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

31 January – 1 February 2018

Summary Report

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

Under the co-chairmanship of Chile, Germany, Guinea, Kazakhstan, Liberia, Norway, and United Kingdom, 22 government delegations from Africa, Asia, Europe, and Latin America, as well as representatives from 8 partner international organisations and institutions, and 48 major firms, industry associations, civil society organisations, academia, law firms and think tanks convened at the OECD on 31 January – 1 February 2018 for the Ninth Plenary Meeting of the Policy Dialogue on Natural Resource Development. International organisations and institutions represented included the African Legal Support Facility, the Commonwealth Secretariat, the European Union, the Extractive Industries Transparency Initiative, the Holy See, the Inter-American Development Bank, the UN Economic Commission for Africa, and the UN Conference on Trade and Development. H.E. Eng. Abdirashid Ahmed Mohammed, Minister of Petroleum and Mining, Federal Republic of Somalia, gave a keynote address and Mr Günter Nooke, Personal Representative of the German Chancellor for Africa, Federal Ministry for Economic Cooperation and Development (BMZ) delivered closing 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 Centre for Tax Policy and Administration, the Directorate for Financial and Enterprise Affairs, the Development Co-operation Directorate, the Environment Directorate, the Global Relations Secretariat and the Directorate for Trade and Agriculture were also represented.

The two day meeting was structured around nine sessions. The first day was dedicated to the first substantive session of the Thematic Dialogue on Commodity Trading Transparency and progress made on tackling BEPS challenges in mining under the Work Stream 4 (Domestic Resource Mobilisation: tackling Base Erosion and Profit Shifting and corruption), as well as providing the opportunity to continue the thematic dialogues on spending mechanisms under the Work Stream 2 (Natural Resource Revenue Management and Spending). The second day was dedicated to advancing work under Work Stream 1 (Shared Value Creation and Local Development), with a thematic focus on local procurement and reporting; and clean technology and innovation. The day was closed by two sessions on Work Stream 3 - Getting Better Deals to discuss aspects of the Draft Guiding Principles for Durable Extractive Contracts.
II. Summary of the Discussion and Conclusions

Throughout the course of a fruitful two day meeting, participants commended the collaborative spirit, high quality analysis and inclusive partnerships underpinning the Policy Dialogue. Under Work Stream 1 – Shared value creation and local development, participants discussed and validated a further four examples for inclusion in the Compendium of Practices. An online tool, the Compendium helps operationalise the Framework on Collaborative Strategies for In-Country Shared Value Creation and contains cases of practices that concretely illustrate how the Framework’s guidance can be implemented by the private and public sector. The examples discussed focused on enhanced local supplier and workforce participation in extractive projects, and participants emphasised the importance of collaborative, process-oriented, bottom-up approaches through which shared understanding and alignment across stakeholders can be built. Participants also discussed the opportunities for sector’s low-emission transition, recognising the existence of a business case for adopting clean technology solutions which can lead to cost savings, along with increased energy, emission and water-use efficiency. At the same time, participants identified a number of challenges to the uptake of these innovative practices, including perceived and actual risks associated with new technology absorption. In this regard, government has a crucial role in creating an enabling policy environment to accelerate the sector’s shift to clean technology, and to foster public-private collaboration to share potential operational and financial risks associated with the transition.

Under Work Stream 2 – Revenue Management and Spending, participants considered the key characteristics, trade-offs and opportunities of cash transfers, as a possible mechanism for governments to distribute natural resource revenues directly to citizens in support of development objectives. This was the fourth in a series of thematic discussions on spending mechanisms. Participants considered that in developing country contexts, governments often face a dilemma, and using resource revenue to give cash to citizens may divert revenues from priority investments such as infrastructure, health, and education. At the same time, cash transfers may be useful in helping smooth the transition away from fossil fuel subsidies, which tend to be poorly targeted and inefficient, yet popularly supported and thus often difficult to remove or reform.

Under Work Stream 3 – Getting Better Deals, participants distinguished between fiscal and non-fiscal changes in respect of the consequences of changes in law on the durability of extractive contracts, and recognised that Governments may introduce changes in law, and/or in their implementation of laws, reflecting evolving human rights, health and safety, and environmental international obligations and standards which should not trigger compensation, unless they amount to an expropriation. However, concerns were raised regarding possible substantive new costs incurred by investors, and/or in their implementation of laws, preventing them from performing obligations under the contract. Participants converged on the need for governments to design a fiscal system that strikes a balance between ensuring a fair sharing of the financial benefits for governments and the investors, whilst maintaining the competitiveness of the fiscal regime under a range of outcomes to provide sufficient incentives for investors to invest.

Under Work Stream 4 – Domestic Resource Mobilisation (tackling Base Erosion and Profit Shifting (BEPS) and corruption), further to the launching of the Thematic Dialogue on Commodity Trading Transparency last June, participants recognised that home countries, host countries and companies involved in commodity trading have a shared responsibility to improve transparency and accountability in commodity sales transactions that relate to the state’s share of production. Participants noted the need for broadening the engagement with trade hubs, with a view to collect more data to inform the dialogue moving forward. Participants agreed on a roadmap to develop a global reporting template for payment disclosure by companies involved in commodity trading; to operationalise due diligence guidance to tackle specific risks of rent diversion and corruption; and to develop a template to support SOEs in selecting buyers, linking up different strands of work across the OECD and coordinating with other international
organisations, including international financial institutions. Participants welcomed the support of the G20 Chair Argentina for the work of the Thematic Dialogue, and noted the opportunity to make meaningful contributions to the G20 Agenda, with particular respect to state-owned enterprises. Participants further welcomed progress under the BEPS in mining project on tax incentives, excessive interest deductions by multinational mining enterprises, and the challenges countries are facing with ensuring accurate and credible mineral product testing, whether this is done by governments, industry or independent parties abroad. Several countries reported significant progress in improving their testing controls, and in developing systems that satisfy both the industry and government, including the possible involvement of international financial institutions to ensure company compliance with best practice, by adding this expectation as a condition of project financing.

Work Stream 1 - Shared Value Creation and Local Development (Sessions 6-7)

Sessions 6 and 7 were co-chaired by the Hon. Sam Russ, Deputy Minister for Operations, Ministry of Lands, Mines and Energy of Liberia, and Mr. Petter Nore, Senior Consultant, Norwegian Agency for Development Cooperation. The discussion during Session 6 focussed on the Compendium of Practices, a companion tool to the Framework for Extractive Projects on Collaborative Strategies for In-Country Shared Value Creation. Session 7 featured a thematic discussion on the opportunities for the low-emission transition of the extractive sector, with a focus on technology and innovation.

Compendium of Practices

The online Compendium of Practices is an ever-expanding body of examples addressing how win-win approaches to local development and shared-value creation, articulated in the Framework, can be implemented in practice.

The four examples presented and validated in Session 6 addressed three of the Framework’s Five Steps, and had a thematic focus on enhancing local supplier and workforce participation in the value chain of extractive projects, with particular emphasis on the role of empirical data to support informed policy making. Forming the basis of a robust peer-learning discussion, the four examples covered initiatives in Chile, Oman, Uganda, and Mongolia, and addressed key questions:

- How can cross sectoral supply and demand data studies contribute to the development of flexible win-win approaches to local workforce participation? (Step 2 & Step 3.1)
- How can industry and government work together to ensure that industrial baseline surveys help to inform long-term decision making and the creation of sustainable economic linkages? (Step 2 & Step 3.1)
- How can industry and government facilitate the linkage of multinationals with local firms, in particular local small and medium-sized enterprises to support local supplier participation? (Step 3.1)
- How can more granular and systematic local procurement reporting by industry facilitate effective and improved policy making? (Step 5)

The discussion focussed on the enabling factors, obstacles, and lessons learned that characterised and emerged from each experience, providing an opportunity to draw-out context specific challenges and opportunities for the purpose of peer-learning.

Recognising that employment is one of the key areas in terms of generating in-country value from extractive projects, participants reflected on how to ensure long-term and yet flexible strategies to enhance local employment opportunities. Consideration of both the Industrial Baseline Survey (IBS) in Uganda and Oman’s In-Country Value Development Strategy (ICV) highlighted the importance of developing a shared understanding and alignment of goals across government and industry stakeholders early-on in a supply and demand assessment process. In Oman, where there is no formal local content legislation, the
government acted as a convenor of stakeholders by forming a committee including multiple government agencies and industry actors. Implementation of the Committee’s outputs was supported by the development and maintenance of tools to collect and share information. A unified supplier database accessible by all operators, for example, was cited as an effective tool through which to maximise benefits from empirical data and to inform decision making, as articulated in Framework Step 2.A. Further, prioritising an approach that was process- rather than result-oriented facilitated flexibility among the stakeholders in the setting and revising of targets and goals as realities shifted.

Participants noted that baseline assessments can help build credible and reliable statistics on existing and future workforce capacity, the supplier landscape, and institutional capacity, providing a detailed understanding of the local context, industry requirements and the barriers to local participation. Through a structured methodological approach, the baseline survey or assessment tool can help to focus efforts on long-term optimisation of linkage opportunities, rather than short-term maximisation. For baseline surveys to be effective, however, discussants highlighted the need for a broad focus beyond extractives to ensure analysis of the whole value chain over the life-time of the project, and a collaborative approach that, when industry-led, engages government from the outset. In Uganda, it was noted that the initial analysis of 300 sectors was, through consultation with government, narrowed down to 25 according to a needs-viability matrix. This recognised that both industry and government requirements can be mobilised in support of diversification efforts, while enabling the identification of sectors that, through collaboration and consultation, could be developed at scale in a systematic way.

Participants agreed that data gathering exercises that engage government early-on can also facilitate flexibility in setting common goals. Noting that it is usually soon after discovery that local content is considered, and that the time needed to train employees tends to be lengthy, participants emphasised that getting an early start on baseline surveys is likewise important, including identifying the kind of support that is needed, such as access to data or necessary partners. In Uganda, implementing a decision to focus on the welding, electrical and mechanical sectors depended on effective training programmes requiring the identification and engagement of training and vocational partners. It was noted that during the implementation phase of the IBS, the government faced challenges in adopting some recommended actions to support the development of linkages. For example, the IBS Action Plan included a recommendation for the development and effective maintenance of a national supplier database, however at the time the government lacked financial and administrative capacity to fully implement the recommendation. Participants emphasised therefore the importance of a long-term vision that seeks the systematic transformation of developing economies through partnerships, and that starting discussions early with the government is imperative to ensuring effective enabling environments and a systematic approach that ensures positive long-term effects for the host country.

Recognising the importance of the collection of solid data in policy making, participants agreed that enhanced reporting on local procurement by extractive companies is a positive step. In Mongolia, while the government has legislated local content requirements, it has also acknowledged a lack of information on whether mining companies actually meet the targets. While government recognised the risk of reporting burden, it emphasised that better legislation requires more data. Increasing the granularity of reported data can be achieved through a standardised reporting template, like the Local Procurement Reporting Mechanism, in that it ensures the comparability and utility of data and facilitates the uptake and implementation of improved standards by lessening the onus and costs for any one company to develop expanded reporting requirements at the site level. Participants concluded that improved data reporting contributes to better informed policy making, and improved local access to procurement opportunities by helping to overcome information asymmetries.

In Chile, an industry-led supplier development initiative aimed at leveraging the cluster of SMEs around mining firms for enhanced innovation and local supplier participation, was picked-up by the state-owned copper mining company, Codelco, and further supported by the public sector. The initiative was first developed by BHP Billiton in response to technical challenges faced in its mining operations in Chile,
such as the need to increase the life-span of truck-tires. The programme worked to match such technical challenges with local SMEs, to facilitate the development of innovative solutions that could be tested in real-time mining operations, and eventually be scaled-up to export. The subsequent co-operation of Codelco and the government with a large multinational mining company further strengthened the programme’s potential to facilitate knowledge transfer and helped to ensure that the types of skills and capacities gained were relevant to the economy. Such co-operation also helped reduce the cost of training programmes, particularly as BHP Billiton also contributed resources, including in-kind through availability of specialists and staff. At a national level, it was noted that the economic impact of the initiative has been limited, with 100 of a possible 6000 firms having participated to date. Further, while incentives for participation, of suppliers and SMEs and the mining firms were aligned at the beginning of the process (identifying innovative solutions to real-time challenges), this alignment fell-away during the scaling-up phase, indicating a further role for the public sector in such programmes to ensuring lasting benefits for host-country economies. The programme itself has nonetheless demonstrated the role of public-private cooperation in ensuring effective communication of policies and facilitation of the right enabling environment, with the approach that is being picked up in other resource-rich countries through pilot programmes.

**Low-emission transition**

At the Eighth Plenary Meeting, as part of the work on the Compendium of Practices, participants discussed the importance of technology and innovation for the extractive sector, with a focus on renewable energy. To continue and deepen this discussion, the Ninth Plenary Meeting provided an opportunity to explore the sector’s future in the context of the global low-emission transition. Besides integrating low-carbon energy sources into extractive operations, participants identified several further avenues, reflecting the key recommendations of the Framework: improving energy efficiency; supplying minerals and metals for clean technology; and diversifying energy companies’ portfolios towards cleaner sources of power generation. The discussion arrived at the policy conclusion that there is a need for a stable enabling environment which would support innovation and investor confidence, accelerating the sector’s transition; as well as better public-private collaboration to share potential operational and financial risks associated with the use of new technology.

Participants emphasised the importance to improve the understanding of the barriers to the uptake of clean technology and the solutions that exist to overcome them. They recognised the role of the OECD Development Centre in leveraging its convening power and analytical work to contribute to building this knowledge, noting the diverse participation of the Policy Dialogue, comprising key stakeholders – resource-rich developing and developed countries, oil and gas, and mining companies, and the civil society.

Participants also highlighted that in order to support a robust discussion of the challenges and opportunities that low-carbon transition will present for the extractive sector and for resource-driven development in general, it is critical to distinguish between fossil and mineral fuels as each may be differently affected by decarbonisation.

While the majority of examples and opportunities that follow relate to the mining sector, the discussion recognised the need for better understanding of the carbon risks associated with developing fossil fuels in the context of a de-carbonising world, given the typical timeframe from discovery to production. This consideration should look beyond the project-level, to the wider energy and industrial development pathways that upstream decisions can lock-in.

Energy consumption represents a significant share, up to 30%, of mining companies’ operating costs, and accounts for nearly 75% of their operational emissions. Therefore, there are significant synergies in cutting costs and emissions through improved energy efficiency. As an example, participants discussed
productivity gains and emission savings from Rio Tinto’s automation efforts. The use of automated trucks and drills eliminates the need for pauses, braking and acceleration, resulting in energy savings and greater engine efficiency, while also reducing wear and tear on engine components, increasing their lifespan.

In view of the water-intensive nature of mining activities, the discussion also acknowledged companies’ efforts to adapt to physical impacts of climate change, such as water stress. In some parts of the world, mining companies tend to increasingly find themselves in competition for scarce water resources with other sectors, such as agriculture, as well as with local domestic consumer. In view of this, timely recognition, planning and adjustment of operations to exacerbating the water risk is crucial for the continued functioning of the sector within the broader sustainable development of the economy. For example, AngloAmerican has adopted practices to eliminate fresh water use from their operations, through water recycling (e.g. eMalahleni water reclamation plant in South Africa, already included as one of the examples in the Compendium of Practices), evaporation control and dry tailings disposal systems. Vale is also exploring opportunities for waterless mining, using the natural moisture in ores.

At the same time, participants recognised that the mining sector supplies several carbon-intensive industries. This implies that the sector’s emissions from downstream activities (the so-called Scope 3 – indirect supply chain emissions which are outside companies’ immediate control) can be up to 30 times higher than those generated by mining operations themselves. This may subject the sector to potential indirect transition risks from environmental policies and regulations, for instance, carbon pricing, particularly in view of China’s plans to roll out a national Emission Trading Scheme (ETS) which may significantly affect commodity demand patterns. Given that China is a major industrial hub and consumer of high-emitting commodities, the introduction of ETS is likely to have a considerable indirect impact on commodity exporters. In this context, placing an emphasis on producing minerals and metals required by the clean technology industry in a most energy and emission efficient manner, can provide an important opportunity for the mining sector to align its operations with the global low-emission transition, while reducing its exposure to regulatory risks.

Low-carbon power generation provides another important cost-effective opportunity to reduce emissions, in view of the declining cost of renewable energy technology. This is particularly relevant for mines in remote rural locations, which tend to use diesel to meet their energy demand. A number of cases already exist, where extractive companies operating in a variety of commodities and countries have successfully integrated solar and wind systems to complement their energy mix. These include, for instance, Vergnet’s hybrid wind-diesel projects in an iron ore mine in Zouerate, Mauritania, and a poly-metallic mine in El Toqui, Chile, as well as the solar energy examples already included in the Compendium of Practices from the Collahuasi copper mine in Chile and DeGrussa copper mine in Australia. They also noted that besides supporting the existing operations, renewable energy can drive the development of the mining sector in countries that suffer from energy deficit. For instance, in the case of Guinea, despite its significant hydropower potential, the low electrification rate prevents it from developing the country’s vast iron ore, and fully benefitting from bauxite resources.

However, while there is a business case for using renewable energy in extractive activities, a number of barriers exist to scaling up these innovative practices. Participants noted a lack of a sufficiently strong carbon pricing signal which would incentivise companies to reduce emission-intensity of their operations, including through renewable energy integration.

At the same time, low-carbon power generation might not always seamlessly fit into extractive companies’ business models. Participants observed that oil and gas, and mining companies may often demonstrate resistance to innovation and absorption of new technologies for financial and operational reasons. It was reported that the mining sector exhibits relatively low levels of investment into Research and Development (R&D) – on average 0.4% of sales, compared to, for example, 7% in the automotive sector (Carbon Disclosure Project’s Digging Deep report 2017). Further, there tends to be a mismatch between the asset life of a renewable energy plant (up to 25-30 years) or the time required to recoup the capital investment by the independent power producer, and a preferred length of a typical electricity
contract, which is often significantly shorter (under 10 years) due to uncertainties around the estimated remaining mine life, driven by changes in commodity demand. A traditional solar PV system is usually amortised over a period of 20-30 years. The cost of power generation when calculated over a shorter timeframe is therefore higher than when spread across the longer operating horizon of a power plant. As a result, it makes it difficult to strike an optimal term for a Power Purchase Agreement. Government’s involvement can help reduce these risks through agreements to transfer power generation assets after mine closure to local communities. However, this raises another question on financing sources available to the government to participate in these schemes. This discussion reflected the key principles formulated in the Framework regarding the respective roles of host governments and extractive companies in promoting shared power infrastructure projects.

Finally, in the broader context of the global energy transition, participants discussed the diversification of energy companies’ portfolios towards cleaner sources of power generation. Along with investment into renewable energy, the benefits of the transition from coal to natural gas as a medium-term solution were considered - compared to coal, gas generates 50% less emissions per unit of energy.

Participants also emphasised the need for a co-ordinated multilateral approach to energy transition, which the Development Centre is well positioned to support, given its expertise in balancing stakeholders’ varying interests and developing policy solutions tailored to different country contexts. Multilateral development banks and donor country development agencies can play a crucial role here, given their support to both extractives-led growth and low-emission, climate-resilient development pathways. While the world has one carbon budget, countries and regions may have different development priorities, including the urgent need to connect 1.1 billion people still lacking access to electricity in 2016 (Energy Access Outlook 2017), the majority of whom live in Africa. In view of this, a point was made that the pace and nature of the low-emission transition may depend on country-specific socio-economic circumstances. There is urgent need for discussion at the national level regarding the optimum role that fossil fuels and mining sectors can play in countries’ long-term development, including access to energy and closing wider infrastructure gap. This discussion should account for the opportunities presented by shifting investment patterns and rapid declines in the cost of low-carbon technologies, as well as the risks of locking in carbon-intensive infrastructure.

Against this backdrop, scaling up the deployment of carbon capture, utilisation and storage (CCUS) systems in fossil-fuel based power generation in the next decade is of crucial importance. There is urgent need for effective mechanisms to remove barriers and promote investment in CCUS both in developed and developing countries, since the current pace of CCUS uptake falls dramatically short of the level required to achieve the objectives of the Paris Agreement.

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

This session considered the advantages and disadvantages of the direct distribution of natural resource revenues through cash transfers. This is the practice by which a government transfers a portion of the revenue from extractive activities directly to citizens in transparent and regular dividends. Chaired by Ms. Aigerim Donbayeova, Chief Expert of the Macroeconomic Analysis and Forecasting Department, Ministry of National Economy, Republic of Kazakhstan, and Mr. Rodrigo Monardes, Counsellor, Permanent Delegation of Chile to the OECD, Republic of Chile, the discussion was also informed by a background report prepared by the OECD Development Centre on Direct Distribution Cash Transfer Mechanisms: Comparative analysis and lessons learned.

Noting the mechanism’s limited uptake in both developing and developed resource rich countries, the peer-learning session first considered the two key country experiences with direct cash transfers to date: Mongolia, and the State of Alaska in the United States, with the aim of developing a better understanding of the key characteristics of, and trade-offs and opportunities provided by, direct cash transfers in achieving development outcomes. Participants then considered the possible role of cash transfers in smoothing the process by which fossil fuel subsidies are phased-out, noting that subsidies tend to be poorly
targeted, inefficient, and drive over-consumption, and are yet popularly supported and thus difficult to reform.

Key themes emerged in the discussion on the distribution of revenues through direct cash transfers. These included identifying potential barriers to implementation, such as administrative capacity and financial literacy, and that, outside the framework of a stabilisation mechanism or macroeconomic stabilisation policy, cash transfers remain subject to the volatility of resource revenues. As a possible pro-poor spending mechanism, participants emphasised the limitations of cash transfers with regard to the particular mix of challenges and dilemmas faced by resource-rich developing countries when trying to meet their development objectives, including the prioritisation of spending at scale on infrastructure, health infrastructure and education. Participants noted that when implemented as part of a long-term strategy that prioritises macroeconomic stability and when supported by strong institutions and clear policy communication on the part of government, cash transfers can have positive effects on accountability and revenue transparency. However, when making decisions on how to distribute natural resource revenues, which often arrive quickly and are subject to volatility, in developing countries, direct spending at scale often comes first.

In considering country experiences, participants noted that the programs in Mongolia and the State of Alaska represent two differently designed mechanisms. In Mongolia, cash transfers were derived from current resource revenues: the initial cash transfers were paid directly from royalties, rather than out of the earnings of a savings or stabilisation fund. It was further noted that the short-lived cash transfer program was implemented in a particular political context – stemming from commitments made during the country’s national election cycles – during a time of booming demand for Mongolia’s mineral resources, and in the context of substantial macroeconomic reforms. Details of the programme were not effectively communicated to the population nor was due consideration given to the volatility of copper prices, leading to the frontloading of the budget.

In the State of Alaska, where the dividend mechanism has been in place for over 20 years, payments are instead derived from the financial returns of a sovereign wealth fund: 25 per cent of resource revenues are placed in the fund, which invests internationally in financial assets. Each year a portion of the financial return on the fund is then distributed as cash to citizens of the State. This model ensures that the cash transfer mechanism does not replicate the volatility of resource revenues nor compound the impact of such volatility on the budget. Participants recognised that the institutional setting of Alaska makes the example particularly context specific, limiting its replicability in many developing country contexts in particular that the requirement of parliamentary approval for transfers out of the Fund and the broader constitutional framework of the United States constrains significantly the potential for legislators to raid the Fund. However the case highlights that cash transfers – as even a very small portion of the resource revenues – can have a positive effect in enhancing accountability, by building a political constituency invested in the transparent management of natural resource revenues. Recent decisions in Alaska’s constrained economic climate, to cap the cash payment at USD 1000, further suggested that an effectively managed mechanism can ensure that spending at scale on infrastructure and the constituency-building benefits of such a dividend are not mutually exclusive.

Participants also discussed the role of cash transfers in facilitating the gradual phasing out of fossil fuel subsidies, including in both resource rich and resource poor developing countries. According to the IMF, the estimated value of energy subsidies is upwards of USD 7 trillion world-wide: subsidies are universal, found in almost every country. Yet they are highly inequitable and distortionary, and promote higher levels of consumption with correlating negative impacts on the environment. As a result, many countries, including Nigeria, Iran and Timor-Leste have been grappling with the challenge of how to remove energy subsidies, efforts that often face popular resistance due to support at the household level. Participants noted that transitioning to a small cash payment can smooth the process by which subsidies are removed in favour of other redistributive or social spending programs, and designing the cash program in a way that enables wealthier households to “opt-out” of the program can address the fact that such a mechanism may
be regressive. Participants also noted the role of technology in facilitating the uptake of cash transfers, noting that technology is already acting as a disruptor to more conventional approaches to fiscal management, including in developing country contexts.

Building on the Policy Dialogue’s previously rich thematic discussions on revenue spending and subnational revenue sharing mechanisms, participants also considered the experiences of Chile in managing revenue volatility, while also achieving social spending and development objectives. It was noted that Chile has recently launched a second savings fund dedicated to supplementing old age pensions of the poor. This discussion further highlighted that saving for the future, spending now, or spending at scale are not mutually exclusive. However, while providing cash to the poor has proven to be an effective tool in accelerating development outcomes for the very poor in a number of developing country contexts, and offers a possible means through which a population may gain a sense of direct ownership over resource production, there may be a trade-off or opportunity cost. Countries need to consider the full mix of influencing factors when considering which resource revenue management policy tools are most appropriate. Cash transfers are one option among a number of approaches resource-rich countries might consider when looking to make social transfers or to design pro-poor spending mechanisms.

**Work Stream 3 – Getting Better Deals (Sessions 8-9)**

Sessions 8 and 9 were co-chaired by Mr Günter Nooke, Personal Representative of the German Chancellor for Africa, Federal Ministry for Economic Cooperation and Development (BMZ) and Mr. Nava Touré, Principal Counsellor, Ministry of Geology and Mines, Republic of Guinea. The discussion provided the opportunity for participants to discuss selected issues covered by the Guiding Principles for Durable Extractive Contracts.

The Guiding Principles can be used as a common reference for future negotiations of enduring, sustainable and mutually beneficial extractive contracts and can lessen the need for renegotiation of contract terms over time. Following the periodic teleconferences among the Friends of the Negotiation Support Forum working group held on 31 January, 28 March, 2 May, 25 July and 30 November 2017, a revised draft of the Guiding Principles was submitted to public consultation until 30 March 2018. At the Ninth Plenary Meeting, discussions focused on Guiding Principles VII & VIII – unpacking both the text of those principles but also the legal and fiscal concepts that underpin them. Participants first explored the contractual challenges related to non-fiscal changes in law as covered by Guiding Principle VII before addressing changes to fiscal laws that seek to provide for a fair sharing of the financial benefits between the investor and the host government across fluctuations in market conditions under by Guiding Principle VIII.

Participants noted that the Guiding Principles lie on the fundamental premise that governments have a desire to develop their resources for the benefit of all their citizens, and that durable extractive contracts should also reflect this premise. When discussing Guiding Principle VII, participants focussed on non-fiscal changes. They recognised that regulatory regimes change over time and therefore so do the expectations and the requirements that extractive projects must meet for the protection of human rights, health, safety and the environment. Participants reflected on the appropriate benchmark that could be incorporated into Guiding Principle VII that the subsequent introduction of any new laws, regulations or policies could be measured against. It was suggested that internationally recognised standards and the international obligations of the host country should be used as a benchmark, rather than relying only on good practices generally accepted from time to time in the industry. In fact, it was recalled that the experience in the North Sea showed how the application of industry standards failed to ensure the effective protection of health and safety in oil and gas operations.

Participants reflected on the business model of investors in the oil and gas and mining industries. The pay-out timeframes are long, especially for frontier, non-conventional and off-shore deep-water projects. An investor may invest billions of dollars in a specific project and not generate a return for 10 years or
more. Investors accept market risk, geological risk and technical/engineering risk but are very sensitive to political and regulatory risk. Participants noted that changes in laws are a regulatory risk over which the investor does not have control and that investors will take into account this regulatory risk when deciding whether or not to make a specific investment in a project or in a country. The higher the perceived risk, the less likely it is that an investor is willing to invest.

When discussing the opportunity to contemplate stabilisation clauses in extractive contracts, it was observed that it is up to the state to appreciate what it would take to attract investments and how competitive the country is. Many countries that are stable do not offer stabilisation clauses. Participants recognised that freezing stabilisation clauses should be avoided. Experience shows that they have proven problematic, in particular in countries undergoing a democratic transition. Industry articulated concerns relating to any arbitrary application of a law, for example the enforcement of a law against a specific project or a specific investor. It was noted that abusive or arbitrary conduct would always be sanctioned under customary international law on expropriation.

Participants also converged on considering that stabilisation clauses in the form of economic equilibrium should be more oriented to fiscal changes and not trigger compensation in matters related to human rights, health, safety and the environment. However, the point was made that in extreme situations the economic consequences of changes in laws may result in an investor incurring significant additional costs and/or rendering the investor unable to perform its obligations under the contract. Other participants questioned the opportunity for investors to use economic equilibrium clauses to seek compensation for changes in law reflecting evolving international human rights, social and environmental standards. It was recommended that durable contracts should clarify the circumstances that would not trigger compensation under any circumstances. Reference was made to the 2003 the Baku–Tbilisi–Ceyhan (BTC) Human Rights Undertaking, where the consortium undertook not “to seek compensation under the economic equilibrium clause in connection with any action or inaction by the relevant Host Government that is reasonably required to fulfill the obligations of that Host Government under any international treaty on human rights, labor or HSE in force in the relevant Project State from time to time to which such Project State is then a party”. It was noted that, fifteen years after the BTC pipeline contract there is a general acceptance that stabilisation clauses, even in the form of economic equilibrium, should not prevent a host country from making necessary and legitimate changes to update its social, environmental and human rights legislation to meet its international obligations, without incurring liability for compensation.

Building on language already incorporated in the commentary, it was suggested to emphasise the need for the parties to engage in good faith discussions and eventually renegotiate the terms of the contract to address extreme situations.

Participants suggested to clarify in the commentary that often times countries have laws in place for the protection of human rights and the environment that are not implemented. It was noted that in many developing countries, the problem is the fact that the law is not implemented due to issues of regulatory capacity. When countries start implementing those laws, this should not be considered a change in law. Other participants observed that implementing regulations may add requirements that were not contemplated in statutory provisions. It was noted that before entering in a country, it is recommended to have a proper assessment of the legal and regulatory framework. When such laws provide for subsidiary or implementing regulations to be put in place, one should expect that such regulations will be developed over time. Investors usually make assessments of the political stability and legislative and regulatory framework as part of the overall country risk assessment which is revisited over time. The point was made that the application of existing laws should not be arbitrary.

In discussion on Guiding Principle VIII, participants explored how durable extractive contracts can be underpinned by a fiscal system that provides for a fair sharing of the financial benefits between the investor and the host government. The underlying premise of Guiding Principle VIII is that a fiscal regime that can adjust automatically to market conditions can have a positive impact on the durability of a contract. Self-adjusting fiscal terms defined in advance that anticipate change and respond by equitably rebalancing the
Revenue sharing can contribute to the durability of the contract and lessen the need of renegotiations, by balancing the interests of host governments and investors in times of both boom and bust and cope with fluctuations in market conditions (price, cost and volume).

There are many variables that can affect investment decisions and fiscal stability is an important factor. When designing a fiscal regime, governments should demonstrate their attractiveness to investors by maintaining a competitive regime whilst also seeking to optimise revenue. It is important to note the differences between a fiscal system for mining and one for oil & gas. Both fiscal systems may include provisions for royalties and general tax, but oil & gas fiscal systems may also include other elements, such as production sharing and service contracts.

Participants agreed that there is no such thing as an ideal tax or fiscal system. Instead, it is important to devise an optimal mix of fiscal instruments for the given set of circumstances, knowing that each instrument has its own trade-offs. Participants discussed the advantages and disadvantages of royalties compared to rent taxes. Royalties are based on revenue. Governments can get them early on and overcome the information challenges related to the determination of costs, but royalties can be distortive for production. Rent taxes are taxes on excess profits, beyond normal profits. Normal profits depend on the correlation of those profits with the rest of the economy, and represent the threshold on which a diversified investor will decide to invest in light of its minimum rate of return. Anything above normal profits reflects the ownership of the resources by the government and the risks taken by the investors. Profit-related fiscal instruments (such as a resource rent tax based on the accumulated net cash flow after a threshold return has been achieved or in a production sharing contract based on the contractor’s achieved rate of return acknowledging the cost of capital or the achieved R factor, which is the ratio of accumulated net revenues over accumulated net costs) targeted on economic rents are a function of the volumes, the oil price and cost per barrel. Profit-related instruments automatically respond in the appropriate direction to changes in the operating environment. In respect of rent taxes based on profit, unless advance payments are contemplated before production starts, these do not deliver revenue for the government upfront as the investor may be able to offset the usually significant exploration and development costs against any future revenue. However, rent taxes may deliver significant revenues to the government over the life of a project if the investor is able to maintain adequate profit margins throughout the commodity cycles. Participants recalled that in many developing countries there are inadequate accounting and auditing systems, therefore, if there is no minimum flow of revenue for each year of production, there is a risk that some countries may not receive any benefit from a specific project. In order to obtain the maximum benefit from a fiscal system that utilises rent taxes, governments should strengthen their capacity to administer and audit the profits (including revenues and expenses) of investors by having both access to the relevant information and also the ability to interpret it.

Participants recognised the need for early revenue to achieve contract stability. The political economy in developing country is such that contract durability requires some early revenue to show visible benefits upfront. Consequently, countries may wish to consider the benefits and trade-offs of a frontloaded system (signature bonuses as the majority of exploration activities do not result in a commercial discovery, or royalties) with a back loaded system (rent taxes) in order to find the right balance for their specific circumstances and stage of development.

Participants further considered the benefits and trade-offs of progressive fiscal systems. Progressivity means the government take increases when profitability increases and decreases when profitability decreases. However, sliding scales with high marginal rates can create disincentives for incremental recovery in late-life fields and create “gold plating”, encouraging inefficient cuts of production and prevent optimal recovery.

Participants also noted that durable extractive contracts should contemplate mechanisms for covering decommissioning costs. Decommissioning costs, especially off-shore, can be very large and they will come at a time when production has ceased and there is no longer any revenue from the field/mine. One possibility is to contemplate provisions to be made during the life of the contract and put into an escrow
account, allowing for cost recovery in a production sharing agreement and deductions from income tax. This would ensure that when the time comes the money is there to pay for decommissioning. If the government decides that provisions during the life of the contract should not be deductible, like in the UK, tax relief is not only postponed, but this could also mean the losses may be carried back against profits made in previous years and all the profit sharing recalculated, with the risk for the company to go bankrupt or disappearing.

Finally, participants considered how the choice of fiscal instruments may be influenced by the capacity (or lack therefore) of a particular country. It was recommended that countries limit the amount of variation between the standard tax regime and the extractives regime and among different contracts to avoid fragmentation and ensure coherence of the system as a whole. If variations are introduced, this should be done for a good reason, for example to capture excess profits with rent taxes. In Namibia there is a normal profit tax of general application to everybody and a special resource rent tax for oil and gas companies. Investors were concerned about the possibility for the government to increase the profit tax in the general regime. Fiscal stability was achieved by devising a formula whereby if the corporate tax increases, there would be an automatic reduction in the first tier of the rent tax and conversely if the profit tax was reduced, the resource rent would increase.

Tax authorities are not usually represented in extractive contract negotiations and it may be prudent to place greater emphasis on their role and the interaction between the administration of upstream taxation and the administration of regular taxation. Countries may also wish to limit the variation between their different extractive contracts in order to realise greater efficiency in administration. For example, if a government regulator is responsible for administering multiple contracts each setting out a different mix of fiscal instruments, this is likely to have an impact on their capacity to effectively perform this task.

**Work Stream 4 – Domestic Resource Mobilisation (Session 1-3 and 5)**

*Thematic Dialogue on Commodity Trading Transparency*

Sessions 1, 2 and 3 of the Plenary Meeting were chaired by Mr. Andrew Preston, Head of Joint Anti-Corruption Unit (JACU), Home Office, United Kingdom. The sessions formed the first full meeting of the Thematic Dialogue on Commodity Trading Transparency, launched in June 2017, as a follow-up to the 2016 UK Anti-Corruption Summit held in London. The three sessions aimed at creating a shared understanding of the risks and benefits of the disclosure of payments related to the purchase of publicly-owned oil, gas and minerals and at mapping relevant initiatives and stakeholders, including the current state of government and company disclosures. The draft scoping paper produced by the OECD Development Centre, facilitated the discussions and offered a suggested roadmap for the next steps of the Thematic Dialogue.

During Session 1, participants highlighted the significance of revenues from commodity sales for the development of many resource-rich countries. International efforts to date have focused largely on enhancing transparency around payments related to upstream activities. Reports from the 51 EITI countries that disclose tax and royalties payments indicate, however, that approximately half of the revenues disclosed – ranging from approximately USD 300 billion to USD 500 billion per year – derived from the sale of government’s share of production. Participants also stressed that enhancing transparency of the sale of publicly-owned commodities is a difficult task, as these sales are often managed by State-owned Enterprises (SoEs) in weak governance contexts. Recent public scandals have further spurred the growing recognition within SoEs at a national level of the need for reform, as observed in the case of the Nigerian national Petroleum Corporation (NNPC).

In recognition of this pressing development issue, the EITI standard (issued in 2016) includes a specific provision on the disclosure of revenues and volumes of publicly-owned oil, gas and minerals sold by
producing countries. A recently established EITI working group comprising various stakeholders aims to support a number of countries in voluntarily implementing the standard. To achieve this, the working group developed a specific Guidance for Reporting on first trades in oil, which addresses three fundamental questions: what type of oil is sold; who are the buyers; and, what is the return on oil sales that a country receives?

Participants noted that good progress is being made in that the information available is becoming significantly more detailed. Eleven countries have started to disclose information on the sales of their state share of production, including Ghana. The Ghana National Petroleum Corporation (GNPC) shared its experience of implementing the EITI requirement for disclosing oil and gas sales data, further to the commitment made at the Anti-corruption Summit held in London in May 2016. Following the disclosure of some information in its annual EITI report, Ghana decided to become a pilot country to implement the EITI guidance to report information on its sales of both oil and gas share of production in a dedicated report in 2018.

During the discussion, it was acknowledged that, from the EITI implementing countries perspective, the template developed to disclose information on oil trading has not been difficult to implement, with the caveat that some information like the beneficial ownership of the buyer may not be available for disclosure. The EITI report in Cameroon includes almost all the data required by the template and more, though the granularity of data disclosure remains contingent upon national contexts. It was further noted that challenges remain when applying this guidance developed for oil trading, to the trade of minerals, where market structures tend to be more complex. A forthcoming study by RCS Global, commissioned by the Natural Resource Governance Institute, on the significance of the sale of publicly-owned minerals, should be finalised March 2018. Some countries were already mentioned as illustrations of SoEs selling publicly-owned minerals: Morocco with phosphate, Botswana with diamonds, Guinea with bauxite and Chile with copper.

As observed in the case of Ghana, where reforms to the corporate law included a provision on beneficial ownership for newly registered companies, participants recognised that the EITI process can drive change at national level. However participants also emphasised during Session 2 the complementarity of the OECD Thematic Dialogue on Commodity Trading Transparency, with particular reference to the fact that:

- the scope of the EITI has to date been limited to member countries and does not include major African oil producers such as Angola, Libya, or Algeria. Other countries such as Azerbaijan, Malaysia and Turkmenistan receive more than 90% of their extractive revenues in-kind, and they are not part of the EITI; and

- companies active in oil trading have not participated in EITI national processes to report their payments to governments, except in Iraq, and that the current EITI standard does not mandate the EITI to create an enforceable reporting guidance for buyers to report on their payments.

Consensus was reached that the new OECD Thematic Dialogue on Commodity Trading Transparency will focus on the other half, the purchase side, looking at existing transparency gaps. It has been acknowledged that the inclusive membership of the Development Centre – covering both OECD member countries and resource-rich developing countries – provides an essential platform to engage the full spectrum of relevant stakeholders. Necessary for this emerging area of work, a number of participants noted though that available data were lacking to enable a comprehensive understanding of the commodities traded in most significant trade hubs across the world, their respective global market share in oil, gas and minerals, and the regulatory framework of each hub, beyond estimates provided by the trading industry. This is partly due to the fact that most companies active in trading are privately-held companies not subject to the same reporting rules as listed companies. Considering this lack of available data, participants emphasised the need for further engagement with trade hubs that share a responsibility beyond the United Kingdom (UK) and Switzerland. The UK is considering launching a scoping study to look at the scope of
commodity trading in the UK, the key actors involved and the potential actions that could be undertaken by the government to enhance transparency.

Several participants also urged companies to take a more proactive approach to information sharing, particularly considering the range of companies active in trading, especially both independent traders and oil majors. Most oil majors are participating in the EITI national processes and are subject in home countries to legislation for the disclosure of payments to governments in relation to their extractive activities. Only one trading company however, Trafigura, has to date incorporated the disclosure of oil and gas purchase payments into its corporate strategy. In order to demystify the functions of independent traders and to provide contextual information in relation to the existing disclosure of trade-related payments data by EITI implementing countries, at almost no cost, Trafigura has voluntarily disclosed for the past four years its payments to government. Information on payments made and volume purchased has been disclosed in EITI implementing countries (amounting to USD 1.1 billion for the year 2017) and not in non-EITI implementing countries (aggregated number of USD 20.1 billion of payments for the year 2017). Considering that the oil market has become more transparent in the past ten years, the company has argued that, rather than revealing commercially sensitive information, a factor companies often cite as a reason not to disclose, the disclosure of these payments has given Trafigura a competitive advantage based on improved reputation and trust.

Considering however that most companies active in trading activities are not yet implementing the Guidance to report on payments related to the purchase of oil, developed by the EITI, participants strongly supported the Thematic Dialogue’s proposal to develop a complementary tool for use by companies active in trading. In supporting the proposal, participants noted that companies tend to be encouraged to act voluntarily by a standardised approach, and that development of a tool specific to companies would minimise the cost of reporting for industry, facilitate the generation of comparable information across jurisdictions, and ensure the harmonisation of efforts. To ensure complementarity, development of the tool would be carried out in collaboration with the EITI Working Group and should take into consideration the end-user’s capacity to use the data in resource-rich countries to create accountability.

Participants emphasised that enhanced transparency of payments would further contribute to mitigating the risks of flawed selection of buyers, as it would disclose the identity of buyers, and diminish the risks of misvaluation or mispricing practices present in poorly negotiated terms deals. However, transparency of payments is only part of the mitigation measures, especially given that data relating to payments is highly context-specific given the complexity of existing commercial arrangements.

Participants heard about that various mechanisms for corruption and rent diversion that exist, ranging from direct payment of bribes to much more complex schemes involving intermediaries, shell companies and off-shore bank accounts. Further, that such diversions may indirectly finance political parties or persons closed to Politically Exposed Persons (PEPs) in a direct or indirect position to grant a contract or shape the terms of a deal for the sale of commodities. Though some participants suggested that the use of intermediaries has diminished, the potential for such practices raises the question of the legal liability of the company active in trading. As the company will not appear in the first-trade transaction with the host government public entities, this undermines the possibility of criminal prosecution, even in the case of identified bribery payments. The OECD has developed a framework to support companies’ efforts to carry out diligence, reflected in the OECD Guidelines for Multinational Enterprises and in the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-affected and High-risks areas, in particular its Five-Step framework for Risk-based Due Diligence. Participants recognised the relevance of the OECD 5-Step Due Diligence Framework, but called for more operational guidance for companies active in trading on how to identify the specific risks of corruption and rent diversion, and the steps necessary to address these risks.

Participants agreed therefore on the need to develop a more in-depth analysis related to the identification of risks, taking in consideration the various types of commercial arrangements used in commodity trading activities, that would help operationalise the Five-Step Framework for Risk-based Due
Diligence, to support companies active in trading to avoid causing or contributing to corruption or rent diversion through their purchasing decisions. Participants agreed on the necessity of further research to better understand the red flags and for identifying the mitigation policies that companies put in place to address these risks.

During Session 3, participants also identified a third knowledge gap regarding the selection process of buyers by governments and SoEs: very few countries, EITI implementing and otherwise, have published data on the selection process of buyers. Participants agreed that this would require more research, noting the need for contextual information in understanding decisions made and the various procedures used. Understanding the selection of buyers was recognised as a crucial step to prevent potential public revenue losses through the allocation of buyer rights to companies in which PEPs have an interest or the granting of preferential sale terms that favour private interests. It was therefore agreed that it would be beneficial for the Thematic Dialogue to review existing selection and procurement processes, with a view to identifying best practices that would inform the development of a template for selecting buyers in the longer term. Participants welcomed the support of the G20 Chair Argentina for this work of the Thematic Dialogue, and noted the opportunity to make meaningful contributions to the G20 Agenda, with particular respect to SoEs.

**BEPS in Mining**

Session 5 began with a briefing on progress under the cooperation project between IGF and the OECD on BEPS in mining, which outlined work underway on tax incentives, excessive interest deductions by multinational mining enterprises, and the policy issues associated with ensuring mineral product testing facilities are accurate and fit-for-purpose. Participants noted consultation drafts on these topics would be available for review early in 2018.

Discussion during the session centred around the challenges countries are facing with ensuring accurate mineral product testing, and the relative strengths of governments or the industry itself providing testing services – under both arrangements there were incentives for the tester to “cheat” (governments over-estimating product characteristics, companies under-estimating) which could lead to an unwanted increase in disputes. One country noted it was able to use a third party tester as an independent “tie breaker” in the event of discrepancies between government tests and the company’s own, and this was working effectively. Participants also suggested the question of who should pay for the testing could be usefully discussed in the forthcoming paper.

During the discussion, several countries expressed their concerns as to the accuracy of testing facilities, noting that local facilities were not up to the standard required, but even when done by independent parties abroad, the country had no way of knowing whether the testing was credible. Despite these concerns, several countries commented that they had made significant progress in improving their testing controls, and that it is possible to develop systems that satisfy both the industry and government. One participant noted that the involvement of IFIs in projects may also provide a mechanism to ensure company compliance with best practice, by adding this expectation as a condition of project financing.