacea for all states irrespective of their level of development; however, these tools can enable governments to maintain the consistency of their spending year on year.
Participants reflected on lessons learned about the performance and functioning of sovereign wealth funds (SWFs) in recent months, given persistently low commodity prices. Participants identified several forms of savings funds, and noted their respective strengths and weaknesses. In some contexts, for example in Russia, SWFs are managed on the basis of benchmark oil prices, but the question is how to benchmark prices from one year to the next. In other jurisdictions, such as in Kazakhstan, the regime provides for a guaranteed transfer from the fund to the national budget, but the issue is how to adjust those guaranteed transfers in the face of macro-economic disturbances as a result of low commodity prices. Another still different scenario is similar to that of Chile. In Chile, the Government makes long term copper price projections and then adjusts the budget and resource revenue transfers to the budget each year, but with commodity prices now half of what they were two years ago and even though the Chilean wealth management system is considered to be good, Chile is now facing a deficit as copper prices are not meeting the prices projected. The SWF has needed to be used to fill existing gaps in financing.

Participants considered that one of the lessons learned from Norway, and the reason Norway is seen as fairly successful in managing its resources, is that Norway had a substantial political consensus around the creation of its fund and on the way forward. Today, some are of the view that the SWF in Norway should become more of a political instrument and that the government should direct which funds or markets the SWF should invest in or not. Nevertheless, because of low oil prices and for the first time since the SWF was established in the 1990s, the Government is now starting to take a small share out of the SWF. This draws attention to the fact that it is not enough simply to put money into the SWF, but you need sufficient resources to put into such funds and if you do not have sufficient resources, you may be better to look at alternative investment options.

Participants also queried whether SWFs should be on or off budget, and whether countries should earmark funds for sectoral spending when a budget allocation already exists. Both issues will be further developed as part of the thematic dialogue on special purpose investment vehicles. It was also noted that irrespective of the mechanisms host governments adopt, or the variables considered, commodity price-setting mechanisms and the instability of global financial markets impact resource revenue flows and these are beyond the control of government.

Participants considered that the type of investment or savings vehicle to adopt in any given context depends upon a country’s level of development and production horizon. Countries in the top quartile of development will not take the same approach as those in the lower quartile. Stabilisation funds should also be seen as distinct from savings funds (e.g. the Norway Fund, Kazakh National Fund); and indeed, it does not always make sense for developing countries to save for the future when the return on domestic investment can exceed the return on savings. However, if a long-term savings fund is adopted, the host state will have access to the fund’s dividend for investment and spending, but it is necessary to have sufficient investment governance capabilities.

Moving beyond the question of stabilising revenues, there is a trade-off that needs to be determined between saving natural resource revenues in a sovereign wealth fund vs. current spending and public investment. Participants agreed to share experience on country practices to clarify the trade-offs, opportunities, and effectiveness of different policy mechanisms for current expenditure and public investment of natural resource revenues in support of the post-2030 development agenda. Four tools were identified: sub-national revenue spending, special purpose investment vehicles, direct distribution and earmarking practices. Participants endorsed the proposal to devote a thematic dialogue to each, starting with subnational revenue sharing.

Subnational Revenue Sharing
Considering the costs and benefits, and particular country experiences of subnational revenue sharing, participants observed that this is just one mechanism by which resource benefits can be distributed to achieve domestic development objectives – and it can work in several ways. At one end of the spectrum, resource revenues may be treated in the same way as other revenues and dispersed as part of planning and prioritisation processes via the national budget – as is the case in Norway, Chile and Vietnam. Another approach is ‘indicator-based’, where the national government distributes natural resource revenues to subnational authorities on the basis of a set of objective criteria—such as population data, poverty levels or geographic characteristics including remoteness —irrespective of the site from which these resources were extracted (e.g. Ecuador, Mongolia, Mexico and Uganda). The final mechanism is ‘derivation’, which is becoming increasingly prevalent and involves the collection of taxes by national government and the transfer of these revenues back to their area of origin or adjacent areas. Derivation is now used in as many as 20 countries, including several in LAC such as Mexico, Peru, Bolivia, and Colombia, but also in countries such as the Democratic Republic of Congo (DRC), Nigeria, Ghana, Myanmar and the Philippines. In most countries, subnational governments receive public funds through a combination of direct tax collection and transfers from the national government.

Overall, the analysis conducted jointly by NRGI and UNDP, together with the findings of the OECD Territorial Review of Peru, show that experiences with these varying sub-national revenue sharing modalities are mixed. In some resource rich countries (e.g. Australia and Canada), living standards have improved. Resource revenues have also contributed to the attainment of peace and security, and to the prevention of conflict. Participants considered, for example, the experience of Indonesia where special subnational revenue sharing mechanisms have calmed separatist tensions with Papua. This was also the case in Nigeria, Papua New Guinea and Southern Iraq. Nevertheless, there is more evidence of the negative impacts; of wasteful spending (as in Canada, Columbia and Peru); and the inefficient allocation of resources, leading to regional inequity and conflict.

Several challenges were noted: national and subnational revenues are similar but different, subnational authorities do not have the same opportunity as national government to delink investment and spending as national government; finance does not always follow function, there is a mismatch between revenues and spending; there is non-payment of promised revenues to subnational authorities; and there are information gaps. Resource revenue management may be driven by partisan policy interests and not economically grounded, and there may be little emphasis on consensus-building.

The particular experience of Peru was read as a case in point. Company taxes and royalties from the extractive industries are two important sources of revenues in Peru, constituting respectively, an estimated 58% and 36% of resource revenues overall.

Under the ‘Canon System’, the national government transfers as much as half of the country’s resource revenues to subnational authorities (regional and local government), and keeps the remainder. Producing regions receive 25% of the Canon sum (5% of which goes to regional public universities for research), while the remaining 75% is transferred to local governments within the producing regions, from where it is further distributed among regional, provincial and district levels, either to acknowledge the area from which the resource was extracted or on the basis of population and basic needs. The distribution of royalties functions in much the same way.

Overall Canon transfers are an important source of revenues for subnational governments, constituting 37% of local government revenues in 2014. The amounts transferred under this regime have increased substantially over the years, from USD 47 million in 2002 to USD 2.5 billion in 2014 (with spikes of USD 2.9 billion in 2013 and 3.4 billion in 2012).
Although the principals behind the distribution of revenues in Peru are to recognise the area from which the resource is extracted, and to address basic needs; in practice, the system has created regional and vertical imbalances. The government is struggling to equalise transfers — and there is a high level of volatility in revenue flows. 77.7% of the overall resources are transferred to 6 of the 25 regions. 4 provinces (out of 196) receive up to 50% of the resources transferred, and local or municipal governments are often better resourced than those at a regional level. In many cases, this money has not triggered higher growth in beneficiary regions, and when commodity prices go down, local authorities encounter revenue shortfalls, making it difficult to maintain spending. Part of the problem is that there is limited capacity for planning in the local authorities and a lack of clear links between planning and spending. There is poor prioritisation, no equalisation and there are no spending assignments, against which regional or local governments can be held to account. Subnational governments are also under significant pressure to spend, and yet have limited absorptive capacities. Capital investments can trigger recurrent spending commitments that must be adopted by central government. It is also the case that subnational boundaries are often ill defined, with the end result that revenue assignments can produce high levels of conflict. Problems can also arise in the flow of funds through the budget from national to subnational government as different agencies (national and subnational) sometimes interfere and it can be difficult to strike the right balance between the interests of the population, as perceived by central government, and the perception of local communities themselves.

Taking the lessons of the Peruvian experience and NRGI/UNDP research, participants concluded that stabilisation mechanisms and subnational revenue sharing are just two of the means by which to counter volatility and establish local confidence in central government, but national government should set the national planning agenda and guide subnational authorities on spending. Ultimately, however, the challenge of effective subnational revenue sharing is in striking a balance between ear-marking and flexibility, and in producing quality data or statistics to ‘follow the money’ and ensure that any allocated funds meet the targets intended. In Peru, recent reforms allow for 20% of resource revenues to be used to prepare and oversee projects in municipal government, and funding requests could be conditional on the presentation of a feasible project plan. At the same time, the establishment of a stabilisation fund could offset the volatility of regional transfers. For such an arrangement to work, however, expenditure assignments would need to be commensurate with local absorptive capacity and in-line with the responsibilities of each level of government. They should also encourage productive regional and local investments, and avoid inefficiencies or fragmentation.

OECD analysis recommends considering the following points when setting up a transfer system including, but not limited to: (a) the logic of the system: whether it is compensatory and designed to account for negative externalities, or property based; (b) its objective, i.e. is it designed to reduce gaps in poverty or to invest in productive assets; (c) the merits or otherwise of adopting a stabilisation mechanism to avoid volatility in revenue flows and manage the strong pressure for spending, which tends to lead to fragmented low quality investments; (d) guaranteeing that system provides incentives to scale investments in order to benefit from economies of scale and network (e.g. ensuring a balance between the funds transferred to local and regional governments); and ensuring that the sum and objective of the transfer is in line with competences and absorptive capabilities of the subnational government where the funds are sent e.g. ensuring that the transfer is done at the right level of government; and investing in capacity building and monitoring of the projects to guarantee better quality and impacts and thus higher social returns; linking planning and budgeting; and increasing the conditionality of the transfers.

Concluding the session, participants endorsed a Questionnaire designed to support the analysis of practices feeding into a preliminary stock-taking of country experiences, by the end of 2016. Participants further agreed a Roadmap 2016-2018 with dedicated thematic dialogues. Special-purpose investment vehicles will be discussed at the Seventh Meeting of the Policy Dialogue on Natural Resource-based Development in December 2016. The Eighth and Ninth Meetings in 2017 will focus respectively on cash transfers/direct
distribution mechanisms and earmarking practices. The responses to the questionnaire and the thematic dialogues will be brought together in 2018 to inform the development of guidance and lessons learned on effective public spending and investment to support the implementation of the 2030 Sustainable Development Agenda.

Work Stream 3 – Getting Better Deals

The second day of the meeting (23 June) focused on issues related to support for extractive contract negotiation within the framework of the Negotiation Support Forum, a joint endeavour between the G7 Initiative on Strengthening Assistance for Complex Contract Negotiations (CONNEX) and the OECD Policy Dialogue on Natural Resource-based Development. Sessions three to six were co-chaired by Mr Günter Nooke, Personal Representative of the German Chancellor for Africa, Federal Ministry for Economic Cooperation and Development (BMZ) and H.E. Mr Abdoulaye Magassouba, Minister of Mines and Geology, Republic of Guinea. A draft report on ‘Dynamic Stabilisers for Long-Term Extractive Contracts’ produced by the OECD Development Centre acting as the Secretariat, served as the basis to support the discussion under the different sessions, without aiming at this stage to propose any specific solutions. Drawing on the plenary discussion, the report will be restructured and integrated with possible guidance options for consideration at the Seventh Plenary meeting of the Policy Dialogue.

Participants noted that 2016 is the first year of the implementation of the 2030 Sustainable Development Goals (SDGs) and recognised the strategic importance of the CONNEX Initiative in helping resource-rich developing countries to meet their SDG targets. Under the Japanese presidency, G7 leaders in Ise-Shima endorsed the CONNEX Guiding Principles towards Sustainable Development. The Principles emphasise CONNEX’s relevance to achieving the SDGs. Well negotiated contracts can help resource-rich countries to mobilise their domestic resources and utilize them effectively, strengthen their institutional capacity and support robust and long-standing deals, benefitting both states and investors. The CONNEX Negotiation Support Forum can help overcome major problems driven by short-term approaches and foster the adoption of a long-term perspective to fully grasp the complexities associated with extractive contracts. This holds the potential to inform better solutions designed to stand the test of time and the obsolescing bargain. The multi-stakeholder approach characterising the CONNEX Negotiation Support Forum is also fully in line with the expectations of the SDGs which require all stakeholders to play a role to support the achievement of the 2030 Sustainable Development Agenda. While CONNEX pilots are underway in countries such as Mongolia, Mali, Mozambique and Tanzania, all of the G7 countries gathered at the Ise-Shima Summit have committed to intensify their “efforts under the CONNEX Initiative” and “to provide developing country partners with multi-disciplinary and concrete expertise for negotiating complex commercial contracts”. On 15-16 September Japan will host the CONNEX International Conference on Capacity Building and Transparency in Tokyo. The conference will provide the opportunity to share knowledge, promote capacity building and to improve transparency and governance.

The objectives of the session were to improve understanding around the main drivers and factors that affect risk and return in contract negotiation. Recognising the inherent uncertainty characterising extractive industries, participants further discussed possible appropriate responses in the short-term to handle pressure for contract adjustments in the current downturn. Participants further reviewed techniques and options for increasing contract responsiveness to the inevitable changes of circumstances that occur during the life cycle of extractive projects, in an attempt to reconcile the need for contract stability and predictability with the necessary flexibility for building durable long-term relationships.

Setting the context for the discussion, participants highlighted tensions underlying contract (re-) negotiations, namely: 1) pressure for short-term gains (which on the extractive company side is driven by the interests of shareholders, lenders and the capital market and on the host governments’ side by political cycles) as opposed to the need for adopting a long-term perspective to maximise benefits from extractive
projects in the long run; 2) investors’ interests to maximise profits which contrast with the broader set of development objectives pursued by governments, for which extractive projects are not just a source of revenue but rather a transformative opportunity for sustainable development; 3) the lag between local agendas and expectations around in-country benefit generation and global corporate practice of structuring extractive operations to capture windfall profits in one operation to offset those gains against losses elsewhere. Understanding the history of contracts, why and how they were negotiated and building government capacity to monitor their implementation were all regarded as very important aspects.

Participants emphasised the need to negotiate good contracts in the first instance to minimise the need for future renegotiation and provide the predictability and visibility needed over the entire length of the investment.

In order to do so, participants called on governments to decide where they are going and how to get there. It is not just for weak institutions and ineffective regulations that countries remain unable to maximise the benefits from natural resources, but it is rather the lack of long-term strategic vision and sound policies in place towards sustainable development objectives that undermine contracts, which have been often constructed with no consideration of the long-term perspective. Zambia was illustrative of the trend to move towards long-term institutional foundations to underpin contracts to avoid past mistakes resulting in a race to the bottom.

The Africa Mining Vision, the 2063 Agenda at the regional level and more broadly the SDGs provide the overarching principles and tenets for the negotiation of good contracts. Participants further considered that the Framework on Collaborative Strategies for In-Country Shared Value Creation provides a useful tool to define the shared objectives of sustainable extractive contracts.

Participants identified a current trend, particularly in Africa, toward reforming mineral regimes from a legal, regulatory and policy perspective. In this regard, participants noted that many states are facing the dilemma as to whether to renegotiate extractive contracts before or after undergoing regulatory reform. It was noted that while there may be significant political or public pressure to renegotiate these contracts immediately, there are benefits for states in taking the time to properly formulate their policy objectives and to set their regulatory frameworks before initiating negotiation or entering into contract renegotiation.

The downturn of the commodity market provides impetus for governments to adopt a long-term perspective and the opportunity to structure a participatory governance process in which trade-offs are carefully considered, going well beyond financial modelling and rewards.

It was noted that there are often asymmetry of information at the negotiation stage of a contract and limited understanding of inter-sectorial linkages. Governments do not always have access to all information that is accessible to industry; or they may not have the capacity to properly interpret that information in a meaningful way. One participant urged companies to take a more proactive approach to information sharing by sharing all relevant information with the host government including the feasibility study, capital costs, operational expenses and the cost of getting the product to the market. Governments need to see and understand this information as this can help them to make informed fiscal calculations on the merits of the deal. It was suggested that information sharing provisions could be built into contracts in order for governments to have better access to information during the life of the contract. Transparent sharing of information during initial negotiations and throughout the lifetime of the contract itself can build trust between the parties.

Participants acknowledged the importance of each party gaining an understanding of each other’s negotiating positions and limitations. It was observed that governments still struggle to understand the basic characteristics and motivations investments in extractive projects, while companies appear concerned
by securing their rate of return, without understanding the political economy and the political environment where they invest. Carefully managing expectations at the outset was also deemed crucial. Often the population of a resource rich country expects that wealth will materialise as soon as the contract is signed, but in reality several years or even decades are necessary for significant benefits to be realised. In that respect, the shared responsibility that governments and investors have in managing expectations through appropriate communication was emphasised multiple times; both with respect to each other but also in the interactions with local communities, civil society and other interested groups. Companies and governments must be careful not to oversell the benefits of the project or promise too much. The communication must be honest and must clearly and accurately describe the level of benefits, such as job and revenue generation potential of extractive projects.

The CONNEX Negotiation Support Forum can assist to develop enhanced mutual understanding by providing a framework under which the parties can negotiate. Fundamentally, CONNEX is about “getting the deal right but also getting the right deal”.

The outcomes of the NEPAD regional dialogue series held in West and Central Africa and South and East Africa show that most of historical extractive contracts, some dating back to the colonial era, were regarded as unbalanced and in need of some form of revision. The point was made that unbalanced contracts are by definition unstable and often lead to renegotiation. Some governments have used the post-conflict or democratic transitional context as either a legal basis for renegotiation or at least to engender good will by the parties.

The recent Guinean experience was regarded as a useful example of a strategic approach to the review of 18 mining conventions. The majority of extractive contracts that Guinea had entered before 2011 were found to be fundamentally unbalanced, affected by passive corruption or asymmetries of forces at play. This caused civil unrest in the country and urged the government to take action. As a matter of consequence, the review of mining contracts was essentially a political process, which nonetheless had to be managed in a professional manner, requiring specialised technical expertise in a complex international and national context, including the adverse impact of the financial crisis, uncertain priorities at national level and sub-regional instability. An additional challenge for the government was to manage contradictory public demands from different constituencies asking at the same time for more revenue, more mining investments and social services.

The government was able to frame the review into a sound process. The first step for Guinea was to revise the existing mining law to clearly articulate the objectives of the new mining policy and the contract review and communicate them effectively. Contract specific derogations are no longer allowed, thus favouring contract standardisation. The end result was a new mining code that sought to balance national aspirations with investor expectations. A strategic inter-ministerial committee was put in place, composed of the Ministries of Mines, Economy and Finance, Justice and Infrastructure. An inclusive technical committee, with two representatives of civil society, was tasked to operationalise the review of mining contracts. The purpose of the review was to assess 18 mining contracts signed before 2011 to verify 1) the compliance with legal standards at the time of award; 2) the integrity of the award process to ensure it was not tainted by corruption; 3) the protection of the balance of interests; and 4) any gaps between the applicable regime at the time of the award and new provisions of the mining code, in particular with respect to environmental standards, social protection and fight against corruption. If this assessment resulted in the appreciation of substantial lack of balance in the protection of interests of the parties, the Guinean authorities would open negotiations in good faith. Guinea differentiated between negotiable and non-negotiable provisions on environmental protection, prevention of corruption, social protection and local employment, which were considered of immediate application and had to be incorporated into the conventions. Fiscal and custom stabilization clauses were subject to good faith negotiations with a view to bringing them into alignment with the new mining code through a participatory process and phased
application of any amendments with important financial implications. As a result of the audit process, the technical committee was tasked with the formulation of concrete recommendations for consideration by the inter-ministerial strategic committee. Once endorsed by the latter, formal renegotiations would be opened with companies concerned to renegotiate the contract in a participatory and non-confrontational manner.

Several key lessons that characterised Guinea’s approach to renegotiation were considered essential for the process to succeed and demonstrate how contracts can be used as powerful tool to improve the governance of the resource sector:

- **Strong political support** – which was an initial driver for the renegotiation but also proved to be necessary throughout the process in order to complete renegotiations within a reasonable period of time. This allowed managing the huge geostrategic interests at stake, and overcoming initial resistance from companies to engage in the renegotiation process.

- **Multidisciplinary (external) technical support** – this was necessary as the renegotiations required legal, financial and technical input for the professional undertaking of the audit process, which took more than one year to be launched. Guinea benefitted from support given by Revenue Watch (now NRGI) and the African Legal Support Facility. One lesson learned was the need to secure adequate financial resources upfront for the provision of external assistance to avoid a certain process fatigue. Participants discussed some of the challenges associated with governments procuring outside expertise. Concern was raised that different advisors may give a government inconsistent advice on the same project, and that often times the external legal adviser is the only one who appears to benefit from the process itself. In terms of the assistance that CONNEX might provide, building internal capacity and ensuring that in-country teams remain accountable for the end results.

- **Balancing exercise** – this was needed to find solutions acceptable to both the state and the investor. Since there was no silver bullet for the definition of the contractual financial equilibrium, the negotiation process itself led to the identification of areas in which the equilibrium of contract should be restored.

- **Communication strategy** – this was essential to create the conditions for mining companies to stay, and in fact the government wanted increased investment in the mining sector. Trade-offs were explained to demonstrate that the decisions taken reflected a balance between what was desirable and what was possible.

Participants commended the government of Guinea and recommended that lessons learned from its instructive experience are widely shared with other resource-rich producing countries to avoid that future renegotiations are short-circuited by shortcomings in the process.

Turning to the impact that low commodity prices have on contracts, the point was made that both governments and extractive industries are on the same boat and confronted with challenging conditions. Many resource-rich countries are under considerable fiscal and macroeconomic pressure with tax revenues, jobs, and exports all in decline. Extractive industries struggle to keep their operations going, save projects in which considerable investments have already been made and protect employment. It was observed that production bonuses and profit sharing terms negotiated during the booms are no longer sustainable. However, the public may assume that the approaches developed during the boom period might still be applicable. Governments have the duty to explain that those conditions are gone and there will be some time before they return, which means that adjustments may be needed. Beyond overall political and macroeconomic stability, participants observed that a lot that can be done to de-risk investments without affecting domestic resource mobilisation. Progressive and counter-cyclical fiscal regimes can be part of the
solution. Beyond fiscal terms, there are many other elements of interest such as facilitating transfers when asked to do so, accepting certain delays and flexibility on the work programme, suspending obligations where necessary, accelerating government’s decision-making, reducing above ground risk by cutting down on corruption, and improving governance and transparency. Everything that facilitates the investment climate is also essential to attract investments. Inter-ministerial coordination is crucial as well as infrastructure, especially transport and power. Sector specific measures are also relevant. Improving environmental licensing procedures and facilitating consultation with communities and flexibility on local content policies may be helpful. If governments choose to be lenient on these issues, monitoring compliance becomes essential.

It was emphasised that exploration efforts should be pursued even in the current price downturn and that the private sector is ready and willing to take the geological risk that the market should finance. The opportunity to invest public resources into oil and gas exploration efforts was questioned due to the high investments needed and the huge potential losses.

Participants agreed that parties entering in good faith negotiations should share the objective to come up with an agreement that forms the basis of a long-term relationship. Both governments and industry showed commitment to structuring durable contracts. Participants agreed that good contracts should reflect the full project life cycle and anticipate potential for change and how the parties will deal with that. Both governments and industry recognised that it is in the interest of both parties to have contracts that are balanced and understood by all parties.

Recognising that there is no static bargain, but an on-going relationship that evolves during the projects lifecycle, participants embarked on a discussion on how contracts can be designed to withstand the test of time, building in the balance between flexibility and stability which minimise the need for renegotiation. Reflecting on possible responses for balanced long-term solutions, participants recognised the need to ensure a minimum of revenues flowing to governments throughout the project life-cycle, while designing revenue sharing arrangements that reflect exposure to risk.

Against this backdrop, participants engaged in a frank discussion around a series of objective elements to be considered in all circumstances when entering into contract negotiation: risk exposure, market and price dynamics, and the role of shareholders, lenders and financial institutions.

With regard to risk and reward sharing, the point was made that extractive companies seek an equitable return on investment throughout the project life, noting that they are constantly balancing many different types of risk. Participants observed that there are fundamental differences between the mining and oil and gas industry. It was explained that in the oil and gas sector there is a very high risk that any exploration venture will fail. The global success rate for exploration wells is below 20% and the commercial success rate is even lower. When companies evaluate investment opportunities, this high failure risk will be taken into consideration. When there is oil and gas exploration success, this does not mean commercial success. Further work needs to be done to evaluate the potential commerciality of the discovery involving additional resources (more than a billion dollars). When the decision to develop the resource is made, further investments in the order of tens of billions of dollars are necessary. And when production starts, it may take up to ten years to fully recoup the initial investment.

Economic analysis is done to understand whether the revenue allocations are sustainable and promote the investment. Moreover, it is often not known if hydrocarbons are present at all, and if they are present, there is often uncertainty on their available size, quality and distribution (in terms of areas and depth). The terms of the contract need to reflect the unique characteristics of the place of operations, the nature of the risks companies are exposed to, the range of possible resource size and quality and costs associated with the development of resources, the capital invested and the timing of those investments. Beyond financial
contributions remunerated by return on capital, oil and gas industry also seeks compensation for the benefits they bring to host countries in terms of technical project management, proprietary technology, operational experience and integrated solutions, all of which require significant development costs. It was stated that host countries benefit from dealing with big multinationals for cheap access to funding and bigger spread of risk over the company able to off-set very high risks against multiple operations worldwide. Besides subsurface uncertainty there is also cost uncertainty related to the operating environment (remote, severe ocean conditions, special local requirements, quality of the resources, market effects with rising prices and costs but cost readjustments lagging behind price falls). It was explained that costs and the rate of return cannot be determined in advance, but there is an expectation that the revenue allocation method is going to sustain the life of the project. The risks in exploration and appraisal development were described as asymmetrically born by the investing companies, justifying some participation in the profit potential in the success case. There are a number of factors that play in the global variation in government take: in mature areas where main hydrocarbon risks are gone and there is an established industry with on-going production, it may be appropriate to have a much higher level of government take.

Given the inherent uncertainty of the sector and the fact that mining, oil and gas companies are at the front of a capital system in which they are held accountable to shareholders and lenders, it was noted that it is essential that investment decisions need strong contracts from the start within a clear, transparent and stable contractual framework, not subject to unilateral subsequent interpretation, but flexible enough to adapt to fluctuations. As it is hardly impossible to predict or anticipate the variety of factors that could affect the contract equilibrium over time, participants recognised there is no silver bullet solution or perfect contracts. It was suggested that well drafted contracts should allow both parties to benefit from upsides, but also “share the pain” when adverse circumstances occur. However, some industry participants cautioned against a slippery slope as higher rates paid to governments seldom come down. In the same vein, government participants have experienced push backs from companies to accommodate governments’ requests to share the gains during the upswing.

The NEPAD regional dialogues highlighted the need for improved understanding around the rationale behind stabilization provisions. For example, all 18 mining conventions renegotiated by Guinea had stabilization clauses in place. All companies but two agreed to review their formulation, recognising that unequitable contracts are unstable contracts.

The notion and scope of stabilization was discussed.

Participants agreed that prices cannot be stabilised in contracts.

Participants also wondered whether stabilization should be understood as referring to profits and for whom. It was noted that a well negotiated contract should ensure a consistent and stable flow of revenues to the government for each year of production and adequate compensation for the risks that mining, oil and gas companies take to develop the resource. It was observed that the current challenge in the oil and gas sector is to get new investment with high cost of discovery and development. It was further observed that the revenue sharing arrangements should reflect the asymmetrical nature of exploration and appraisal development risks, which are born by oil and gas companies. In this regard, progressive fiscal regimes were considered part of the answer as they can be designed to ensure responsiveness to price, cost and volume fluctuations and deal with the worst. Progressive fiscal regimes provide the state more revenue when there is more value to be shared. Sometimes, fiscal design chosen by the government may create some misalignment of interests which results in value being left on the table. For example, fiscal elements do not always provide incentives for maximum recovery. High production based royalties do not work for the state in an environment of high prices. A profit sharing schedule can be based on a fix rate of return but the rate of return doesn’t change when prices drop or costs increase. On-going operations can be
discouraged in price-based systems that do not reflect costs. Another example of misalignment of interests has to do with cost recovery mechanisms. While companies seek to recoup initial investment in a reasonable period of time, sometimes cost recovery mechanisms only allow to recoup the costs before any of the hydrocarbon is shared according to the profit sharing schedules.

Most lawyers and economists refer stabilization to taxes. It was observed that considering the level of risk and the size of the investment involved, investors do expect tax stability at least for a period necessary to get their return on investment. The less visibility is provided in contract the more the costs of financing will increase. Participants urged to internalise lessons from the end of the last super-cycle. In fact, most of the frustration expressed by some countries may be explained by the measures offered during the past cycle of low commodity prices. A stabilisation clause is sometimes offered to make one country’s offer more attractive to investors than the offers made by neighbouring countries at the regional (rather than at the international) level. The reaction to the downturn pushed some countries to offer certain forms of stabilization that after years were perceived, often correctly, as unfair and too generous. The purpose of stabilization clauses was to encourage investors to make a long-term commitment for the development of resources when other options were available. But, it’s the reaction to that earlier cycle that often triggers many disputes. Participants stressed the importance to fully understand what happens with price fluctuations and perceptions of prices, in particular with respect to the relationship between price rise and profitability. In this respect it was clarified that when prices rise, costs rise as well, and when prices drop, costs do not necessarily automatically readjust at the same pace.

It was noted that there is flexibility in the system but provisions need to be designed properly. The more modern approach developed in the 1990s is to have a form of stabilisation, with a possibility to renegotiate certain issues in defined circumstances. Participants further observed that stabilisation clauses have moved away from the traditional “freezing” provisions to the more modern “equilibrium” concept. The trigger may be a change in fiscal terms and laws, including subsequent evolving interpretation. In this case, the state discretion to change the law is not fettered, but it has to restore the bargain that was struck at the beginning. Allocation of burden provides another form of flexibility when the state wants to change the law. In such a case, the national company steps in and rearrange the benefits so that the investor does not end up worst off.

Participants also discussed whether stabilization effects should apply to changes in law of general application. It was observed that contracting practice has considerably evolved over time and that stabilisation provisions are much more sensitive to state concerns about sovereignty than they have ever been before. Political risk insurance and legal doctrines on undue discrimination and indirect expropriation were put forward as useful mechanisms to deal with such circumstances. Many commentators recognise that applicable standards and norms of general application evolve over time within any government. For example, domestic and international environmental standards do evolve over time as industry standards do. It was observed that no single responsible company would actually expect the law of general application not to change over the life-cycle of the project. In this regard, the Model Mining Agreement developed by the American Bar Association (http://www.iisd.org/sites/default/files/publications/mmda_transparency_report.pdf) applies first a principle of non-discriminatory regulatory measures concerning health, safety, the environment, and to address the proximate human rights impacts of mining operations as a protection for the company. To protect investors against true political risk of unreasonable or inappropriately targeted measures, “the changes in social and environmental standards should be reasonable and achievable under good industry practice. In short, the provisions shift away from stabilization to tests of non-discrimination, reasonableness and good industry practice, putting the burden on a company to argue that any new measures breach these standards, instead of creating an automatic claim to the non-application of such measures, or to economic compensation for adopting them”. The United Nations Principles for Responsible Contracts developed by the UN Special Representative on Special Representative of the
Secretary-General on the issue of human rights and transnational corporations and other business enterprises, Professor John Ruggie (see http://www.ohchr.org/Documents/Issues/Business/A.HRC.17.31.Add.3.pdf), recommend that “contractual stabilization clauses, if used, should be carefully drafted so that any protections for investors against future changes in law do not interfere with the state’s bona fide efforts to implement laws, regulations or policies in a non-discriminatory manner in order to meet its human rights obligations. In particular, the Principles recommend that “stabilization clauses, if used, should not contemplate economic or other penalties for the State in the event that the State introduces laws, regulations or policies which: (a) are implemented on a non-discriminatory basis; and (b) reflect international standards, benchmarks or recognized good practices in areas such as health, safety, labor, the environment, technical specifications or other areas that concern human rights impacts of the project. The Principles specify that mechanisms to manage the material and economic impacts on an investor of non-discriminatory changes in law should be carefully designed to mitigate the specific risks to which the investor is exposed, while noting that such mechanisms should not undermine the State’s bona fide efforts to meet its human rights obligations.

It was observed that in contemporary practice, it is quite common and uncontroversial to have a carve-out in stabilization clauses for environment, health and safety. The COP21 declaration emphasised that countries have the right to regulate in the field of climate change. The Canada-EU FTA and the Transpacific Partnership Agreement specify that a change in the law does not constitute a breach of the fair and equitable treatment. Given the inherent uncertainty of prices, quantity and quality of available resources, and the variety of interests across governments, investors, shareholders and lenders, it was suggested that rather than focusing on specific contractual terms, it would be perhaps more useful to stabilize expectations. Investors and companies will always seek competitive terms (secure tenure, good governance, predictability and stability in law and policies, with minimum negotiation of fiscal terms). Secure tenure and stability are not just delivered by terms, law and contracts. The objective of feeling and perceiving value should also be given attention in the development of agreements. It was noted that value creation is the agreement stabiliser and settler, and that the collaborative framework for in-country value creation developed by the OECD is the way to create that felt value which is needed to stabilise agreements. Economic distribution of benefits as reflected in revenue sharing arrangements will almost never be perceived as adequate to host governments and their people. It was suggested that negotiation should be preceded by an agreement on the fundamentals reflected in a baseline economic and financial scenario subject to regular update every six months. This baseline would form the basis for the formulation of simple clauses related to a set of key parameters. Changes above a certain threshold or below the basic ratio would act as red flags and trigger compensation by other variables within the originally defined equilibrium. In this scenario, it is not just a clause that will be changed, but it is the collective assessment of the basket of information which will be considered. For example, an increase in the costs of operations could be offset by other benefits, without renegotiation or need to apply the stability clause. This approach is expected to enable improved management of expectations, reduce asymmetries of information and ensure predictability and stability going forward.

Participants agreed to explore further pragmatic ways to construct contracts for the long-term, with the objective of striking deals able to withstand the best and worst of times, thus minimising the need for contract renegotiations throughout the commodity price cycle. Defined flexibility in the agreement can provide predictability and limit renegotiations to exceptional circumstances. It was agreed that drawing on the discussion in plenary, it would be useful to convene a small group to define the key attributes of win-win stability over the long-term, providing some level of comfort for both investors and host governments and help to move towards enhanced convergence between the parties.