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

25-26 June 2018

Summary Report

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

I. Meeting objectives and structure

Under the co-chairmanship of Chile, Kazakhstan, Liberia, Nigeria, Norway, and United Kingdom, 31 government delegations from Africa, Asia, Europe, Latin America and Oceania, as well as representatives from 6 partner international organisations and institutions, and 36 major firms, industry associations, civil society organisations, academia, law firms and think tanks, convened at the OECD on 25-26 June 2018 for the Tenth Plenary Meeting of the Policy Dialogue on Natural Resource-based Development. International organisations and institutions represented included the Commonwealth Secretariat, European Union, Extractive Industries Transparency Initiative, UN Conference on Trade and Development and World Bank. Mr Mario Pezzini, Director of the OECD Development Centre and Special Advisor to the OECD Secretary General on Development and H.E. Mr Abdoulaye Magassouba, Minister of Mines and Geology, Republic of Guinea delivered welcoming remarks. H.E. Mónica Aspe, Ambassador and Permanent Representative of the Republic of Mexico to the OECD, and Chair of the Governing Board of the Development Centre delivered opening remarks. Mr. Ibrahim Coulibaly, Director General of Mining and Geology, Ministry of Industry and Mines, Republic of Côte d'Ivoire, gave a keynote address on behalf of H.E. Souleymane Diarrassouba, Minister of Industry and Mines, Côte d'Ivoire. H.E. Dr. Emmanuel Ibe Kachikwu, Minister of State, Petroleum Resources, Federal Republic of Nigeria co-chaired the Thematic Dialogue on Commodity Trading Transparency, together with the United Kingdom.

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 Environment Directorate, the Directorate for Financial and Enterprise Affairs, the Development Co-operation Directorate, and the Directorate for Trade and Agriculture were also represented.

The two-day meeting was structured around seven sessions and a workshop. The first day opened with a discussion to share progress made on tackling BEPS challenges in mining, under Work Stream 4 (Domestic Resource Mobilisation: tackling Base Erosion and Profit Shifting and corruption), followed by a discussion on planned future work under Work Stream 2 (Revenue Management and Spending), and two further sessions advancing work under Work Stream 1 (Shared Value Creation and Local Development), with a thematic focus on clean technologies and innovation. The second day was dedicated to three full sessions advancing the work of the Thematic Dialogue on Commodity Trading Transparency. The meeting was closed by a workshop held under 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 explored the opportunities for, and barriers to, integrating renewable energy solutions to power mining operations, and possible approaches to overcoming key persisting challenges. When discussing the integration of renewables into mining companies' energy mix, participants noted the crucial importance of understanding the levelised cost of electricity incurred by individual mines, and the drivers associated, which may accelerate (e.g. low maintenance and increasing fuel costs, declining cost of technology) or impede (e.g. reliability, technology complexity, risks of debt financing and uncertainty around life of mine) the uptake of renewable energy technology. Further, participants highlighted the potential benefits of the mining sector's transition to clean power generation for improving the energy access of remote off-grid communities by selling excess power generated, noting however that there should be, foremost, a compelling business case for the shared use of renewable energy infrastructure. Participants also discussed and validated a further three examples from South Africa and Western Australia, 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 mobilising innovation to reduce the environmental impacts of extractive operations and developing green supply chains, while exploring options for shifting away from the export-led growth model, in addition to facilitating the uptake of clean technologies.
Participants noted that addressing risks and challenges associated with new technologies, such as ensuring secure supply of key minerals and impactful R&D initiatives, requires alignment across all levels of government to promote effective policies, including paying proper attention to the consequences for local communities. Further, as the "environmental hotspot" for green technologies differs from conventional ones – shifting from use, to extraction and production – both effective regulation and shared value creation around these minerals will be paramount. Participants further discussed efficiency gains linked to automation – in safety, productivity and emissions – and associated trade-offs, in particular jobs, further problematising approaches to local participation through employment quotas and targets. As technologies continue to evolve, determining which skills to prioritise is a further challenge for countries and industry alike, with consensus among participants on the need for reskilling initiatives focusing on transferable skills across multiple sectors, and the need to rethink benefits from mining beyond employment creation. Change, however, presents an opportunity to avoid mistakes of the past, and participants converged on the need for further work to support host countries in ensuring shared value creation in this new context.

Under *Work Stream 2 – Revenue Management and Spending*, participants welcomed the new focus for future work on how extractive revenues can contribute to the financing of resource-rich countries' energy transition. The discussion recognised that international action to combat climate change is rapidly reshaping the economic context of natural resource-based development, aiming to decouple economic growth from greenhouse gas emissions. Given that access to finance is one of the key challenges in facilitating the economic shift, helping developing countries manage and spend their extractive revenues effectively in preparation for the transition is crucial. Participants emphasised the pressing need to reform fossil fuel subsidies; to create new low-carbon industries; and to diversify the energy mix and invest in clean energy infrastructure in order to improve security of supply, hedge carbon risks and address risk multipliers entrenched in emission-intensive economic growth. Importantly, the discussion also identified the need to scale up just transition policies to ensure that the new economic model would leave no one behind. When considering the different revenue spending tools available to resource-rich countries to finance their transition, participants emphasised the importance of remaining flexible and country specific, given countries' varying development level, institutional capacity and fossil fuel production stage.

Under *Work Stream 3 – Getting Better Deals,* a Workshop on the Guiding Principles for Durable Extractive Contracts took place, to follow up on the mandate received by the OECD Development Centre's 52 member countries in October 2017 to further develop guiding principles so that host governments and investors can have a common reference to shape durable, equitable and mutually beneficial relationships for mineral, oil and gas exploration and development. Participants recognised that there is always a level of risk and uncertainty associated with long-term extractive contracts, and while it is not possible to eliminate every potential driver for renegotiation, it is desirable to minimise them. Participants focused on Guiding Principle VII and converged around a workable approach whereby costs of compliance associated with the introduction of new non-fiscal laws, and wholly and necessarily incurred in the pursuit of the specific operations, would be deductible as legitimate operational costs, contributing with prices and other variables, to the determination of the profitability of the project under Guiding VIII, and resulting in a change in the share of benefits. Participants agreed to reconvene in a workshop to finalise the text of the Guiding Principles to be held on 11 December 2018 at the OECD in Paris and present them at the Eleventh Plenary Meeting scheduled for 12-13 December 2018 at the OECD in Paris.

Under *Work Stream 4 – Domestic Resource Mobilisation (tackling BEPS, corruption and commodity trading transparency),* participants recognised that interrelated mechanisms of corruption and rent diversion in commodity trading are both multifaceted and global in nature, requiring producer countries, trade hubs, OECD countries home to companies active in trading and all other relevant actors involved in the trading chain to drive collective global action. Participants noted the role of the Thematic Dialogue on Commodity Trading Transparency in providing a platform for collaboration on how these challenges can be addressed from both the supply and demand side. Companies acknowledged the importance of transparency of trade-related payments and shared emerging disclosure practices around oil sales. At the same time, they also called for an assessment of the critical need for such information and the assurance that it would indeed translate into effective demand for accountability by end-users. Participants welcomed the peer-learning exercise on the procedures and criteria used to select buyers of publicly owned oil, gas and minerals and encouraged further exchanges within the dedicated SOE Working Group to identify best practices and inform the development of specific guidance. A protocol of collaboration between the OECD Development Centre and the OECD Directorate for Financial and Enterprise Affairs is being developed to clarify how possible future work on due diligence in commodity trading can be advanced.

Regarding progress on on-going efforts to address tax base erosion and profit shifting in the mining sector in developing countries, the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF) and the OECD Centre for Tax Policy and Administration presented a new draft toolkit titled 'The Hidden Cost of Tax Incentives in Mining'. The toolkit aims to help countries identify and cost the potential behavioural responses by mining investors to tax incentives. Preliminary work on stabilisation clauses; specifically, the challenges relating to countries applying new legal measures to address base erosion and profit shifting to existing mining investment agreements was also discussed.

Work Stream 1 - Shared Value Creation and Local Development (Sessions 3-4)

Sessions 3 and 4 were co-chaired by the Hon. Emmanuel O. Sherman, Deputy Minister for Operations, Ministry of Lands, Mines and Energy, Republic of Liberia, and Prof. Petter Nore, Senior Consultant, Norwegian Agency for Development Cooperation. Session 3 featured a discussion on the integration of renewables into mining companies' energy mix. The discussion during Session 4 focussed on the *Compendium of Practices*, a companion tool to the *Framework for Extractive Projects on Collaborative Strategies for In-Country Shared Value Creation*.

Renewables in Mining

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. The Ninth Plenary revealed the need to improve the understanding of the key barriers to the uptake of low-carbon energy solutions by extractive activities, and the crucial role of public-private collaboration in overcoming potential bottlenecks. To address this knowledge gap, the Tenth Plenary Meeting convened a focused peer-learning discussion, soliciting inputs from stakeholders with a practical experience of implementing renewable energy solutions in mines in a number of regions and countries, for example, Chile, Mauritania and South Africa. The discussion also offered an opportunity to discuss the findings of the Development Centre's analysis of over 30 projects worldwide, exploring their design – technology mix, ownership structure, and financing models.

Participants agreed that the integration of renewables into mines' energy mix has become an integral part of mining companies' business models. Participants highlighted the need for mines to have a clear understanding of their levelised cost of electricity, which depends on a number of factors, such as fuel, investment and maintenance costs. For example, the development of a renewable energy plant involves high upfront capital costs, but relatively lower maintenance and zero fuel costs, compared to fossil fuels. Participants also noted that while baseload and provision of a stable power stream throughout the day and night remains a challenge, a smart combination of different energy sources and active grid management can offer workable solutions. As a result, renewable energy has become cost-competitive and can generate significant savings for mines. As a number of existing successful projects for remote off-grid mines, for instance in Canada, have shown, the integration of renewables is both technically viable and economically beneficial. Combined with storage systems, renewable energy allows the achievement of a substantial diesel substitution rate, and reliance on fossil fuels only as a backup.

In addition, the integration of renewables in mines provides an opportunity to link countries' industrial strategies with environmental objectives and efforts to combat climate change. There is an increasing pressure on mining companies to reduce their emissions, particularly from downstream companies in the green technology industry. These companies seek to reduce the overall carbon footprint of their final products, and therefore focus on the emission intensity of the extraction of minerals and metals required in the clean technologies they manufacture. An example is the Responsible Copper Initiative by the Chilean state-owned copper producer Codelco and BMW, with an aim to establish a green copper value chain, and reduce the environmental impact of increased copper consumption, driven by the production of electric vehicles.

Participants also highlighted that a number of obstacles persist in the uptake of renewables, including capacity constraints, inflexible policy frameworks oriented to fossil fuel use, and in particular, the issue of bankability of pilot renewable energy projects. Participants noted the challenge to balance various risks involved, both technological and financial, to find a lender and bring projects to financial closure. For example, under a Power Purchase Agreement (PPA) model, whereby a mine offtakes renewable energy from an independent power producer (IPP), a number of factors need to be taken into account when the IPP is seeking financing for a project. This includes tenure, cost and guarantees associated with a specific debt-financing instrument; life of a mine, and the market price of the commodity it extracts, as well as the optimal PPA terms and overall legal framework of specific jurisdictions. Participants also pointed out that in this context, state-owned mining companies may be well positioned to explore renewables for their operations, given that governments can often provide the necessary guarantees to hedge risks for investors. In view of these financing challenges, mines often start small, gradually expanding their energy generation capacity, thanks to the scalable nature of renewable energy, particularly that of solar systems.

Participants also discussed how development co-operation could play an important role in helping partner countries overcome challenges, through a number of entry points. Development co-operation agencies can act as a catalyst between different stakeholders: mining companies, energy service providers, investors and governments. Donors also offer scientific and technical expertise, for example, to provide training programmes, and advice on technological issues and policy frameworks. Importantly, development co-operation providers can also assist with collecting meteorological data of solar radiation and wind patterns of a specific location where a power plant is contemplated. For example, in Mauritania, before announcing a tender, the government, in partnership with development co-operation agencies, had carried out a study to assess wind resources around Nouadhibou city, where it planned to build a wind farm to power the operations of the state-owned iron ore mining company Société Nationale Industrielle et Minière (SNIM). The results of the assessment pointed to an advantageous wind speed, which lent itself to the successful development of the power plant.

Development co-operation providers can also offer seed and co-financing on favourable terms to partner countries to hedge financial risks that impede the uptake of renewables. For example, in Chile, GIZ and KfW have implemented a number of renewable energy projects, with an increasing focus on the mining sector to promote industrial application of low-carbon energy technologies. At the start, when Chilean banks were reluctant to invest in renewable energy projects, KfW co-financed some of the projects through concessional loans. As more renewable energy projects were delivered, the domestic financial sector started to better understand the risk profiles involved, and became more willing to invest. Participants considered this an important contribution of the German development co-operation to building domestic investor confidence in the Chilean renewable energy sector.

Participants also explored opportunities for shared use of renewable energy infrastructure, and recognised that the mining sector can significantly contribute to improving access to energy for local communities, thereby strengthening its social licence and generating additional income for mines. As an example, SNIM considers using the power generated by its wind farm, mentioned above, to supply Nouadhibou city located close to the mine. In collaboration with the state utility Société Mauritanienne d'Electricité (Somelec), it also explores options to connect the power plant and mine to the national grid, to improve the offtake of the excess power generated. However, participants noted that many countries do not have adequate arrangements in place, which would allow supplying excess power into the national grid. Participants also highlighted that government's and mining industry's efforts to power local communities should be complementary to each other, to avoid competition for often scarce financial resources in some countries. It is also important to manage expectations of local communities for the ability of the mining industry to deliver socio-economic benefits beyond its core business. Participants concluded that there should be, foremost, a compelling business case for mining companies to promote the shared use of their renewable energy infrastructure.

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 three examples that were presented and validated in Session 4 focused on mobilising innovation to reduce environmental impacts of extractive operations and developing green supply chains, while exploring options for shifting away from the export-led growth model and facilitating uptake of clean energy technologies. Forming the basis of a robust peer-learning discussion, the three examples covered initiatives in South Africa and Western Australia, and – focusing in particular on Step 4 of the *Framework* – addressed a set of key questions:

- What are the opportunities; risks and challenges associated with developing green supply chains, and what collaborative steps can governments and industry take to ensure positive development results for host countries through backward linkages and improved access to affordable and clean energy?

- What potential trade-offs are associated with technological innovation in mining such as automation, including those relating to employment and skills, and how can governments address these challenges in partnership with industry?
- How can host governments support the development of new supply chains through investment in R&D, to develop linkages and in a way that engages productively with the private sector?

The aim of the discussion was to consider 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 and shared knowledge generation.

The first example considered how, in the context of the global low-emission transition, extractive companies are reorienting operations towards minerals experiencing increased demand driven by the trends towards electric vehicles (EV) and decarbonisation of the power sector. When discussing the increased demand for nickel and lithium – key inputs into lithium-ion batteries used for energy storage and EV technologies – participants considered the challenges and opportunities for government and industry to align on developing green supply chains. While there is clear intent to see the world transition away from fossil fuels towards greener technologies, participants noted that generating shared-value from the minerals and metals used therein will depend on effective collaboration to minimise risks and maximise opportunities arising from green technologies. Given the mineral-intensive nature of these new technologies, ensuring extraction occurs in a sustainable manner will be essential, while at the same time lower grade ore bodies and higher operational and capital costs continue to result in higher costs of development.

Given that 90% of all emissions from the extractives industry are generated during the transport of minerals, and that for EVs the critical point for minimising environmental impact is in their mining and production rather than in use, as is the case for combustion engines, the arguments for local beneficiation around minerals used in the transition are, however, significant. Participants emphasised the critical need for host countries and industry alike to not only optimise supply chain opportunities, but to ensure strong governance, environmental regulations, and ongoing dialogue between the different actors at all stages. Changes in the transport market towards electrification will need to be supported, for example, by well-aligned government policies to facilitate charging infrastructure. This will depend in part on collaboration across all levels of government. For industry, risks associated with ensuring a secure supply of key minerals, which tend to be highly specific to new technologies and thus particularly susceptible to shifts in the market, will also require government to be aligned on promoting climate sensitive approaches and policies, as well as greater sensitivity towards the material implications of policy decisions themselves.

Participants from developing and developed economies alike noted the imperative to shift their extractives sectors away from an export-led growth model, seeing the low-emission transition as a means to do so by generating in-country value through downstream activities. As in the example from South Africa and experiences shared by other participants, Australia also faces the challenge of exporting resources in a basic form, as minerals such as nickel, but also iron ore, are generally exported to the Asia market without any value-add. This called for a better assessment of potential opportunities to produce not only refined nickel products but also nickel sulphate, other precursors and cathode active material used in new low-emission technologies. A common theme throughout the session's discussion related, however, to the often large and seemingly widening gap between countries, in terms of their ability to adapt to and generate value from innovation and change, which tends to demand financial, technical and administrative capacities that many developing economies may lack.

This issue was further highlighted with regard to the move towards automation in mining, a trend with significant implications for approaches to natural resource-based growth. Discussion on the shift in Western Australia's iron ore mines towards automation illustrated the need to consider not only gains, in terms of safety, energy efficiency and reduced emissions, but trade-offs, in particular around jobs and the broader shift in the sector from low-skill to high-skills roles. While labour-saving technologies are likely to be deployed more readily where wages are highest, these changes will also impact developing countries as fewer job opportunities from extractives activities will limit the scope for direct and indirect socio- economic benefits. Machines are increasingly replacing workers, who are now employed in the maintenance of this machinery, and often constitute foreign labour attached to a particular technology. This trend will have a major impact on government expectations regarding the sector's contribution to local employment.

Participants in turn engaged in a robust discussion around the different approaches to and interventions available for facilitating local development, highlighting the need to remain country and context specific when designing policies and approaches to promote extractives-led development. Participants agreed that approaches should endeavour to look beyond employment for local populations to focus instead on *benefits* for local populations, while seeking always to align the extractives sector's development objectives with the development objectives of the country and region in which extractives activities take place.

When considering how to manage trade-offs relating to jobs through training, education and re-skilling, participants also noted that these technologies are still evolving, making it difficult to determine which skills exactly will be needed in the future. Discussants therefore emphasised the need for re-skilling initiatives and related collaborative approaches to education that focus on mobile training, or on skills that can be used in other sectors. This also includes recognising that automation is affecting multiple sectors, making a cross-sectoral approach that focuses on transferable skills particularly relevant, while also helping employees to eventually move out of the sector.

When considering innovation as a means to generate efficiencies in energy consumption, and thereby to reduce the environmental impact of operations, participants further emphasised the need for ongoing cooperation between the multiple stakeholders involved, including in supporting Research & Development. A key lesson from the Australian example was the role of government-led studies to map out and project long-term implications and impacts of automation, facilitating in turn an aligned approach across different stakeholders in terms of broader strategies towards education and ensuring a skilled and relevant workforce. Participants noted that such an approach could be replicated in developing country contexts, which may also benefit from regional approaches.

Finally, participants considered South Africa's HySA programme, an initiative to develop hydrogen fuel cell technology capabilities – a family of technologies that uses chemical reactions rather than combustion to generate energy, electricity and heat, and which leverages the country's substantial reserves of platinum group metals. Discussants considered not only how to generate linkages from the country's mining sector but how to connect this objective with the transition away from fossil fuel-based domestic power generation. While mobilising resources and greater private sector participation remains a challenge for the programme, participants noted that the collaborative approach to R&D not only brought industry and research institutions into the 15-year initiative, but sought alignment across policy areas, including with the National Climate Change Response Strategy, helping to create a mutually reinforcing and supportive policy environment.

While each of the examples discussed drew out critical challenges to be faced at local, regional and even international levels, participants recognised that being on the brink of change makes it possible to adapt and to avoid mistakes of the past. This will depend in part on strengthening the dialogue between the mining, climate, clean energy, sustainable development, financing and investment communities to ensure countries do not simply supply the low-emission future but rather that mining activities enable countries to invest in their own transition, and that local populations also benefit from this shift. Taking into account the potential to collaborate and generate shared value, participants converged on the need for further work to be undertaken by the Policy Dialogue to support countries in achieving resource-based development in these changing circumstances.

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

Session 2 was co-chaired by Mr. Askar Japparkulov, Deputy Director of Macroeconomic Analysis and Forecasting Department, Ministry of National Economy, Republic of Kazakhstan, and Mr. Rodrigo Monardes, Counsellor in Trade and Investment, Permanent Delegation of Chile to the OECD.

At the Ninth Plenary Meeting, participants raised the issue of the extractive sector's potential to contribute to financing the energy transition of resource-rich countries. The Tenth Plenary Meeting offered an opportunity to explore this issue in detail, including different options available to facilitate the timely and effective re-allocation of government revenues from non-renewable natural resources towards low-carbon power generation, as well as for the diversification of energy companies' portfolios towards renewables. The discussion during Session 2 also sought to identify concrete avenues for future work for the Policy Dialogue on this topic.

Participants welcomed the new proposed focus of the Work Stream 2 moving forward on how extractive revenues can contribute to the financing of resource-rich countries' energy transition, noting that the fossil fuel sector remains a significant source of government revenues. There is a potential to channel the spending of these resources towards countries' energy transition. Participants recognised that international action to combat climate change is already rapidly reshaping the economic context of natural resource-based development, aiming to decouple economic growth from greenhouse gas emissions. Participants noted that reliance on the fossil fuel sector, for example, for government revenues, power generation and employment, locks countries into a high-emission economic model, and subjects them to carbon risks, in turn creating a risk multiplier through various economic linkages between the fossil fuel sector and the rest of the economy.

The need to keep the objective of revenue reallocation from non-renewable natural resources towards low-carbon energy sufficiently broad was emphasised during the discussion. While following Article 2.1C of the Paris Agreement, which calls for the alignment of financial flows with the goals of the Agreement, it is important to maintain flexibility, when considering the different revenue spending tools available. The actual approaches employed by countries may differ significantly, given their specific socio-economic context: varying development levels, institutional capacity and fossil fuel production stage.

Participants also emphasised the dynamism of the global shift to a low-emission economy, and the difficulty of predicting the pace of this transition. They identified the need to prepare for multiple futures for both governments and the energy industry. The rapid expansion in the renewable energy sector, driven by declining cost of technology, has already led to record low electricity prices. For example, last year in India solar power prices reached 4c/kWh, and in Mexico below 2c/kWh. Renewables have become increasingly cost competitive, and generally no longer require subsidies. Another illustration is the recent stagnation of the global coal market in 2014-2016, driven by China's reduced consumption. In parallel to addressing the challenge of replacing its coal imports with domestic production, China has also started tackling the domestic oversupply of coal. To this end, China has introduced a programme to consolidate mines and reduce coal production. Importantly, in order to reduce the negative impact of these developments on employment, China has created a fund aimed at supporting the just transition of workers in the coal, as well as in the steel industry, which also faces the overcapacity challenge.

In view of rapid developments associated with the dynamic landscape of the global energy transition, policy recommendations that may have been pertinent three or five years ago, might lose their relevance today or in the near future. Participants contended that the work of the Policy Dialogue on this topic should reflect this dynamic context of the transition. For example, a typical good practice approach to extractive revenue management has traditionally advised, that avoiding the resource curse and reducing fiscal distortions generated by the development of the fossil fuel sector can be achieved by channelling the revenues generated outside the domestic economy. However, the urgency to scale up finance for the low-emission transition may call into question this classical paradigm. Resource-rich countries are starting to recognise the potential to re-invest extractive sector revenues domestically into diversified energy mix and distributed power solutions, to improve energy access and security, and reduce reliance on one type of, often centralised, energy generation.

While government revenues from fossil fuel production remain substantial, recent commodity price fluctuations have led to considerable losses in tax receipts. Therefore, the objective of channelling volatile and potentially diminishing revenues towards the energy transition must be balanced with other development objectives particularly in the context of low-income economies. In view of the persisting challenge of access to finance, participants emphasised the need to reform fossil fuel subsidies.. Over the period 2010-2015, the combined IEA and OECD estimates for fossil fuel support among 76 economies totalled between USD 370 and USD 620 billion annually (OECD (2018), *OECD Companion to the Inventory of Support Measures for Fossil Fuels 2018*, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264286061-en). Examples of significant fossil fuel subsidy reforms include India and Indonesia, which generated savings in the order of USD 15 billion for both countries.

Participants also explored the future of large energy companies, traditionally focused on fossil fuel production, in the context of the energy transition. For example, Equinor (former Statoil) made a recent shift from an upstream oil and gas company to a broad-based energy company, and committed to producing energy for the low-carbon future. To this end, along with improving energy efficiency of its oil and gas production, Equinor has emerged as a major producer of offshore wind energy in the North and Baltic Seas. One of the drivers of the change in its business strategy and long-standing efforts to improve energy efficiency of its operations is the fact that Equinor has been since 1991 subject to a relatively high carbon price, of around USD 50-65 per CO2 tonne. This signals the effectiveness of carbon pricing to change companies' behaviour and the importance of creating an adequate incentive structure for the energy industry to lead the energy transition.

Participants concluded that as energy companies are starting to test their resilience against carbon risks, fossil-fuel dependent economies should also follow suit and prepare for the energy transition. This should involve a number of simultaneous efforts, including: the reform of fossil fuel subsidies; creation of new low-carbon industries; and to diversification of the energy mix and investment in clean energy infrastructure, as well as scaling up just transition policies to ensure that the new economic model would leave no-one behind.

Work Stream 4 – Domestic Resource Mobilisation (Session 1 and 5-7)

BEPS in Mining

Participants in Session 1 discussed progress made to date by the collaborative endeavour undertaken by the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF), and the OECD Centre for Tax Policy and Administration to equip developing countries with the knowledge, skills, and tools they need to address base erosion and profit shifting in the mining sector. The discussion focused on the role of tax incentives in the mining sector, and also open a discussion on fiscal stabilisation in mining, noting that the latter was also on the agenda of the Workshop on Guiding Principles for Durable Extractive Contract, which took place after the Plenary Meeting on 26 June.

Participants noted the existence of cross-cutting guidance on the design and use of tax incentives for developing countries, but acknowledged the lack of specific guidance applicable to the mining sector, focusing in particular on improving understanding of how investors may change their behavioural response to tax incentives provided, in order to further maximise the benefits they obtain beyond what government originally intended, and how this response may increase the foregone fiscal revenues for the government. In order to improve the understanding of these broader implications of tax incentives, the IGF and OECD have developed a toolkit 'The Hidden Cost of Tax Incentives in Mining', which aims to help countries identify and cost the potential behavioural responses by mining investors to tax incentives. In this context, tax incentives are defined as any special tax provisions granted to mining investors that provide favourable deviation from the general tax treatment that applies to all corporate entities. The toolkit includes a step-by-step guide to reviewing mining tax incentives and a detailed account of mining companies' potential behavioural responses to incentives. The discussion in Plenary focused on tax holidays, which are a very different set of incentives than accelerated depreciation or relief on import duties, which arguably make a quite a lot of sense

Participants considered the example of a country where mining companies are subject to income tax and royalties, but that also host economic processing zones (EPZ) where related party processing facilities are tax-free. The mine will sell the mineral products to the processing facility. It may sell it at below market price, with the tax revenue from the processing facilities foregone and a further tax benefit resulting from reduced royalties and income tax by virtue of selling products at below market rate. So, investors may change their behaviour in response to the processing facilities being tax-free in economic processing zones, thereby encouraging mining companies to shift profits from the mine to the processing facility, for example, by under-pricing minerals sold, in order to reduce taxable income and royalties. Costing the impact of these tax incentives is critical, particularly when governments are making decisions during contract negotiations about what incentives might be appropriate to offer or to hold back. It was recommended that incentives which create parallel fiscal regimes, such as the example of the export processing zones and the mine, should be avoided. It is advisable to define the cost base in order to avoid compounding effect, looking at the associated BEPS risks and limiting the time and scope of tax incentives. The experience of the Côte d'Ivoire showed that mining companies accelerated production during the period of a tax holiday at the end of which revenue decreased further due to the devaluation of the resource, with reduced royalty rates decreasing the revenue further. After carrying out a stocktaking exercise, Côte d'Ivoire realised it was the only country in the UEOMA West Africa sub-region with a five-year tax holiday in the tax code. As a result of a consultation process with the private sector and in-depth analysis of the investment attractiveness profile of the country, the state decided to get rid of such incentives, with a transition period for projects in the feasibility stage. In Guinea, tax holidays of three, five, or twelve years' long are included in contracts, in order to facilitate the setting up of infrastructure linked to specific projects. In fact, without the necessary logistical infrastructure, the investment would not have been realised. So, Guinea strategically decided to grant those tax incentives in order to attract investments. Because investors are reticent to co-create financial modelling with governments, there is a risk of a lack of understanding between investors and host countries which, in turn, may affect the balance of the deal and the competitiveness of the project.

Participants welcomed the forthcoming development of an illustrative financial model which would factor in the behavioural responses of investors into the economic analysis in order to provide an understanding of the cost, the value and the need for incentives in any given context. This financial model will supplement the toolkit, to help countries assess the practical fiscal impacts of incentives. A database of tax incentives in publicly available mining contracts in 22 countries is being set up to provide a more granular view of the prevalence of incentives in the mining sector and which taxes countries are competing on.

Participants also highlighted that there is no empirical evidence, only anecdotal experience, of the effectiveness and efficiency of tax incentives in attracting mining investment. Most existing studies by the IMF and other organisations are cross-sectoral, or focus on other sectors, such as manufacturing. Redundancies are quite high. As countries look to reform their fiscal regimes, it would be useful to know how tax incentives have performed in practice at attracting investment in mining. It is important to understand not only how incentives provided by one government compare to those offered in other countries in the region, but also to have clarity on the impact of these incentives on investment. Participants also raised the issue that there is a general view that incentives in the mining sector might have a limited impact on investment, compared to incentives in other more mobile sectors, such as retail or manufacturing. While fiscal regime is an important factor, the overriding consideration for investors in the mining industry is the quality of the resources, which depends on geographic location. In addition, considerations around efficiency, strategic acquisition of assets and access to market prevail. Participants also noted that an overall stable macroeconomic and political environment and a good legal system, with functioning institutions, physical infrastructure and human capital are more important factors in attracting mining investment than tax incentives.

A presentation by the IGF on fiscal stabilisation clauses illustrated how they can limit the government's capacity to change laws applicable to investors, directly or indirectly, through the impact of an economic equilibrium clause. The discussion focused on BEPS-specific issues, relating to new provisions in the law, or the administration of the tax law, that seeks to address BEPS impact. The context needs to be understood in a broader changing framework for both jobs and revenue. The number of jobs in the mining sector will continue to diminish. At the same time, BEPS practices, strategic planning by corporations, tax haven issues and updating tax code to maintain the expected tax base are providing further challenges to governments' tax collection. The global tax architecture is changing and governments and companies need to realise the impacts of stabilisation clauses. Some participants emphasised the need for governments to get the language of stabilisation clauses right, and have a clear understanding of the concessions made to investors through fiscal stabilisation. Otherwise, investors may use international arbitration to seek compensation. Arbitral tribunals can also read the right to regulate in the treaty between the home state and the host state differently if there is a stabilisation provision in a contract.

According to IGF research, there is a difference between fiscal stability and stabilisation clauses: the latter do not necessarily contribute to the overall long-term stability of projects. Fiscal stability is a rational objective for investors, banks and financiers. The issue raised by IGF is whether very broad, long, open-ended stabilisation clauses, as some have been constructed during the last 25 years, are the right tool or whether they create more instability for the project. In fact, what works at the legal level may not work at the political level. In addition, there is a trend away from the conventional view that the government is entitled to its share of taxes and royalties, while mining companies are entitled to the rest. It was suggested that the emerging approach is that mining companies are entitled to a fair return on their investment, however governments, as the owner of resources, should be entitled to the rest. The point was made that the primary common goal of the government and investors should be the stabilisation of the agreed rate of return, and not taxes, thereby moving from stability to predictability. General anti-avoidance rules should be included in contracts and investment treaties, as should the right to regulate and to implement changing BEPS standards. These are reflected in the new investment treaty between Canada and Mongolia which includes specific treatment of tax issues, and excludes arbitration for tax, putting in place dispute settlement buffers, before arbitration can be triggered. Participants noted that the government teams involved in mining contract negotiations often have limited technical knowledge. They should fully master financial models before assessing opportunities to grant incentives, including stabilisation clauses, making sure that companies enjoy a fair rate of return on investment.

Thematic Dialogue on Commodity Trading Transparency

Sessions 5, 6 and 7 of the Tenth Plenary Meeting were chaired by H.E. Dr. Emmanuel Ibe Kachikwu, Minister of State, Petroleum Resources, Federal Republic of Nigeria and Mr. Andrew Preston, Head of Joint Anti-Corruption Unit (JACU), Home Office, United Kingdom and constituted the second dedicated meeting of the Thematic Dialogue on Commodity Trading Transparency. It was recalled that the Thematic Dialogue was launched in June 2017, following commitments made in 2016 by twelve countries at the London Anti-Corruption Summit to enhance transparency in commodity trading in order to fight corruption. In January 2018, the Thematic Dialogue made the case for action and identified priority areas in which to make progress. Complementing the efforts of the Extractive Industry Transparency Initiative, it was identified that the following was needed in order to address existing transparency gaps: 1) the development of a global reporting template for payment disclosure by companies involved in commodity trading; 2) the operationalisation of due diligence guidance for companies to tackle specific risks of rent diversion and corruption in commodity trading; and 3) the development of a template to support SOEs in selecting buyers.

The June session of the Thematic Dialogue offered the opportunity to start taking stock of existing initiatives and tools to address the identified transparency gaps. Session 5 improved understanding of the use of existing templates for disclosure of oil payments for the purchase by companies of publicly-owned commodities, including the EITI reporting template. In session 6, participants embarked on a peer-learning and experience sharing exercise on the procedures used by State-owned Enterprises to select the buyers of publicly-owned commodities. During session 7, participants learned about existing business practices that companies use to prevent risks of corruption and rent diversion in commodity trading.

Participants emphasised that the interrelated mechanisms of corruption and rent diversion in commodity trading are both multifaceted and global in nature. They also noted the role of the Thematic Dialogue on Commodity Trading Transparency, with its membership of both OECD and non-OECD countries, in providing a platform for collaboration in addressing these challenges from both the supply and demand side. Participants noted that discussions should involve major oil producers from both OECD and non-OECD countries, refiners, banks, as well as more trade hubs and traders to drive collective global action. Setting up measurement indexes for encouraging compliance with reporting standards to improve accountability would also help.

During Session 5, participants discussed instances where trading companies disclosed information on oil purchases from governments, either on a voluntary basis, as in the case of Trafigura, or following government requirements, as in the case of companies operating in Iraq and Chad as part of the EITI implementation process. The objective of the session was to share the type of information disclosed by companies and the lessons learned from these experiences. Participants noted that Iraq played a pioneering role in requesting international companies buying oil from the national oil company, State Organisation for Marketing of Oil (SOMO), to disclose data on their annual purchases. In the aftermath of the Oil-for-Food Programme scandal and the 2003 Iraq War, Iraqi authorities, in an attempt to prevent oil sales from corruption risks or rent diversion, devised a broader strategy for transparency which operated throughout the sales cycle rather than only focusing on transparency of sales data. This strategy includes:

- the payment of sales proceeds to an account different from the one of the SOE;
- the transparency of the buyers selection process and of some specific criteria – for example, the refinery capacity of buyers;
- transparency of pricing: the Official Selling Price (OSP) is determined by Iraqi experts, based on international formula set by international markets but with adjustments made in respect of a premium or a minus from the previous month’s prices. Consequently, there is no intervention in setting the OSP by external parties;
- transparency of sales contracts.

Between 40 and 50 international oil companies and refineries active in Iraq have been asked to disclose various information related to the purchase of oil from SOMO through EITI national reports since 2010, although some companies were reluctant to make these disclosures at the outset. The amount of information disclosure required has decreased over the years. For example, in its 2014 EITI Report, Litasco, the trading arm of Lukoil’s crude and petroleum products, disclosed the following information: Payments made to the Iraqi government; Quantity (bbl. & tons); Price, (USD per bbl.); Shipment number; Contract number; Invoice number; Invoice Amount (USD); Port; Loading date; License number; Destination; Payment due date; API; Vessel’s name; Settlement date. In 2017, 42 million Iraqi crude were traded through two different routes, namely a joint venture between Litasco and SOMO to trade part of the Iraqi oil, a model which is also used in the UAE, or by independent traders including Litasco. Lukoil’s general terms and conditions include an anti-corruption clause.

Participants also noted that Trafigura began to disclose information in 2015, on a voluntary basis, on their 2013 purchase of commodities from governments. Trafigura discloses data for direct ‘first purchase’ of crude, refined products and gas payments (USD), volumes (tonnes and barrels), and the identity of the SOE or government counterpart. Information on payments made and volume purchased has been disclosed only for EITI implementing countries (amounting to USD 1.1 billion for the year 2016) and not in non-EITI implementing countries (aggregated number of USD 20.1 billion of payments for the year 2016). Trafigura aggregates the data for non-EITI implementing countries or where the the loading port is in an non-EITI implementing country.

According to Iraqi authorities and companies active in Iraq, the practice of data disclosure has had a positive effect on traders' reputation which has translated into commercial benefits. In the case of Trafigura, this disclosure had allowed for an increase in the understanding of the trading business – including unconventional sales, like pre-payment agreements, which has been seen as opaque by many of their stakeholders, including significant financial partners. It has been acknowledged that the reporting time lag of one year prevents any potential risk in terms of confidentiality and competitiveness related to the disclosure of sensitive commercial information. Finally, the number of the transactions at stake are so large that they can have significant impacts on the sustainable development of the state that a degree of accountability around these transactions in producing countries is necessary.

In recognition of this pressing development issue, the EITI Standard (published in 2013 and then revised in 2016) includes a specific provision on the disclosure of revenues and volumes of publicly-owned oil, gas and minerals sold by producing countries, including state-owned companies. It should be noted that the EITI Standard encourages, rather than requires, companies to disclose data related to the purchase of publicly-owned commodities. Instead, countries can decide to request data from companies in order to reconcile payments with their records to revenues received. Out of the eleven countries that have begun to disclose information through the EITI process, only Iraq and Chad have done so thus far. A recently established EITI working group aims to support a number of countries in voluntarily implementing the standard.

Participants noted that Cameroon has disclosed a sizeable amount of information disaggregated cargo-by-cargo, although the information is not reconciled with the complementary disclosures made by companies. The information disclosed includes: the type of oil sold (equity oil from SNH shares or from collection of payments for the government); the number of cargo; the date of delivery; volume (barrels); the field; the price per unit and the total value (USD and FCFA); the decrease in Brent price; the buyer's identity and, finally, countries destination.

Both Mauritania and Albania engaged a marketer to sell their share of oil production and the EITI reports give some details on the type of procedures used, the criteria used and the identity of winners and unsuccessful candidates. Chad has disclosed for the first time in its last EITI report important information regarding the volume of reimbursements to Glencore, which granted several pre-payments to the country.

To achieve further uptake of the requirement of the EITI Standard for government disclosure of data on commodities sales, the EITI working group developed a specific Guidance for Reporting on first trades in oil in June 2017. The Guidance is structured across three key questions:

- *what type of oil is sold*: identity of the SOE; equity oil vs oil collected in-kind on behalf of governments as royalties or tax payments, etc.;
- *who are the buyers*: the identity of buyers; beneficial ownership of the company; load port; etc.;
- *what is the return on oil sales that a country receives*: volumes sold; revenues received; price information; contract types.

Participants recognised in principle the feasibility for companies involved in commodity trading of disclosing data based on the EITI Guidance. However, they emphasised that in order to maximise commodity trading transparency by trading companies, the number of items to be disclosed should be more limited, to avoid overburdening buyers for the following reasons:

- The scope of information required to meet genuine demands for accountability. In this perspective, it was suggested that critical information should be limited to oil volumes purchased, types of crude and value. The point was made that information like the destination that can change many times during one single shipment or beneficial ownership information may be less necessary ;

- All critical information must be verified or audited before becoming publically available;
- Any standard should thus avoid requesting non-audited information from companies or creating reporting fatigue with the burden of a long list of items.

Session 6 constituted the first peer learning session for SOEs to share their experiences and start building common knowledge on the different types of buyers' selection process in relation to different commercial arrangements used for commodity trading to prevent risks of corruption and rent diversion. It was reported that in crude oil sales, the selection of off-takers is circumstantial, depending on what a country wants to achieve. Options may include competitive open tender processes and government-to-government transactions. When producers borrow, this may be associated with some form of transactions related to the crude oil sales. The lender can insist that the producer has a special purpose vehicle to sell the oil crude to or requires the producer to sell to a particular buyer, with little or no control on the selection process. In Production Sharing Contracts, the host governments and the investor parties to the contract need to agree on the price determination of the crude for purposes of calculating revenues. Countries can also choose to sell to long-term end users, like refiners. Another alternative for the supply of petroleum products are swap deals, whereby the off-taker sells the crude oil on the market and gives the equivalent value in petroleum products.

Participants noted how the importance of having robust procedures to select commodity buyers is related to the strategic question of optimising the value of a country's resources. Participants observed that commodity trading is often undertaken using a commission-based business model, which can constitute a significant cost in the value chain, based on the difference between the cost of production in the producing country and the final price of the product in the destination country. When selecting buyers, pricing is key to avoid loss of value as nobody knows at what price the crude will be sold at the end of the chain. Transactions that take place in the market are reported by specialised agencies and are used as a basis for the determination of the benchmarks for different crudes, that are publicly available. Producers need to determine themselves the official selling price (OSP) for their crude as a premium or a discount against the benchmark crude, based on the oil quality. Most jurisdictions face challenges on how to determine the OSP, which is key to avoid leaving margins that would open up opportunities for corruption. Besides Iraq, Nigeria has also established a transparent framework for the determination of the OSP. In this perspective, an additional strategic consideration that producing countries may wish to take into account when they design selection procedures may be to sell every two, three or four years to avoid losing out on price volatility while using short-term contracts. This can provide countries with security of buyer, based in a satisfactory valuation of the commodity. In Zimbabwe, the national mining company, Minerals Marketing Corporation of Zimbabwe (MMCZ), is mandated to sell the country's entire production (except gold and silver), including the share of the private sector, to ensure a good valuation of the commodities and to avoid any intra-group transaction at less than market prices within the subsidiaries of international companies. Participants expressed the need for further discussion on the pricing mechanisms based on international benchmarks and their disclosure in producing countries.

Participants acknowledged that the risks of corruption in the selection of buyers of publicly-owned commodities is significant due to the large volume of commodities and amount of money involved. The establishment of rigorous and robust processes and criteria for the selection of buyers can help to reduce the political pressure to use discretion (whether in terms of pricing or arbitrariness of selection), especially considering the potential for involvement of Politically Exposed Persons (PEPs). Beyond the development of such procedures and rules, participants recognised that a the Policy Dialogue's peer-learning process could contribute to tackling corruption in this selection process by providing guidance on efficient checks and balances that institutions can use when selecting buyers. For example, participants noted that not only has the Nigerian National Petroleum Corporation (NNPC) implemented an open competitive tender process for oil sales, including making bids publicly available in major international media, internet and local media since 2015, but also that Nigeria is undergoing sector-wide reforms that limit the intervention of political actors in the oil sales process. In Ghana and Zimbabwe, it was reported that political and operational discretion is limited through clear composition of the selection team and its line management obligations, through audit obligations and through the reporting obligations of SOEs to other authorities (Petroleum or Mining Ministry, Reserve Banks, national EITI chapters, etc.). Both Nigeria and Ghana are expected to meet the expectations of the EITI Guidance for Reporting on first trades in oil when undertaking a pilot exercise to implement this new Guidance during 2018. In the case of Ghana, the Ghana National Petroleum Corporation's reporting obligations are also set out in the Petroleum Revenue Management Act 2011.

Participants noted that there are some situations where a competitive process to select the buyers may not be appropriate. For example, government-to-government transactions; resources-backed financing mechanisms, and arrangements in which investing companies lift and sell the government share of production as set in Production Sharing Agreements.

Some participants expressed their interest in understanding the existing pre-qualification processes in the case of mid-term contract (around one year) or very specific commodities that require further due diligence checks on sellers and buyers – for example the steps undertaken by the Zimbabwe Consolidated Diamond Company (ZCDC) in respect of sales of diamonds. The prequalification of buyers can provide a set of reliable buyers with financial and technical capacity, and can provide SOEs with more time to focus on the second part of the bid process, including the valuation of the commodity. In terms of the criteria used to select buyers (in both pre-qualification processes and conventional tenders), three main components are ordinarily covered:

- technical capacity: the ability of the prospective buyers to lift and their commercial experience with markets,
- financial capacity: this includes the strategy buyers/marketers will use to achieve the best differential, their credit rating of their bank credit line
- the potential for local participation in trading activities: Ghana and Nigeria have local content criteria, which accounts for 25-30% of total marks in some instances
- capability to ensure payments

Participants agreed to continue this exercise of knowledge building and peer learning, through the dedicated working group of SOEs facilitated by the OECD Development Centre and future Plenary Meetings in order to develop guidance to support SOEs to select the buyers or marketers of publicly owned oil, gas and minerals, and complementing the EITI's efforts to improve transparency and mitigate corruption risks. Emphasis was placed on the active involvement of SOEs in the peer learning process, to inform the provision of a questionnaire and the subsequent stocktaking exercise, comparative analysis and the identification of emerging good practices.

In Session 7, participants learned about existing business policies and practices that companies use to prevent risk of corruption and rent diversion in commodity trading, acknowledging the significant exposure to corruption risks and rent diversion that commodity trading can attract considering the amounts involved in each transaction and the potential involvement of Politically Exposed Persons (PEPs). For example, Vitol is a large private trading Dutch company with offices in 40 countries, but doing business in many more. As such, whenever entering into a transaction, whether physical or derivative, Vitol is subject to the requirements of both home and host countries as well as relevant international, national, and industry standards. Internal and external compliance audits are carried out. Vitol applies a Know-Your-Customer and Know-Your-Business policy, asking for information about the corporate structure and the full ownership or board members, not only of their trading counterpart, but also of any intermediary in the supply chain (e.g. the shipping company, the inspecting company, the refineries, etc.) with a zero ownership threshold Questionnaires are filled out and responses are rated following a risk-based approach. Customers' reviews are carried out on a yearly basis. If concerns arise, customers are reviewed every three months and, if necessary, the matter can be escalated to get the transaction vetted by senior management and even the executive board. State-owned companies and third party intermediaries (e.g. commercial agents, consultants) automatically trigger enhanced due diligence. Vitol sends questionnaires and additional information is collected through specific worldwide intelligence systems such as Factiva. The information is reviewed and the proposal for retaining the intermediary is submitted to senior management for final decision. The trading counterpart needs to be set up in the internal IT integrated system, also to avoid frauds when authorising payments. When intermediaries are involved, Compliance undertakes a full due diligence to make sure that the payment is not diverted. Over time, additional due diligence checks have been implemented, which include the automatic screening of every single payment.

Some participants argued that, considering the scarcity of convictions for bribery and corruption in commodity trading in both host countries and home countries and the continuation of cases revealed by international information leaks in recent years, involving intermediaries an off-shore companies, robust due diligence practices for trading companies should be made mandatory. Beyond the increased enforcement of anti-bribery and anti-corruption legislation in host countries, it was suggested that other measures could include mandatory disclosure of payments related not only to extractive activities but also to trading activities by companies, transparency related to beneficial ownership, and transparency of contract terms by resource-rich countries.

When considering the possibility to develop guidance for companies active in commodity trading on how to identify and respond to the specific risks of corruption and rent diversion, participants heard about available OECD due diligence tools that are relevant for any additional work on due diligence commodity trading, and renewed interest for further work notably to take into consideration the various types of commercial arrangements used in commodity trading activities. In terms of process, it was agreed that the Multi-Stakeholder Steering Group, established in 2013 under the aegis of the OECD Investment and Development Assistance Committees to support the implementation of the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas and identify priorities for future work, should be involved in any further work on due diligence in commodity trading . To this end, a protocol of collaboration between the OECD Development Centre and the OECD Directorate for Financial and Enterprise Affairs, serving as the Secretariat to the OECD Investment Committee, is being developed to clarify how possible future work on due diligence in commodity trading can be advanced.

Participants noted that the Anti-Corruption Task Team (ACTT) of the OECD Development Assistance Committee (DAC) is initiating work on illicit financial flows in commodity trading in response to the drain on development resources exhibited in several oil-rich countries. DAC members will assess what steps donors can take to address illicit financial flows in commodity trading with the objective of producing guidance for Official Development Assistance (ODA) programmes.

Work Stream 3 – Getting Better Deals: Workshop on the Draft Guiding Principles for Durable Extractive Contracts

A Workshop on the Draft Guiding Principles for Durable Extractive Contracts took place in conjunction with the Tenth Plenary Meeting of the Policy Dialogue on Natural Resource-based Development at the OECD on the afternoon of 26 June 2018. The Workshop was attended by representatives of 12 government delegations from Africa, Asia and Europe, as well as representatives from 2 partner international organisations and institutions and 12 major firms, industry associations, civil society organisations, academia, law firms and think tanks. International organisations and institutions represented included the Commonwealth Secretariat and the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development.

The objective of the Workshop was to re-assess a revised version of the Guiding Principles, reflecting comments received during the public consultation period from January to March 2018.

Background

The Guiding Principles for Durable Extractive Contracts set out eight principles and supporting commentary that host governments and investors can use as a common reference for future negotiations of enduring, sustainable and mutually beneficial extractive contracts. They aim to provide guidance for the content and negotiation of durable extractive contracts that can reduce the drivers of renegotiation and can provide adaptive and flexible provisions that, for example, can automatically adjust to prevailing market conditions.

An initial draft of the Guiding Principles was prepared by the OECD Development Centre, serving as Secretariat, and was discussed during the Seventh Plenary Meeting of the Policy Dialogue on Natural Resource-based Development held on 30 November 2016 at the OECD in Paris. Following that meeting, the Guiding Principles were revised by the OECD Development Centre and benefitted from the input of a working group composed of willing subject-matter experts who met via teleconferencing to review subsequent drafts on 31 January, 28 March and 2 May 2017.

As part of the consultation process, an informal expert workshop was held on 7 April 2017 at the OECD in Paris. Subsequently, a draft of the Guiding Principles was submitted for consideration during the Multi-Stakeholder Consultations of the Eighth Plenary Meeting of the Policy Dialogue on Natural Resource-based Development held on 17 June 2017 at the OECD in Paris, and further revised following teleconferences on 25 July and 30 November 2017. An advanced draft of the Guiding Principles was discussed at the Ninth Plenary Meeting of the Policy Dialogue held on 31 January – 1 February 2018 and simultaneously submitted for on-line public consultation during the period January – March 2018. The majority of the submissions received during the public consultation process related specifically to Guiding Principle VII, Guiding Principle VIII and contract transparency.

The version circulated for the Workshop reflected thorough consultation amongst participants in the working group, Policy Dialogue's Plenary Meetings and the public.

Executive Summary

The Workshop on the Guiding Principles for Durable Extractive Contracts took place to follow up on the mandate received by the OECD Development Centre's 52 member countries in October 2017 to further develop guiding principles so that host governments and investors can have a common reference to shape durable, equitable and mutually beneficial relationships.

Participants recognised that there is always a level of risk and uncertainty associated with long-term extractive contracts, and while it is not possible to eliminate every potential driver for renegotiation, it is desirable to minimise them. Participants further noted that contract durability means that the parties continue to see the contract as producing benefits for everyone. Participants focused on Guiding Principle VII and acknowledged that costs of compliance associated with the introduction of new non-fiscal laws, and wholly and necessarily incurred in the pursuit of the specificproject, would be tax deductible as legitimate operational costs, contributing with prices and other variables, to the determination of the profitability of the project for fiscal purposes under Guiding VIII.

Participants agreed to reconvene at a workshop scheduled for 11 December 2018 at the OECD in Paris to finalise the text of the Guiding Principles and present them at the Eleventh Plenary Meeting of the Policy Dialogue on 12 -13 December 2018. It is expected that the final version of the Guiding Principles will be submitted for consideration and possible endorsement at the 5th High-level Meeting of the Governing Board of the OECD Development Centre, tentatively scheduled for the first half of 2019.

Summary of the Discussion and Conclusions

It was clarified that the OECD Development Centre received a mandate from its 52 member countries in October 2017 to further develop *Guiding Principles for Durable Extractive Contracts* so that host governments and investors can have a common reference to shape durable, equitable and mutually beneficial relationships. Participants also reflected on the history of the Guiding Principles document, including the role of the G7 CONNEX Initiative. Consequently, with regard to the ownership of the Guiding Principles, participants welcomed the clarification that the document would be presented as a publication of the OECD Development Centre, benefiting from input from partner countries, industry and expert organisations.

Participants noted that the amended version circulated for consideration during the workshop contained changes made in response to submissions received during the public consultation process and plenary discussions. In respect of the views of the different organisations that provided input for the Guiding Principles, language around "convergence" has been replaced with language drawing attention to the thorough and inclusive nature of the consultation process. Participants noted that the development of the Guiding Principles had benefitted from the input of a wide variety of stakeholders, including representatives from governments, industry, civil society and international organisations. However, the lack of direct involvement of indigenous peoples' representatives in the process, so far, was noted.

Participants also considered the nature and the value-added of the Guiding Principles as a forward-looking aspirational document, rather than simply reflecting existing approaches in contractual practice.

It was acknowledged that the language in the Preamble around renegotiation had been amended to recognise that renegotiation cannot be eliminated in every circumstance. The point was made that the Guiding Principles should explicitly recognise in the preamble or in a footnote that in some situations, renegotiation may be appropriate. In this respect, reference was made to the work of the IMF Fiscal Affairs Department 2012 statement, that "while the obligation to respect contracts is vital, renegotiations do and sometimes should occur. Renegotiation can be warranted when terms have become egregiously out of line with international practice or with terms in comparable circumstances: no contract can anticipate all conceivable outcomes. When this happens through consultation, or by mutual agreement, the investment climate may be strengthened rather than weakened. In contract schemes, provisions for periodic reviews are increasingly common".

Turning to Guiding Principle VII, participants discussed the changes that had been made to this principle dealing with non-fiscal changes in law, following the public consultation process. Specifically, participants debated on: the introduction of bona fide, non-arbitrary, and non-discriminatory changes in law; the question of who should and how to absorb the costs associated with a change of law, if that change affects the economics of an extractive project; the deletion of the reference to "*internationally recognised standards and/or good practices generally accepted from time to time in the industry*"; and language designed to address substantive adverse impact of new legislation on the economics of the project ("*with due regard taken of the economic consequences of any substantive adverse impact on the project*").

With respect to the opportunity to use the term "bona fide", participants noted that this addition was intended to address concerns expressed by the industry regarding the adoption of laws that are used as disguised means of expropriation. Some participants noted the term "bona fide" would be too vague and would leave too much room for interpretation.

Regarding the opportunity to include a reference to "*internationally recognised standards and/or good practices generally accepted from time to time in the industry*", the point was made that when such a reference was made during Professor John Ruggie's process for the development of the *Guiding Principles on Business and Human Rights*, the purpose was to provide a guarantee to governments that new legislation introduced to comply with human rights, international obligations and standards would not be regarded as arbitrary or discriminatory. It was an enabling provision, designed to provide certainty that new human rights laws would not be subject to challenge and it was never intended to be a limiting provision, constraining governments in their ability and need to regulate. In addition, it was observed that international standards and obligations often follow and not lead, reflecting practice that already broadly exists. For instance, international environmental standards do not cover every situation in which mining, oil and gas operations need to be regulated. It was thus recommended that any such reference should be regarded as an enabling provision, and not constraining governments' ability and need to regulate. Some participants noted that as governments transition toward a low carbon economy, assets in the oil and gas sector are going to be stranded at a faster pace and in a greater number that is currently recognised. That is also why some participants considered that it is so important to make sure that the language used in the Guiding Principles does not suggest that governments have a financial liability in covering those stranded assets.

Some participants expressed the view that the expression "*with due regard taken of the economic consequences of any substantive adverse impact on the project*" could be read as contemplating economic equilibrium style stabilisation clauses, providing for the duty of the government to compensate the investor for the non-fiscal changes in law covered by Guiding Principle VII and that this ambiguity should be avoided. Other participants argued such language simply points to the impacts resulting from associated additional project costs that make the project go bankrupt or the investor unable to perform any of his rights or obligations. Participants discussed the competing views on whether, on one hand, stabilisation clauses should be contemplated to reduce the risk associated with the adoption of new non-fiscal provisions, and on the other hand, whether stabilisation clauses should never be applied for non-fiscal provisions due to their *de facto* potential restraint on a government's ability to regulate in the public interest. Some participants pointed out that stabilisation clauses are not intended to result in such restraint, nor were they aware of any instances where stabilisation clauses had ever created such restraint. Some participants observed that stabilisation clauses should be part of the government's toolbox and within the broader context on risk and reward and depending on where a country is coming from and its specific context, there might be instances in which stabilisation clauses may be appropriate, although as an exception rather than the rule.

Setting aside stabilisation clauses and compensation for non-fiscal changes in law, participants converged and acknowledged that costs of compliance with new non-fiscal laws resulting in an increase of the project costs should be treated as legitimate project costs that would be tax deductible as a business expense for the purposes of determining the costs of the project under Guiding Principle VIII. The point was made that governments should carefully consider that by changing social and environmental regulations, project costs may increase and make the project less profitable. This in turn would result in a change in the share of the fiscal benefits, as additional costs would translate into reduced revenue for the state and investors, since costs are one of the variables for the determination of the project profitability for fiscal purposes under Guiding Principle VIII.

In the vast majority of fiscal regimes, when there is a change in law that affects the costs of the project, ordinarily those costs will be tax deductible. In oil and gas production sharing contracts, these additional costs would be recoverable from the allocation of "cost oil"/or "cost gas". In a mining contract, these additional costs would be treated as deductible expenses in both income taxes and rent taxes. Participants recognised that any change in law that affected the economics of the project would ultimately result in reduced profits to be shared between the state and investors, whilst also preserving the states' right to regulate in the public interest.

Participants recommended the inclusion of a linking sentence in Guiding Principle VII that reflects that the cost of complying with regulations is an ordinary cost of doing business, which is therefore deductible in income and rent taxes and cost recoverable in production sharing contracts. A responsive fiscal regime, as contemplated by Guiding Principle VIII, will help adjust the distribution of project revenues to reflect these costs. Participants stressed that in order for the protections under Guiding Principle VII to apply, the costs must be wholly and necessarily incurred in the pursuit of the specific operations.

While changes in non-fiscal laws would ordinarily be tax deductible, one participant cautioned that when changes to non-fiscal requirements have such a substantive adverse impact on the economics of the project, so as to make it uneconomical, this may have negative consequences, ending up with leaving the resources in the ground, or leading to bankruptcy or renegotiation. To avoid renegotiating the contract or a tax deficit scenario, it was suggested that consideration should be given to other forms of automatic adjustment, other than tax deductibility for fiscal purposes, such as an extension of the licence.