BEST PRACTICES IN DEVELOPMENT CO-OPERATION SERIES

Policy Guidance on Mitigating the Risks of Illicit Financial Flows in Oil Commodity Trading

Enabling Integrity in the Energy Transition

OECD

BETTER POLICIES FOR BETTER LIVES

This document was approved by the Development Assistance Committee via written approval on 17 April 2023 and prepared for publication by the OECD Secretariat.

This document, as well as any data and map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

Please cite this document as OECD (2023) “Policy Guidance on Mitigating the Risks of Illicit Financial Flows in Oil Commodity Trading: Enabling Integrity in the Energy Transition”, Best Practices in Development Co-operation, OECD Publishing, Paris.

Summary

- **This Policy Guidance aims to address risks of Illicit Financial Flows (IFFs) in oil commodity trading.** It is designed for development policy makers and practitioners.
- **The extractives sector, and oil commodity trading in particular, are significant contributors to IFFs.** IFFs almost exceed combined inflows of official development assistance (ODA) and foreign direct investment in Sub-Saharan Africa. Four out of the top seven African emitters of IFFs are oil producers.
- Bribery, kickbacks and collusion, tax evasion, trade mispricing, trade-based money laundering, and malfeasance conducted via offshore corporate entities and subsidiary vehicles, are among some of the IFF practices that occur in oil commodity trading.
- IFFs in oil commodity trading represent a critical development issue, for three main reasons:
  - **Domestic resource mobilisation**: more than half of Africa's 12 oil and gas producers rely on oil and gas exports for more than 50% of total export revenues. Yet, a 2016 analysis of 33 national oil companies (NOCs) found only 22% of oil sales revenues were remitted to government treasuries.
  - **Alleviating debt distress**: oil-rich developing countries face high public debt levels. The share of low-income countries either at high risk of or currently in debt distress increased from 30% to 60% during 2015-2021.
  - **Promoting integrity in the energy transition**: high levels of IFF risks in oil commodity trading are likely to persist in the energy transition, particularly in carbon trade.
- **Recommended priority actions** for ODA providers are as follows:
  - **Improve understanding of IFF risks and automatically consider IFFs in project design, to inform development programming.**
  - **Increase engagement with NOCs**, notably by:
    - Extending existing ODA support to Public Financial Management (PFM) procurement and accounting to include NOCs;
    - Building NOC capabilities in financial management, commodity marketisation and trading, due diligence, compliance and risk management.
  - **Adopt a multi-scalar approach to addressing the problem of IFFs.** This involves:
    - Assessing the relevance and feasibility of establishing an IFF advisory facility to provide just-in-time information to actors and operations critical to IFFs.
    - Collaborating with dedicated policy networks to address offshore, transnational networks and enablers of IFFs, including the OECD Investment Committee, Working Party on Responsible Business Conduct, Working Party on State-Owned Enterprises (SOEs), the Financial Action Task Force (FATF) and the International Institute of Finance.
  - **Leverage capabilities and engagement of the International Monetary Fund (IMF)**. This would involve enabling and resourcing the IMF to fully utilise IMF Article IV 'surveillance',

provide just-in-time guidance on managing macro-critical IFF risks, and tackle transnational IFF risks.

- **Carry out corollary actions, in particular through the Extractive Industries Transparency Initiative (EITI) partnership, to enhance the impacts of transparency**. This includes supporting efforts to enhance integrity in the selection of suppliers and intermediaries, strengthen data disclosure and usage, improve monitoring of commodity-backed lending, and build the evidence base on IFF and corruption risks arising in the energy transition.

Table of contents

Summary 3

Introduction 6

Illicit financial flows in extractives and oil commodity trading 6

Why is this issue important for development actors? 7

1 Illicit financial flows and oil commodity trading: What we have learned? 9

2 The role of official development assistance in tackling illicit financial flows arising from oil trade activities 12

3 Policy guidance to better target and utilise official development assistance (ODA) 14

References 18

Annex A. Illicit financial flow practices in oil commodity trading 20

Notes 21

TABLES

Table A.1. IFF vulnerabilities in first trade oil sales 20

Introduction

This Policy Guidance aims to respond to a particular problem: the risk of illicit financial flows (IFFs) in oil commodity trading. In adopting this focus, the Guidance corresponds with three development policy agendas: financing for sustainable development, specifically domestic resource mobilisation (debt management and transparency), and the energy transition to net-zero carbon emissions ('energy transition'). For the purposes of this Guidance, IFFs refer to "money illegally sourced, transferred or used" (OECD, 2018[1]). This definition underscores the cross-border dimension of IFFs, as distinct from corruption per se which is defined as the "abuse of public office for private gain" (Shah, 2016[2]).

This Policy Guidance is designed for development policy makers and practitioners working to assist partner countries to enhance domestic resource mobilisation, stem illicit finance and corruption, and to enable oversight, transparency and integrity as a basis for a just and fair energy transition. This Guidance is non-legally binding and aims to serve as a practical resource tool for members of the OECD Development Assistance Committee (DAC). It focuses on 'equity oil', that is, oil deriving from a government's share of oil or gas production (either as an operator or as a partner to international companies) and in-kind payments to governments from companies undertaking extractive operations, but could be applicable to other sectors as well, in particular the energy transition. It builds upon the insights generated by the Anti-Corruption Task Team (ACTT) programme of work on IFFs in oil commodity trading, as summarised in the Synthesis Report, "Illicit Financial Flows in Oil and Gas Commodity Trade: Experience, lessons and proposals" (Porter and Anderson, 2021[3]) and reflected in a set of accompanying working papers (Nesvetailova et al., 2021[4]; Hickey and Mohan, 2021[5]; OECD, 2023[6]; OECD, 2023[7]).

This Guidance also identifies relevant policy domains for development actors to engage with policy makers and practitioners working in sectors related to commodity trading, corporate governance, financial service sector regulation and responsible business conduct, so as to increase policy coherence for sustainable development. Key actors in these sectors have been consulted in the development of this Guidance.[1]

Illicit financial flows in extractives and oil commodity trading

The extractive industries sector is particularly prone to trade-based IFFs and corruption. Although estimates vary, the magnitude of domestic resources lost in Sub-Saharan African countries on account of IFFs are thought to nearly exceed the combined value of receipts from official development assistance (ODA) and foreign direct investment, valued respectively at USD 44 billion and USD 54 billion.[2] United Nations Conference on Trade and Development (UNCTAD) further estimates that IFFs related to the export of extractive commodities (USD 40 billion in 2015) are the largest component of illicit capital flight from Africa. Four of the top seven African emitters of IFFs (totalling almost USD 30 billion) are oil producers (Signé, Sow and Madden, 2020[8]).

Corruption risks may arise at any point in the extractive industries value chain. However, commodity trading presents specific and heightened risks due to the significant scale of funds involved and the complex and opaque nature of the financing and accounting instruments used for oil sales agreements (OECD, 2021[9]).

Vulnerability to IFF risks in oil sales and trades arises at three key points in the oil sales process: the selection of buyers and allocation of buyers' rights, the negotiation of terms of sale, and the collection and

transfer of sale revenues into national spending systems (Porter and Anderson, 2021[3]). Bribery, kickbacks and collusion, tax evasion, trade mispricing, trade-based money laundering, and malfeasance conducted via offshore corporate entities and subsidiary vehicles, are among some of the IFF practices that occur in this sector (Table A.1).

Why is this issue important for development actors?

IFFs in oil commodity trading are a problem for domestic resource mobilisation and can expose oil-producing developing countries to significant fragility risks due to their potential to exacerbate already high levels of vulnerability to macro-economic crises, chronic poverty, institutional fragility and episodic political instability and conflict.

In a global context of tighter access to credit, IFFs in oil commodity trading are also contributing to rising debt, as developing producer countries increasingly turn to private and non-Paris Club lenders in the absence of concessional and sustainable finance (IMF, 2022[10]). Although public debt levels have increased in recent years in both resource-poor and resource-rich countries across the developing world, the debt surge is greatest in oil-producing countries, resulting in debt distress in several Sub-Saharan African countries.[3] Finally, with the energy transition gaining momentum, and the emergence of new carbon markets, many of which involve the same actors, institutions and even financing instruments as those featured in the oil trade sector, there is good reason to believe that IFF and corruption risks in oil trade activities will follow the energy transition and feature in the expanding carbon trade.

In light of these multidimensional and far-reaching consequences, the role of ODA in assisting partner countries to reduce IFF risks, enhance domestic resource mobilisation and enable integrity in the energy transition, has never been more important.

Oil trade and domestic resource mobilisation

Reducing the scope and incidents of IFFs in the sale and trade of equity oil is key to enhancing domestic resource mobilisation. Oil trade activities are the most significant source of domestic revenues for many oil-producing developing countries. Corruption and IFFs in this sector can therefore have severe and substantial flow-on effects for the fiscal, poverty and stability prospects of an impacted country.

More than half of Africa's twelve oil and gas producers rely on oil and gas exports for over 50% of their total export revenues, and revenue generated from equity oil sales significantly outstrips petroleum tax income in several oil-producing developing economies (Leke, Gaius-Obaseki and Onyekweli, 2022[11]). From 2011-2012, for example, the top ten oil exporters in Sub-Saharan Africa generated more than USD 250 billion in oil equity sales, equalling 56% of their combined government revenue (Gillies, Kummer and Guéniat, 2014[12]). Despite its weight, much of this revenue does not end up in state treasuries, depleting the prospects of domestic resource mobilisation across oil-producing countries. A 2016 analysis of 33 national oil companies (NOCs) showed that of USD 2 trillion generated each year by the sale of oil and gas commodities, on average just 22% of the proceeds are remitted to government treasuries (Malden and Williams, 2019[13]). Although a share of these funds may be used for onwards investments, and despite the fact that IFFs in the sector are difficult to quantify with precision, successive incidents of corruption have shown the high risks of IFFs and corruption in the oil trade sector and their significant detrimental impacts on the development prospects of these countries.

Illicit financial flows, oil trading and debt distress

According to the World Bank, the level of public debt among oil-rich Sub-Saharan African countries has increased significantly in recent years, reaching 73% of their combined gross domestic product (GDP) in 2018[4], echoing International Monetary Fund (IMF) reports of an increase in low income countries (LICs)

either at high risk or currently in debt distress, from 30% in 2015 to 60% in 2021 (IMF, 2022[10]). The nature of public debt among developing producer countries is also changing and increasingly includes short-term and expensive non-concessional private lending, with a significant proportion of debt (as much as 20%) backed by oil collateral.[5] The IMF has remarked that the creditor landscape which has seen an increase in lending from non-Paris Club and private creditors poses new coordination challenges.[6]

Collateral debt is often hard to oversee and off-budget, and is extended by oil commodity traders on conditions of higher interest rates and shorter maturities. Several known cases of high indebtedness have resulted from dubious oil trade exposures, including cases in which there is documented evidence of bribery, collusion or undue influence. In other cases, collateral loan agreements have been entered into without the necessary parliamentary approval. There are also high risks that these funds might be misappropriated or diverted, given that this type of financing does not fall under the regulation or supervision that would typically apply to comparable types of financial agreements provided by entities domiciled in OECD member countries. The IMF recommends a series of debt management and transparency efforts and yet prevention is better than the cure, thus section 3 identifies some initial preventative actions for ODA to explore.

Illicit financial flows, oil trading and the energy transition

By supporting oil-producing developing countries in their fight against IFFs in commodity trading activities, ODA can help promote integrity in the global energy transition, particularly in carbon trading. Although the evidence is yet to be firmly established, early indications suggest the high levels of IFF risks that accompany oil commodity trading activities will persist in the energy transition, particularly in carbon emissions, offsets and trading, given the commonality of actors and institutions, the proliferation of opaque and complex financing vehicles or instruments, and the sheer scale and pace of change envisaged. In the context of growing numbers of mandatory national and supranational schemes for carbon trading, integrated energy firms, large independent and smaller traders are increasingly arbitraging the price, risk and regulatory differences that arise between carbon and decarbonised energy products to their advantage.[7] At the same time, NOCs (and potentially partner state-owned enterprises (SOEs)) will be increasingly engaged in global carbon trade either on account of their efforts to sell their products abroad, or as a consequence of their own domestic or supranational obligations in carbon mitigation and trading. In short, where carbon is sold as a product or commodity abroad, many of the same actors, institutions and instruments as well as market features of opacity, complexity, and risk transference that have characterised IFFs in oil sales and trade transactions, look set to emerge in the carbon trade sector. As a catalytic and scarce resource, ODA support to NOCs and SOEs to manage these risks and to enable integrity in the carbon trade and energy transition has the potential to yield substantial dividends. More on this at section 3 below.

1 Illicit financial flows and oil commodity trading: What we have learned?

First, oil trading is a complex industry that changes rapidly in response to crises and global trends. This has consistently increased the vulnerability of developing producer countries to illicit financial flow (IFF) risks. Major shifts or transitions including the 2008 Global Financial Crisis, COVID-19 and Russia's war of aggression against Ukraine, have affected the nature of the actors participating in the trade, the way that commodity trading is transacted and regulated, the instruments and sources of finance used, and the nature of relationships between sellers and producers. Each of these shifts has accentuated both market opportunities and IFF risks for oil and gas producers, and foreshadows particular risks for developing country producers as the world rapidly shifts from fossil fuel activities to renewable and carbon markets, given the scale, pace and complexity of the changes envisaged.

Second, the IFF risks faced by producer countries are the result of distinct market characteristics. Two aspects are particularly important. On the one hand, developing country oil and gas producers are subordinate to global market actors and systems, often due to their comparatively limited capabilities in commodity pricing, trade and marketization. On the other, developing country producers often possess limited capabilities to offset the risks of market exploitation, capital flight, IFFs or financial malfeasance in commodity trade transactions. This is not to dismiss the well-documented instances of rent-seeking and corruption that are known to accompany some NOCs, but rather to recognise the asymmetries of information and capability that exist between NOCs and international traders and financiers in terms of market fundamentals.

Third, ODA has tended to view NOCs narrowly, as posing general risks of corruption and unreliability. Again, and to acknowledge the integrity risks associated with NOCs, this view has also served to obscure the global context and the contradictory pressures that NOCs face in advancing the domestic sovereign interests of their host country.

- NOCs play complex, multi-faceted roles. Typically assigned responsibilities for fossil fuel production, development and marketisation, NOCs are often also responsible for enabling sovereign energy or infrastructure investments (including renewables) and, in many cases, carry out a host of service delivery and 'quasi fiscal' functions.
- Despite the myriad macro-fiscal, developmental and political obligations borne by NOCs, donor engagements have been narrow in range, tending to focus on legal, regulatory reform, and an unbundling of their policy, operational and regulatory functions.
- As the energy transition gains momentum, the roles of NOCs and related SOEs are variously expanding to enable energy sector decarbonisation; in some cases through carbon capture, offsets and trading (a new form of commodity trade); and in others, renewable energy investments (OECD, 2022[14]). Thus, ODA support to scale up due diligence, risk management and basic market

capabilities in NOCs and SOEs becomes crucial if development actors want to see integrity in the energy transition.

Fourth, OECD research shows that a growing diversity of trading and financial actors and novel financing instruments in this field are exposing oil-producing developing countries to new and heightened IFF risks.

- IFFs risks are directly influenced by the nature of the trade financing agreements adopted by traders and oil-producing developing countries. Pre-financing agreements, commodity swaps, off-take agreements, and collateralised lending, for example, each bring distinct IFF risks, some of which are also envisaged in the carbon and energy transition.
- The oil commodity trading sector is dominated by three different kinds of actors – international oil companies, independent commodity-trading companies, and national oil companies – each with different practices in terms of due diligence, risk management and sensitivity to the implications of their activities on host country development. Some, including international energy companies, tend to be multifunctional, highly structured, and well-practised in due diligence and IFF risk management. Conversely, large independent commodity traders typically operate as equity firms (Nesvetailova et al., 2021[4]). This means that equity holders (i.e. traders themselves) are encouraged to take high levels of risk with the promise of substantial personal rewards or returns, with potential downside effects for due diligence and risk management. Although increasingly engaged in financing, commodity trading firms consulted for the purposes of this programme of work have confirmed that, unlike banks, they are subject to limited regulation. With few exceptions, independent commodity traders are not treated as financial institutions and thus are not subject to the disclosure and due diligence requirements that apply to such actors.
- Particularly high IFF risks accompany the operations of large independent commodity traders. An examination of the ownership, equity and accounting practices of these firms suggests that these risks are the result of the following factors:
    - The exceptionally high use of offshore financial centres (OFCs) by large independent traders. OFCs are, among other reasons, often favoured for their low taxation, lenient regulation and provision of banking secrecy, which makes them popular among those who seek to hide illegal activities, criminal identity and criminal ownership of assets. A study of the top 100 global corporations shows that an average of 18% of their group subsidiaries are owned via OFC-based holding companies. By contrast, independent oil and gas trading companies own 97% of subsidiaries via OFC-based holding companies (Nesvetailova et al., 2021[4]).
    - The fragmented ownership, equity and accounting arrangements of large independent trading companies, as well as their centralised pooling of value among different entities and mixing of trading and treasury functions. Although such structures tend to be legal, they will typically weaken states' ability to enforce regulatory standards or punish malfeasance, as assets are sheltered from seizure or fines.
    - The highly sophisticated corporate organisation of commodity traders, which contrasts with the comparatively less dynamic and complex corporate footprint of NOCs as counterparties to the trade. This unevenness enables traders to effectively trade or transfer risks to their advantage, and at the same time creates opportunities for collusion and corruption among the parties.

Fifth, and finally, the vulnerability of developing producer countries to trade-based IFFs has increased as an unintended consequence of policy responses to crises. The retreat of the large banks from the commodity trading sector, due to heightened regulation in response to the 2008 Global Financial Crisis, has seen traders and oil producers turn increasingly to more diverse and un(der)-regulated sources of finance. The evidence shows that NOCs are increasingly relying on large independent traders as financiers of last resort and that a 'drift eastwards' is occurring – including to the Gulf states, Singapore and in particular China – in the financial actors and sources of finance. One consequence of the fewer financing options has been growing macro-critical risk in the form of rising levels of collateralised debt, and a further

weakening of NOC bargaining positions vis-a-vis traders. Persisting oil price volatility, a growing number of sanctions, and the accelerated de-risking or divestment of responsible sources of development financing from the non-renewable energy sector (both corporate and non-corporate) risk further escalating IFFs and unsustainable borrowing as producer countries increasingly turn to non-Paris club and private lenders in the absence of concessional finance.

2 The role of official development assistance in tackling illicit financial flows arising from oil trade activities

Although official development assistance (ODA) providers are well placed to assist developing countries to reduce illicit financial flow (IFF) risks and vulnerabilities, they have not yet made use of potential synergies in their ongoing country programming. This conclusion is based on the following:

- ODA engagements with national oil companies (NOCs) have been both narrowly conceived and executed on a limited scale. In particular, Development Assistance Committee (DAC) members tend to favour a standard suite of policy reforms and modes of engagement, irrespective of the diversity of NOCs, their histories and their political economies. This policy and operational conformity is evident in the tendency of ODA providers to focus on the adoption of standard state-owned enterprise (SOE) reform actions – such as the 'unbundling' or separation of functions, across policy, commercial and regulatory domains of oil governance; or in radically curtailing the NOC's quasi-fiscal expenditure activities. There has also been an over-reliance on adoption by NOCs of revenue transparency norms as the principal means of regulating industry and trading conduct.
- Opportunities have been missed for impactful ODA engagement with NOCs, and the intensity of ODA engagements with NOCs is declining, a trend that is accelerating in the context of Paris Alignment. This at a time in which the need for sustained concessional financing for NOCs, and their counterparts leading the energy transition, has never been greater. A particular incongruity exists between the long and substantial track record of ODA engagements in public financial management (PFM), procurement and financial oversight, and the failure to extend that support to NOCs, despite the fact that NOCs are typically responsible for a country's largest share of revenue, procurable goods and services, and investments. More generally, ODA has failed to provide consistent support to the institutions which combat IFFs, and which are crucial for financial integrity, including supreme audit organisations, financial intelligence units and specialist prosecution, judicial and enforcement capacity.
- Overall, the record of DAC member evaluations of engagements over the past decade reveals little emphasis or impact on NOC performance or in respect of the IFF risks specifically associated with commodity trading. The IMF's current advisory and capacity development roles, and innovative public-private partnering by the World Bank in Mozambiquan gas development are examples of what can and should be done more often.

Although there is currently no readily available body of knowledge or experience about what works, under what conditions and with what approaches with respect to tackling oil trade IFFs, three important lessons have been learned from the broader work on extractive sector transparency.

- First, transparency is a necessary yet insufficient response to IFF risks, and corollary actions are needed to enhance impacts. Efforts by DAC member countries to improve the transparency of contracts, payments and revenue flows in the extractive sector have included an impressive array of donor-funded activities, ranging from dedicated global extractive industry facilities (Extractive Industries Transparency Initiative, EITI) to efforts by advocacy groups to unite media, political leaders, faith-based organisations and prosecutors in response to egregious oil-related corruption (*biens mal acquis*). In advanced economies, increased public awareness of extractive sector corruption has led to regulatory advancements and improved corporate governance, legal and oversight practices. By contrast, in developing oil producer countries, although exceptions exist, extensive evaluations of the array of donor-supported transparency efforts do not lend support to the underlying assumption that public information would be sufficient to trigger collective action and accountability, or to substantially alter the underlying incentives that result in corrupt activities, in producer countries and abroad (OECD, 2023[7]). Corollary approaches are both plausible and warranted, and are further discussed below.
- Second, more direct and sustained engagements with NOCs (and their SOE counterparts) are needed to reduce IFF risks and to support integrity in the energy transition, particularly in decarbonisation and carbon trading where NOCs are expected to play a lead role, alongside partner SOEs. Research underpinning this Guidance has shown the costs of ODA divestment from a sector that is prone to corruption and IFF risks, and yet remains a leading driver of the economy in many countries. Supporting actions that prevent price manipulation and enable enhanced risk management in both the carbon and decarbonised energy sectors, through support to NOCs and their SOE counterparts, could improve domestic resource mobilisation for these countries in the future.
- Third, evidence has shown that technically informed, politically savvy engagements by civil society, advocacy and investigative organisations can be effective in both OECD and developing country contexts, both through direct action and by providing granular knowledge that is valuable to multilateral technical surveillance and operations (OECD, 2023[6]). Yet, to date, the support for such ventures is sporadic and insufficiently funded by reliable and durable commitments (including by ODA providers).
- Fourth, the success of ODA in curbing IFFs will remain limited unless the impact of development programming is enhanced by complementary actions designed to ensure policy coherence for sustainable development. Tackling IFFs in developing countries requires development actors to collaborate with policy specialists, regulators and private sector actors that are responsible for overseeing complex networks, and corporate interests and enablers that sustain them. Targeted engagements on responsible business conduct, public private partnerships, corporate governance and financial investigation are particularly needed, at multi-levels of governance. This is applicable to both OECD countries and offshore financial centres (OFCs), some of which are beyond the reach of regulatory institutions.

3 Policy guidance to better target and utilise official development assistance (ODA)

In the context of the energy transition and in a sector that has seen relatively low levels of official development assistance (ODA) support despite the high illicit financial flow (IFF) risks involved,[8] the following policy guidance is suggested:

1. **Understanding IFF risks in the environment of operation.** Ensure that the 'governance filters', now commonly an integral part of the country diagnostics, inform strategic and programmatic decisions in development programming. In its board update, the World Bank made a commitment to automatically consider IFFs in the context of any public financial management project. Other ODA (bilateral and multilateral) providers are strongly encouraged to follow suit (World Bank, 2017[15]).
2. **Engage NOCs to counter IFF risks and set the tone for integrity in the energy transition**. The objective of such efforts would be to develop NOC capabilities in the management and oversight of finances, commodities marketisation and trading, as well as risk management to enhance the overall performance of NOCs in decarbonisation, and to counter IFF risks systematically. Four actions are key to improve engagement with NOCs and mitigate IFF risks:
    a. **Map the diverse roles and functions of partner NOCs, and the networks of trade, finance and business with which such entities are affiliated.** The purpose of such mapping is to inform ODA strategies for NOC engagement, and to reveal its links to the global market system. Given the changing energy context, such efforts would, by necessity, include a mapping of any obligations related to the energy transition, including carbon capture, offsets/mitigation and trading.
    b. **Discuss with developing country partners practical ways in which public sector reform initiatives already supported by ODA programmes – in PFM, procurement and accounting – could be extended to include NOCs.** With an average of USD 220 million invested year-on-year to support PFM and procurement reform,[9] development co-operation actors are encouraged to include NOCs within the suite of support they offer as part of wider public sector reform initiatives. Some DAC members have also accumulated considerable experience in specialised areas of PFM that are immediately relevant to NOC performance (i.e. public investment management of assets created through sovereign wealth funds).
    c. **Assist NOCs to build capabilities and expertise in commodity marketisation, pricing and trading, drawing on existing tools. ODA support to the commercial activities of governments and NOCs has been scant.** This is despite the potential of enhanced trading expertise combined with proper price risk management to increase the revenue NOCs and their governments receive on behalf of their peoples, reduce producer countries' reliance on high-risk deals, and improve their ability to manage market fluctuations to their advantage. Improvements in the position of producer countries vis-a-vis the global market could be

achieved by strengthening their capabilities in commodity marketisation, pricing and trade, and through joint investments, catalysed by ODA, in due diligence and risk management (see below on risk management). NOCs often ask their trading counterparties to 'teach them' the trade, raising direct conflicts of interest. Peer-to-Peer (P2P) learning and twinning arrangements among development country NOCs and SOEs, including with members of the OECD Working Party on SOEs, offer significant opportunities to enable institutional development, and to begin to lay the foundation for integrity in the energy transition among NOCs, as well as SOEs.

d. **Assist NOCs to build informed compliance and risk management capabilities.** This can be achieved in several ways, including through blended finance and credit risk or compliance guarantees. This could also be facilitated through regular IMF surveillance and engagement, in one of two ways: through discussion and agreement among IMF Executive Directors, or through the creation of a standing IFF advisory facility through which the IMF and development cooperation actors could resource standing IFF risk-management knowledge and experience. It is important that DAC members support the routine application by the IMF of its recently revised fiscal transparency and governance frameworks. Finally, remaining alert to the potential of unintended effects resulting from the energy transition, and scaling up ODA commitments and support by development financiers to NOCs but also SOEs will be particularly important. Among the unintended effects of a fast-paced energy transition are: the risks of a potential rise in predatory financing to support oil and gas production, sales and trades, in the absence of concessional development financing; the potential for increased debt and rising incidents of debt distress; the locking-in of unsustainable carbon intensive energy projects; and IFFs in the energy transition, particularly in carbon trade.

3. **Adopt a multi-scalar approach to addressing the problem of IFFs**

a. **Acknowledge, invest in, protect and leverage the critical role of global and domestic investigative, supreme audit and advocacy networks** to ensure accountability for malfeasance, but also to reveal institutional and systemic weaknesses. These measures could also serve to better inform the targeting of ODA support, and to minimise the risk of perverse or unintended impacts resulting from ODA interventions.

b. **Assess the relevance and feasibility of establishing an IFF advisory facility to support energy sector policy and governance experts, in OECD and developing producer countries.** Such a facility does not currently exist and would be in recognition of the value of technically informed and politically savvy engagements with producer countries, whether by donor agencies/IFIs, or by CSOs, or by academic/professional agencies and networks. The facility could provide *just-in-time* information and advisory support to the range of actors and operations that have proven to be critical in tackling IFF risks, including members' country strategy and development programming, as well as to donor and IFF policy and operations (e.g., IMF missions in relation to Fiscal Transparency Code Pillar 4), NOC and state regulatory agencies, and specialist networks of academics and professional experts and CSOs. Delivery could take the form of short-term technical assistance and expert dialogue, as well as longer running special purpose investigations of systemic issues – e.g. the relationships between rising indebtedness and vulnerability to IFFs in oil trading, or of issues arising in particular transactions that likewise expose producer countries to IFF risks. The facility could also provide material support to advocacy agencies concerned with energy sector corruption and governance reform. The character and governance of such a facility would require further consultation, elaboration, and refinement, as part of the DAC's ongoing IFF policy dialogues.

c. **Collaborate with dedicated policy networks to address the offshore, transnational networks and enablers of IFFs, through initiatives to improve policy coherence for sustainable development.** This could include direct engagements between the DAC and the OECD's Investment Committee, Working Party on Responsible Business Conduct and

Working Party on State Owned Enterprises. Further horizontal engagements are recommended with the Financial Action Task Force (FATF) on trade-based money laundering and managing unintended consequences of the FATF Standards, and with the International Institute of Finance to establish policy guidance on the transparent and sustainable provision of credit.

4. **Leverage IMF capabilities and engagement**
   a. **Leverage IMF Article IV surveillance to identify and mitigate 'macro-critical' IFF risks, at system and transaction levels**. Working through the IMF's Board of Executive Directors, this would involve enabling and resourcing the IMF to utilise its Article IV capabilities to engage, variously, with ministries of finance, energy and economy but also relevant SOEs (most prominently NOCs) to provide *just-in-time* guidance on managing 'macro-critical' IFF risks, including in the energy transition. Specific tasks and functions might include a review of existing or prospective oil and carbon trade financing agreements, and any prospective resource-backed lending arrangements, to optimise domestic resource mobilisation and reduce IFF risks. In the context of resource constraints on the part of the IMF, contracting out such expertise or commissioning the services of an IFF advisory facility, as per 25(b) above, might also be envisaged.
   b. **Improve policy coherence for sustainable development through IMF Article IV surveillance of macro-critical IFF risks in countries at source, transit and destination of IFFs.** Again, working through the IMF's Board of Executive Directors, this would require moving away from largely voluntary and discretionary existing Article IV arrangements to enabling more systematic and structured engagements across low-, middle-income and advanced economies. The goal would be to tackle the transnational links of macro-critical IFF risks, facilitate approaches to IFFs that advance policy coherence for sustainable development, and identify and respond to IFF enablers.
   c. **Deepen the IMF's collaborative engagement with relevant actors on macro-critical IFFs, including through a potential IFF advisory facility** (i.e. FATF, UNCTAD, International Institute of Finance) to enhance the IMF's surveillance and monitoring capabilities.
5. **Corollary actions and role of EITI partnership to enhance the impacts of transparency**
   a. **Support actions that enhance integrity in the selection of suppliers and intermediaries.** Large independent traders often rely on intermediaries to provide in-country services (i.e. facilitation of day-to-day operations, opening doors and securing business in foreign countries), yet the use of third-party agents is associated with corruption risks. Some trading firms have developed policies and safeguards to manage third-party agents (i.e. screening out suspicious intermediaries, and those with links to politically exposed persons, for example) but information sharing about these practices remains limited. The EITI Commodity Trading Working Group, where many of the top trading firms globally meet, could be leveraged to develop guidelines and act as a platform for information sharing on best-practices regarding procurement rules and processes, supplier identities, local procurement and spending. Together with EITI, it is worth exploring how existing global reporting standards by EITI and partners can be used for member countries and supporting companies to promote good supplier governance.
   b. **Take measures to strengthen the data disclosure results chain.** One way to achieve this is to ensure collateral support to government agencies – audit, financial intelligence, investigative, prosecutorial, and judicial – to help these entities to interpret and use publicly released data. This might also include support to CSOs, media and related investigative and advocacy institutions, although not as proxies for government. Using existing data disclosures to inform the design and implementation of current and prospective ODA projects and programmes, including through targeted measures to track and reduce IFF risks, would also be helpful. EITI's forthcoming guidance on 'Making data disclosure more successful and

impactful in a given context' aims to identify the data that may be necessary and relevant for stakeholders to scrutinise commodity traders' behaviour and hold them to account.

c. **Support efforts to enhance monitoring and tracking of commodity-backed lending, including from the private creditors.** Several actions could be taken including measures to better reflect commodity-backed loans in debt statistics and tracking mechanisms, convene regular policy exchanges with the private sector (particularly large independent traders) on due diligence, debt sustainability, transparency and management, under OECD stewardship or elsewhere, and, together with other major stakeholders (such as EITI), supporting policy discussions that seek to enable greater transparency in resource-backed lending.

d. **Support efforts to build the evidence on the corruption and IFF risks arising in the energy transition, to better understand the implications of these risks for development.** As yet, insufficient effort has been made to empirically establish the linkages between corruption and IFF risks in the carbon market and renewable energy sector. Understanding the commonalities and distinctions between these sectors, in terms of the actors, financing instruments and institutional systems and processes involved, would provide an important basis to ensure integrity in the energy transition.

References

Calderon, C. and Zeufack (2020), *Borrow with sorrow? The changing risk profile of sub-Saharan Africa's debt, Policy Research Working Papers, No. 9137*, World Bank, http://hdl.handle.net/10986/33293. [16]

Gillies, A., L. Kummer and M. Guéniat (2014), *Big Spenders: Swiss Trading Companies, African Oil and the Risks of Opacity*, Natural Resources Governance Institute. [12]

Hickey, S. and G. Mohan (2021), *IFFs and Commodity Trading: Assessing the impact of the oil governance agenda on Africa's new producers*, OECD Publishing, https://www.oecd.org/development/accountable-effective-institutions/assessing-impact-oil-governance-agenda-africas-new-producers.pdf. [5]

IMF (2022), *Macroeconomic Developments and Prospects in Low-Income Countries, IMF Policy Paper*, IMF, https://www.imf.org/en/Publications/Policy-Papers/Issues/2022/12/07/Macroeconomic-Developments-and-Prospects-in-Low-Income-Countries-2022-526738. [10]

Leke, A., P. Gaius-Obaseki and O. Onyekweli (2022), *The future of African oil and gas: Positioning for the energy transition*, McKinsey & Company, http://www.mckinsey.com/industries/oil-and-gas/our-insights/the-future-of-african-oil-and-gas-positioning-for-the-energy-transition. [11]

Malden, A. and J. Williams (2019), *Big Sellers: Exploring the Scale and Risk of National Oil Company Sales*, Natural Resource Governance Institute, https://resourcegovernance.org/analysistools/publications/big-sellers-exploring-scale-andrisk-national-oil. [13]

Nesvetailova, A. et al. (2021), *IFFs and Commodity Trading: Opportunities for identifying risks in energy traders' financial conduct using groups' corporate filings*, City University of London. [4]

OECD (2023), *Governing through transparency: Corruption, accountability and illicit financial flows in oil trading*, OECD Publishing, https://www.oecd.org/dac/corruption-accountability-illicit-financial-flows-oil-countries.pdf. [7]

OECD (2023), *Investigative journalism and fiscal transparency: Catalysts for addressing corruption in oil-producing developing countries*, OECD Publishing, https://www.oecd.org/dac/invetigative-journalism-fiscal-transparency-iff.pdf. [6]

OECD (2022), *Equitable Framework and Finance for Extractive-based Countries in Transition (EFFECT), OECD Development Policy Tools*, OECD Publishing, https://doi.org/10.1787/7871c0ad-en. [14]

OECD (2021), *Typology of Corruption Risks in Commodity Trading Transactions*, OECD Development Policy Tools, OECD Publishing, Paris, https://doi.org/10.1787/590e80e8-en. [9]

OECD (2018), *Illicit Financial Flows: The Economy of Illicit Trade in West Africa*, OECD Publishing, Paris, https://doi.org/10.1787/9789264268418-en. [1]

Porter, D. and C. Anderson (2021), *Illicit financial flows in oil and gas commodity trade: Experience, lessons and proposals*, OECD Publishing, https://www.oecd.org/development/accountable-effective-institutions/illicit-financial-flows-oil-gas-commodity-trade-experience.pdf. [3]

Shah, A. (2016), "Corruption and Decentralized Public Governance", *World Bank Policy Research Working Paper*, No. 3824, World Bank, Washington, D.C., https://documents1.worldbank.org/curated/en/153481468177556563/pdf/wps3824.pdf (accessed on 12 June 2023). [2]

Signé, L., M. Sow and P. Madden (2020), *Illicit Financial Flows in Africa: Drivers, Destinations, and Policy Options*, Brookings Institution, https://www.brookings.edu/research/illicit-financial-flows-in-africa-drivers-destinations-and-policy-options/. [8]

UNCTAD (2020), *Tackling Illicit Financial Flows for Sustainable Development in Africa*, United Nations Publications, https://unctad.org/system/files/official-document/aldcafrica2020_en.pdf. [17]

World Bank (2017), *Domestic Resource Mobilisation and Illicit Financial Flows: Board Update*, The World Bank, https://documents.worldbank.org/en/publication/documents-reports/documentdetail/877291492623853466/domestic-resource-mobilization-drm-and-illicit-financial-flows-iffs-board-update. [15]

Annex A. Illicit financial flow practices in oil commodity trading

Table A.1. IFF vulnerabilities in first trade oil sales

1. Selection of buyers and allocation of sales contracts	2. Sales transactions and collection of revenues	3. Collection and transfer of revenues into national spending systems
• Opacity and discretion in bidding processes • Absence of competitive and open bidding processes • Favouritism and political capture through tender evaluation criteria and prequalification of bidders • Inadequate legislative, regulatory and governance framework of the licensing • process • Kickbacks, bribery and collusion with public officials to secure contracts • Kickbacks and collusion with corrupt intermediaries • Selection of buying companies with insufficient capacity to lift and market the products	• Kickbacks and collusion resulting in unsustainable financing arrangements (e.g. illegal pre-financing and resource backed loans resulting in debt distress) • Abusive transfer pricing and fraud in sales/financing agreements (e.g. commodity swaps) • Tax evasion in commodities for export • Under or over invoicing at export terminals • Fraud and document falsification in book- and record-keeping or • audit reporting • Oil bunkering and theft • Back-to-back sales, immediate re-sales, crude-for-refined products swap contracts	• Extortion, embezzlement and misappropriation of collected revenues • Lack of transparency and oversight in revenue transfer from NOC to central government • Money laundering through opaque offshore corporate entities and subsidiary ventures • Misallocation or diversion of revenues through opaque subsidiary ventures • Systemic under-taxation and tax concessions bypassing existing tax rules

Notes

[1] Amongst others Natural Resources Governance Institute (NRGI), Public Eye, Extractive Industries Transparency Initiative (EITI), the Financial Action Task Force (FATF), International Monetary Fund (IMF), the OECD Directorate for Financial and Enterprise Affairs, OECD Centre for Tax Policy and Administration, OECD Development Centre, OECD Governance Directorate. The Guidance also benefitted from policy dialogue with the African Union Commission, and discussions with the commodity trading industry actors including Vitol, Mercuria, Trafigura, Glencore, Sahara, and other members of the EITI Commodity Trading Working Group.

[2] Averages for 2013-2015. Foreign direct investment figure is from UNCTAD (2020[17]). ODA figure is from the OECD Creditor Reporting System (official donors, total, disbursements).

[3] From 2013 to 2018, oil exporters' median debt-to-GDP ratios grew from 31% to 54% of GDP. Excluding Nigeria, the public debt level of oil-rich Sub-Saharan African producers increased by more than 40% since 2013, to 73% of GDP in 2018 (Porter and Anderson, 2021[3]).

[4] This number excludes Nigeria. See Calderon & Zeufack (2020[16]).

[5] Note this is also the case for LICs writ-large where the IMF has observed private creditors as being responsible for as much as 17% of public debt (IMF, 2022[10]).

[6] Ibid.

[7] Ref: interview with Petrobras Compliance Officer, and panel event at International Anti-Corruption Conference (IACC), December 2022.

[8] In 2018, approximately USD 17 million was spent by bilateral DAC donors to support the oil and gas sector, down from USD 25 million in 2017. In terms of total numbers, for 2018 this represents 0.015% of total ODA from bilateral DAC members and 0.02 percent for 2017. The CRS does not provide a breakdown of the specific share of that ODA that was received by the NOC (Porter and Anderson, 2021[3]).

[9] These figures are extracted from the OECD Creditor Reporting System (CRS) and correspond to PFM and procurement support, by bilateral and multilateral donors, to the following 13 countries over the period 2010-19: Algeria, Angola, Chad, Egypt, Equatorial Guinea, Gabon, Ghana, Libya, Nigeria, Republic of the Congo, South Sudan, Sudan and Tunisia.