Using Extractive Industries for Sustainable Development

International Oil and Gas Resources Management Seminar

Summary Report

Libreville, Gabon
April 27-30, 2008

THE WORLD BANK

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Extractive Industries Transparency Initiative (EITI)

The EITI is a global initiative established in 2002 to promote and support improved governance in resource-rich countries through the full publication and verification of company payments and government revenues from oil, gas and mining. As a voluntary association of various stakeholders with shared goals, the structure of the global EITI movement has been an open and participatory one. An EITI Board, with an elected chair and members representing resource-rich developing countries, donors and supporting countries, international and national oil, gas, and mining companies, civil society members, and investor representatives, oversees the Initiative. International development agencies such as the World Bank, the International Monetary Fund, and the African Development Bank attend EITI Board meetings as observers.

A Secretariat based in Oslo, Norway supports the work of the EITI Board and coordinates EITI work overall. More information on the Initiative, the Board, and Secretariat can be found at http://www.eitransparency.org.

*Cover photo of seminar: Participants in oil contract negotiation role playing

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Acknowledgments

This Seminar was organized through the efforts of various partners, including: the World Bank, the African Development Bank, the Global Corporate Governance Forum, the United Nations Development Program, and the International Monetary Fund. The organizers wish to express their gratitude for their continued financial and logistical support, and their intense cooperation which made this seminar a success.

The organizers also wish to thank the delegates from the 13 participating countries for their presence and the lively debates they produced. Special thanks are extended to the seminar speakers for liberating their busy schedules to share their valuable expertise with each other and the participants.

Particular thanks go out to the staff in the Country offices of the organizing partners in Gabon, under the leadership of Olivier Frémond (World Bank), Bassary Touré (AfDB), Djibo Bintou (UNDP), and Samba Thiam (IMF). Philip Armstrong and the staff of the Global Corporate Governance Forum provided equally invaluable support through their Washington offices. Further acknowledgments go out to Tove Strauss (AfDB Tunis) and the French cooperation in Gabon.

Eleodoro Mayorga Alba (COCPO-World Bank) was instrumental in the development of the agenda, in getting so many high-level presenters to Libreville and in ensuring the coherence of the Seminar work. Steve Stoop and Patrice Etong Oveng, from the Bank Libreville office, provided an enormous contribution in ensuring the logistics and the contact with the local press.

The publication of these proceedings was made possible by the much appreciated reporting done during the seminar by Celine Ambrosetti (AfD), Taïb Diallo (UNDP), Assitan Diarra (AfDB), and Steve Stoop (World Bank). For the final editing and formating, special thanks go to Esther F. Petrilli-Massey (COCPO).

Executive Summary

Natural resources are an important and vital source of revenue for many developing countries. Those resource-rich countries depend on their revenues to drive growth. The World Bank recently launched a new initiative to help developing countries manage and transform this new wealth into long-term economic growth and to spread the benefits more fairly among their people.

The so-called Extractive Industries Transparency Initiative Plus Plus (EITI++) was designed to help countries develop their capacity to handle the boom in commodity prices and channel the growing revenues into reducing poverty, hunger, malnutrition, illiteracy, and disease. The success of the program and its effectiveness depends on the countries themselves, which must take responsibility for managing the resources and setting the targets for positive results. The initiative aims to improve the awarding of petroleum contracts, monitoring operations, and the collection of taxes and royalties. It will also help countries build capacity to make economic decisions on resource extraction, managing price volatility, and investing revenues effectively for national development.

This seminar in Gabon illustrates the first step in this process. In close partnership with other agencies (International Monetary Fund, African Development Bank, United Nations Development Bank, and the Global Corporate Governance Forum), the World Bank organized an international seminar on oil and gas resources management from in Libreville. Over four days (April 27-30, 2008), seminar participants focused on building the capacity to manage revenues from these industries, especially oil and natural gas, including the negotiation and implementation of oil and gas contracts. With surging oil prices, the effective and responsible management of the added revenues can prove instrumental in the fight against poverty.

Government officials from 13 African countries (Algeria, Angola, Burundi, Central African Republic, Cameroon, Equatorial Guinea, Democratic Republic of Congo (DRC), Gabon, Ghana, Mauritania, Nigeria, Republic of Congo, and São Tomé and Principé) participated in the seminar as well as representatives from national oil companies such as SONANGOL and SONATRACH. The seminar opened with a keynote speech by Alan Gelb, Acting Chief Economist of the World Bank and included presentations by experts from

many organizations including the World Bank, International Monetary Fund (IMF), African Development Bank (AfDB), United Nations Development Bank (UNDP), the French Petroleum Institute (IFP-ENSPMFI), the International Petroleum Associates Norway (IPAN), the EITI international secretariat, and representatives from the private sector like Total and KPMG.

The three-day event allowed the participants to exchange experiences and learn from the mistakes and successes of their peers in the management of natural resources. The interactive nature of the seminar produced lively debates as all participants were invited to present their views on a wide range of subjects. The seminar participants returned to their countries with an improved understanding on the management of natural resources and the potential impact on development.

Introduction

Five central themes were addressed throughout the three-day seminar. After each plenary session, participants were given the opportunity to interact with the speakers and explore those issues of particular interest to them.

1. Good Governance

Good governance is a key element in the effective management of natural resources, yet it is often elusive and difficult to define. Good governance implies responsible government with a focus on using the country's natural resources to obtain social and economic development. The human development aspect of governance was touched on by John Kakonge (UNDP), and the consensus was that the responsible management of natural resources can go a long way in combating poverty and redressing the inequalities that plague many African countries. In Bassary Touré's (AfDB) presentation, it was stressed that the current oil boom offered African leaders a second chance to 'get it right,' since the first resource boom of the 1970s was squandered. For some established producers like Gabon, this new boom may very well be the last chance to get it right, as natural resources are non-renewable and dwindling. Participants agreed on the urgency of this matter, and their presence at the seminar confirms their conviction to improve their institutional capacity in managing their resources. The representatives of participating countries alluded to the fact that throughout the continent, the political will to improve governance is a key element in 'getting it right,' and many governments have demonstrated their adherence to such principles. Trond Kubberud's (IPAN) presentation did not aim to provide a 'best practice' model, however, it did stress the importance of a sound institutional framework and the use of qualified personnel to implement government strategy in the oil and gas sector. Participants were particularly interested in the way Norway manages its relations with international oil companies, and how it goes about making the national oil company work together with these international oil companies (IOCs).

2. Capacity Building

While wanting to implement policies with responsible governance as a central concern, African governments are suffering from a lack of institutional capacity to implement such policies. With recent

discoveries throughout the continent, many countries without previous experience in the oil and gas sector are facing tough negotiations with the seasoned experts of IOCs. One of the aims of the new EITI++ is to support governments in building the capacity to negotiate such contracts in order to extract the maximum benefit for the country as a whole. A first step in this direction was taken during the seminar with Michel Vuillod's (IFP) presentation. After presenting a theoretical framework for negotiation techniques, Mr. Vuillod offered the participants an opportunity to simulate an oil contract negotiation. This exercise was particularly useful for countries with limited experience in the oil and gas sector. Lively debates ensued on the importance of mastering technical issues and seismic data and how to use this information to come to an agreement which is centered on the country's sustainable development. The negotiating techniques presented such as the SWOT (Strengths, Weaknesses, Opportunities, Threats) analysis proved to be of great interest to the participants. Ghislain Pastre's (legal consultant) presentation offered a legal framework to negotiate and implement oil and gas contracts. A sound legal framework should take into account all the steps, from developing the initial petroleum law, to bidding procedures and the actual attribution of exploration acreage. To implement such measures, participants concurred on the need for institutional capacity building and the training of government officials through the use of external consultants. A sound legal framework encourages investors and enables a country to extract the maximum benefit out of its natural resources. The case study that supported this argument was presented by Syanga Abilio (SONAGOL), which explored how Angola developed its legal framework and how the country developed its framework for bidding procedures. The participants judged this presentation to be very useful as it enabled them to see how the principles advanced by Ghislain Pastré could be implemented and how it benefits an oil-producing state.

3. Corporate Governance

Many oil-producing countries decide to create a national oil company to manage exploration and production facilities. Corporate governance is crucial to the functioning of such national oil companies (NOCs), and it impacts every segment of the economy, as well as government agencies. A critical element in analyzing economic actors is the auditing process through which they have to go. Alexis Majnoni (KPMG) provided a well-received presentation on the tech-

nical aspects of audits and the areas of particular importance to an auditing company. Participant cited auditing as being essential to the EITI process. However, a contentious issue was raised when discussing the actual results of those audits. While auditing company or government accounts is a necessary first step, how to manage and use the results of these audits to improve governance and accountability is another element that is often overlooked. After this technical discussion, Jean-Pierre Cordier's (Total) presentation went into detail on how a large multinational oil company like Total perceived corporate governance as vital to their overall strategy. The rights of shareholders and duties of the boards were areas that proved to be of particular interest to the participants. The roundtable held at the closing of Plenary IV produced an open exchange of opinions on such governance issues, with a particular focus on the tension between confidentiality and transparency.

4. Economic management

Countries active in the extractive industries have huge resources at their disposal. Nevertheless, many of these countries are plagued by social inequalities, endemic corruption, and a weak infrastructure. Samba Thiam, International Monetary Fund (IMF) offered his views on how to avoid the 'resource curse' and transform natural resources into strong economic growth. Participants identified the need for budget restraint and a targeted investment policy as key issues to ensure macroeconomic stability. Charles McPherson (IMF) expounded on the need for a sound fiscal regime as being equally instrumental for this stability and on the mechanisms and best practices in the field, which proved to be of great interest to the participants, in particular representatives from their respective ministries of finance. Other mechanisms contributing to the pursuit of macroeconomic stability were presented by Ivan Zelenko and Stephan Piot (World Bank Treasury), whose discussion on commodity savings funds inspired several participants to re-examine their country's policy with regard to such funds. Furthermore, these presentations allowed the participants to discover how such funds can be used in order to ensure a stable macroeconomic environment combined with strong economic growth. Particularly interesting was the management of oil price volatility, the major factor in the 'boom and bust' cycle that has plagued oil-producing countries in the past. This cycle can be avoided through sound hedging and investment policies.

5. Transparency

While the above-mentioned issues are obviously imperative, none of it is really possible without embracing transparency. Eleodoro Mayorga Alba (World Bank) covered the EITI principles, and Tim Bittiger (EITI Secretariat) presented the policies and activities of the international EITI secretariat. Finally, Paolo de Sa (World Bank) explained the evolution from EITI to EITI++ and its implications for oil- and gas-producing countries for the nature of their partnership with multilateral organizations. While participants agreed on the necessity for transparency, the debates centered on the tension between what should be made available to the public and which information should be considered as highly confidential information. The publication of contracts was one of these contentious issues. While participants did see the usefulness of making such contracts available to the public, some apprehension could be perceived as some of the information in such contracts is considered confidential, such as signature bonuses. Governments are hesitant to publish the full contract, first not to jeopardize their relationship with the oil company as the publication of such information might unveil company strategy, and second because increased public scrutiny requires a well-educated civil society, in order to prevent the information from being misconstrued. Nevertheless, neither of these concerns can justify a lack of transparency in the extractive industries. While EITI was centered solely on transparency in financial flows between governments and oil companies, EITI++ encompasses much broader measures, such as capacity building through technical assistance. A clear and transparent legal framework is necessary, as is the political will of governments to comply with the EITI principles. Adherence to the EITI++ is a voluntary engagement by governments.The growing number of candidate countries demonstrates the importance that many governments attach to concerns about transparency in natural resource management.

Plenary I: Introduction

Lecture 1: The Challenges of Human Development in Oil and Gas Economies

– John Kakonge, Senior Deputy Director, Special Unit for South South Cooperation, UNDP

Promoting human development means expanding people's choices for improving their lives or livelihood. These choices include wide-ranging issues such as employment, education, prevention and/or quality treatment of diseases, housing, and improving governance. Oil and gas economies typically face specific obstacles to achieving this kind of human development. With developing countries at the forefront of the new energy debate, the good management of these resources becomes evident. Within the next 3-7 years as many as 30 new oil-producing countries could reach commercial exploitation of their oil and gas sectors. In order for these countries to transform the oil revenues into human development, a strong macroeconomic policy must be given a high priority. These policies include rational public sector investments, developing human resources, transparency, and encouraging a competitive economy.

In order to help these countries achieve this goal, UNDP proposes four focus areas:

(1) Private sector partnership and corporate social responsibility—aimed at cooperation with companies active in the extractive industries.

(2) Capacity building through various programs adjusted to each country's specific needs and capabilities.

(3) Knowledge sharing and policy dialogue with technical assistance projects.

(4) South-south cooperation—the sharing of solutions and experiences among developing countries.

The hydrocarbon sector is fraught with potential political, economic, environmental, and social consequences that can have potentially negative impacts on a country and its citizens. Managed well, oil and gas resources offer developing countries great opportunities to accelerate the pace of human development. Managed poorly, oil

and gas revenues may in fact impede human development and worsen income inequality.

Lecture 2: Governance, Development, and the Oil Sector

– Bassary Touré, regional representative for Gabon, AFDB

Africa is currently the world's fastest growing source of oil and much of the continent's potential is yet untapped. With surging oil prices, the development of extractive industries offers some great opportunities for Africa, but also poses some great challenges such as a higher risk for conflict and corruption tied to the so-called 'resource curse.' The challenge for Africa in the 21st Century is to 'get it right,' which in the positive scenario would lead to a well-managed development of the petroleum industry in several new countries, with broad-based growth and poverty alleviation. However, the equally plausible negative scenario could mean that almost all new producers end up with mismanagement, corruption, low growth, and high poverty. Furthermore, new conflicts may erupt, with spillover effects on the subregion.

The key to sustainable development is to allow the petroleum industry to contribute more to socioeconomic development and to transform resource endowments into poverty reduction and sustainable development. Central issues in the pursuit of this goal are improved governance, transparent legal and regulatory frameworks, more capacity and accessible information. The AfDB will adopt a new governance strategy in May 2008, the Governance Strategic Directions and Action Plan (SDAP) for 2008-2012. The SDAP will concentrate on accommodating country demands and providing tailored approaches with the aim to complement and strengthen country systems, instead of bypassing them. Another key point in the SDAP is the AfDB's commitment to stay engaged, even in fragile and high risk environments.

In order to implement this program, the AfDB has developed four support areas:

(1) The African Legal Support Facility calls for the establishment and maintenance of a roster of law firms and experts available to represent regional member countries (RMCs) as well as training and equipping of lawyers from RMCs with the legal expertise to deal with complex com-

mercial and investment transactions in the extractive sector.

(2) AfDB has endorsed the EITI and EITI++ and has taken a two-pronged approach to its engagement with this initiative: advocacy to create political will among countries that have not endorsed the EITI and provide technical and financial assistance for EITI implementation.

(3) For any of these programs to succeed, AfDB will give its support to institutional strengthening focused on technical, human, and institutional capacity while promoting good financial governance and sound public financing policies.

(4) To enhance economic and financial management, AfDB will support the development of sound investment and environmental guidelines, taxation regimes, and labor laws. In order for this strategy to succeed, it is important to provide support before exploration starts and contracts are signed.

There is nothing inevitable about the resource curse. Africa missed the first round of opportunities and several countries experienced violent conflicts, indebtedness, and rising poverty. Occasioned by the current unprecedented "resource boom," Africa must seize this second opportunity for shared growth and sustainable development.

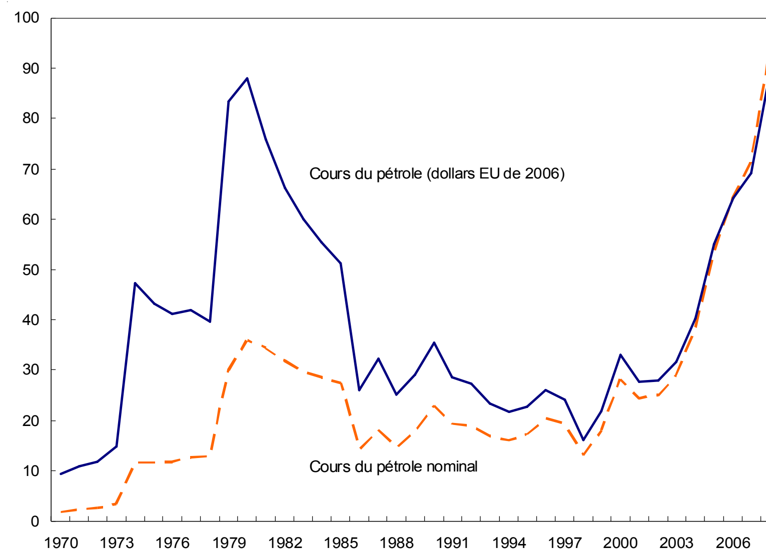
Lecture 3: Macroeconomic Aspects of Management of Revenue from Natural Resources

– Mr. Samba Thiam, Resident Representative for Gabon, IMF

Because of the inherent volatility of oil prices and revenues, macroeconomic policies in countries active in the extractive industries face some serious challenges for achieving macroeconomic stability. When oil revenues are high, many countries tend to unleash budgetary constraint. When the oil prices finally go down, it is very difficult to cut down these expenses, mainly civil service salaries and infrastructure works. This logically leads to high debts which in turn negatively affects the rest of the economy. To counter this threat to macroeconomic stability a sound budgetary policy should aim to save some of the revenues, which alleviates budget pressures at times

when oil prices are low. Governments should keep their spending on the same level as their human and institutional capacity allows them to assure the quality and usefulness of the projects undertaken.

FIGURE 1: OIL PRICE VOLATILITY



An oil boom obviously tends to inflate government budgets,; however while these rents are being spent the Dutch disease lurks in the background. Exchange rates and prices for non-traded goods rise rapidly which destroys the non-oil economy, and increases dependence on a single economic sector: extractive industries. With a volatile oil market, such dependence puts great stress on the pursuit of macroeconomic stability. Sound public finance policies are crucial in avoiding the pitfall of the Dutch disease. A viable policy should take into account future oil production and prices, provide for a certain amount of the current windfall to be put aside for saving and by acquiring external financial assets, and importantly continuing the push to diversify the economy to counter dependence on the oil sector.

Transparency is crucial if these policies are to succeed to assure that the oil rents are used to develop a stable and diversified economy. Without transparency, a country is exposed to several important risks: corruption, capital flight, and an inefficient allocation of the resources at hand. This is where the EITI comes into play due to its focus on

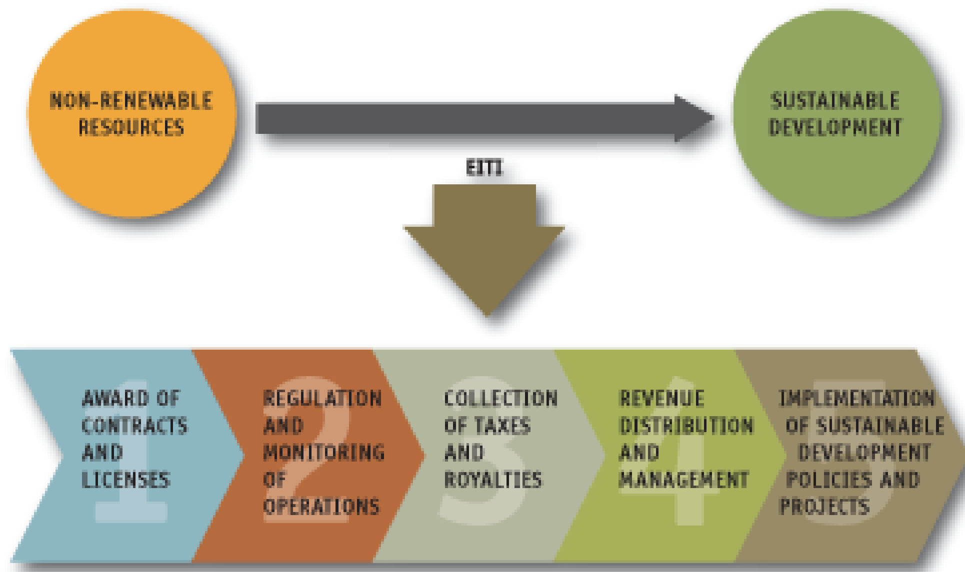
transparency in public finances. The IMF supports the EITI by encouraging countries to endorse the initiative, identify best practices, publishing IMF reports, and making reports on the observance of standards and codes (ROSC) in public financing.

Lecture 4: A Framework for the Management of Non Renewable Resources in Sub-Saharan Africa

— Eleodoro Mayorga Alba, Coordinator SSA Extractive Industries, COCPO, World Bank

Extractive industries should contribute to sustainable development and poverty reduction in Sub-Saharan Africa. Any policy regarding the oil, gas, and mining sectors should be based on principles of transparency and good governance. In addition, countries need to take into account environmental and social challenges and develop a long-term development strategy within a solid macroeconomic environment. A government's political determination to implement these measures features highly as a factor in the program's success.

Figure 2: The Value Chain



To use non-renewable resources for sustainable development, policies must go through a value chain, from the initial contract awards and tax collection to implementing government policies. Throughout this value chain, several transversal issues remain, such as good

governance based on laws, regulations, and sound contracts founded on the principles of transparency and fair competition. While these principles are important, the institutional and human capacities of governments to be able to implement these policies are another critical issue.

The first link in the value chain is contract awards and licensing, which necessitates a sound legal, contractual, and institutional framework. The licensing rounds should follow competitive and transparent procedures. After the contracts have been awarded, the next link is regulation and oversight of operations. These regulations include technical, economic, and environmental regulation. To successfully enforce these regulations, governing institutions need to have sufficient capacity to oversee them. The third sequence in the value chain refers to tax collection and royalties. Again, transparency is essential to assure the rent collection . Following the rent collection, the question remains on how to manage them; a sound macroeconomic budget should be in place bearing in mind the volatility of the non-renewables market and savings mechanisms should be implemented in a transparent way. The fifth and final link in the value chain is to implement sustainable development projects with investments that fully integrate the country's poverty reduction strategy and contribute to the sustainable development of production areas.

The general framework presented here offers a valuable tool to identify policy deficiencies and to determine what kind of technical assistance these countries require to improve governance and transparency throughout all five links in the value chain.

Plenary II: Auction of Exploration Acreage

Lecture 5: Preparing an Exploration Campaign and Developing a Model Contract

– Ghislain Pastré- Legal Consultant

Awarding contracts is central to manageming natural resources because it conditions the quality of investors and the rents the state will derive from their activities. To ensure that producing countries get the maximum benefit from their natural resources, this process should follow competitive rules for contract awards that guarantee fairness, objectivity, and transparency in the award decisions.

There are two types of procedures to go about this matter: (i) negotiated procedures; and (ii) the invitation to tender, which can be either open or restricted, after an initial selection of candidates. While the developed oil producers such as Norway and the United Kingdom all use the invitation to tender method, in Africa the practices vary widely. Invitation to tender usually leads to the best results, as competitive bidding, transparency, and better governance lead to higher shares for the government. Nevertheless, this is not always applicable as it presupposes certain conditions such as previous experiences in the oil sector and a sound legal and fiscal framework, which is a long and difficult process to implement.

The overriding goal of such an invitation to tender is for the government to get the best possible offer for the country. How this is determined is a matter of strategic political choices, such as: (i) where will the rents be invested; (ii) what are the financial conditions; and (iii) what will be the effects on the local economy. Transparency is crucial to prevent corruption. Furthermore, an opaque system dissuades many investors, while an objectively defined set of rules would also defend the decision makers in government.

The invitation to tender consists of five stages, starting with the promotional campaign where the blocks selected for award and the legal context are decided. After this is done, interested companies are called to come forward. If several companies express their interest, governments need to examine the offers and announce those companies that have been preselected. Only then can the competitive bidding really start, which entails technical discussions on the data avail-

able and several clarifications that may be asked before the companies can actually present their offers. Obviously, these offers then need to be examined thoroughly before the government can finally announce the results of the procedure and eventually proceed to the signing of the contract.

Six key elements qualify as good practices that have been established in the awarding of contracts. The development of a sound legal framework necessitates a clear hydrocarbon/oil law. A protocol should be developed to designate the blocks on offer and establish the rules to be followed by candidate companies and the government. This is tied to the development of a sound and transparent institutional framework, clearly defining the roles of the ministry, the national oil company, or independent agencies. The candidates must be submitted to a thorough review of their technical, financial, and legal capacities. Any contract that has passed through these steps should remain irrevocable, which solidifies the engagement by both the company and the government and further discourages dubious offers. Transparency remains fundamentel throughout this process, from the initial development of the legal framework, to the official publishing of the contracts and the results of the award process.

Lecture 6: The Bidding Process on New Blocs in Angola

– Syanga Abilio, SONANGOL

While Angola has only fairly recently become Africa's second largest oil producer after Nigeria, prospecting for hydrocarbons already began in 1910, with the first oil discovery in 1955. Today, Angola is producing 1.9 (million barrels per day) mbpd from reserves of 13.8 (million barrels of oil) MMBO, 11.5 TCF (trillion cubic feet) for the Angola liquefied natural gas (LNG) project. SONANGOL, the national oil company was established in 1976 and made the sole concessionaire for exploration and production since 1978.

SONANGOL governs its core business operations based on the full integration of three segments: oil concessions; exploration and production; and refining, marketing, and shipping. Petroleum exploration and production activities are governed by The Petroleum Activities Law No. 10/04 on Petroleum Activities November 12, 2004 (the 2004 Petroleum Law), which replaces Law No. 13/78 of August 26, 1978 (the 1978 Petroleum Law). The new 2004 Petroleum Law vests ownership of hydrocarbons in the state (in accordance with the

Angolan Constitution) and establishes that only the national oil company, SONANGOL, may hold petroleum rights.

In practice, SONANGOL enters into production sharing agreements (PSAs) in nearly all cases. The 2004 Petroleum Law establishes that all new concessions can only be awarded through public bidding processes. Direct negotiations to award new concessions are only permitted by law in limited situations. The blocks are offered to the companies that present the best offers.

Angola has developed a comprehensive framework for licensing terms. The Minister of Petroleum defines concession areas by executive decree. The exploration and production periods are established in the concession decree and normally are, respectively, 6 and 20 (shallow water) or 25 (deep and ultra deep water) years. There are no relinquishment requirements during the exploration period. At the end of the exploration period all areas other than development areas or areas in which appraisal work is progressing must be relinquished. Minimum exploration obligations are biddable and are specified in terms of expenditure, seismic, and number of exploration wells.

The bidding process goes through three steps starting with its preparation where the objectives are defined and the blocks are selected, taking into account the economic and contractual strategy. The bidding process is managed first by making available a data package from Angola's blocks, and then the bidding is promoted through the national newspaper, road shows, and the SONANGOL Web site. After this process, the company announces the requirements for prequalification and publishes the results, after which the terms of reference are elaborated. In the third phase the proposals are evaluated and the winners are selected and made public by a public announcement. The final phase considers the negotiation process where a negotiation team is put together to discuss the PSAs with the selected contractor.

Direct negotiations can only be allowed in the three following cases: (i) immediately after the public bid if there have been no offers; (ii) immediately after the public bid if the offers differ from the previously defined terms; or (iii) if the concessionaire receives only one bid for a given block.

Plenary III: Negotiating Exploration and Production Contracts

Lecture 7: Basic Theories for Negotiating Exploration and Production Contracts

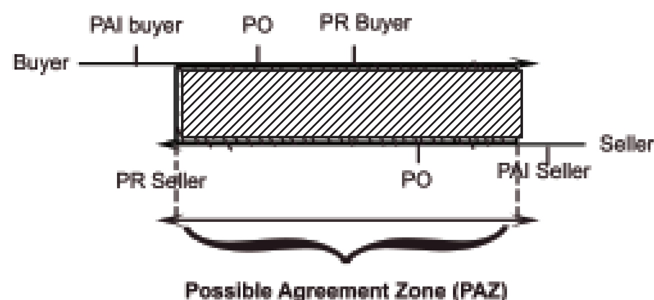
– Michel Vuillod, ENSPMFI, Institut Francais du Petrole

When developing an exploration and production contract, the projects need to be evaluated and classified first, following a project trajectory from the initial concept to the project's implementation. Another crucial step in the negotiation process is to move from inter-party cooperation to legal commitments.

The preparation of a negotiation plan entails several steps: (i) distinguishing the fundamental elements; (ii) defining the objectives and issues for negotiation; and (iii) finally the development of a negotiation strategy which can be either competitive or cooperative. To define the key issues for negotiation, one needs to know the issue, context, actors, and the stakes of the negotiation. The work schedule should be developed in relation to the basic negotiating SWOT framework (Strengths Weaknesses, Opportunities, Threats).

A value scale needs to be developed for several key issues, in which both parties put a nominal value on each of the issues. This already makes clear the possible areas of agreement. These possible areas of agreement lead to a possible agreement zone (PAZ) that facilitates the negotiation.

Figure 3: The Possible Agreement Zone



Another central element in determining the negotiation strategy is to know the other party so that complementarities of the objectives of both parties and the degree of durability of the relationship can be

determined. To further enhance the negotiating framework, possible project scenarios need to be developed. To successfully conduct such negotiations, the negotiating team needs to master techniques to structure key issues and be aware of tactics for argumentation.

Lecture 8: Negotiation of Exploration and Production Contracts: Case Study and Role Play

– Michel Vuillod, ENSPMFI, Institut Francais du Petrole

Participants in this case study were divided into two groups: one representing the government of a fictitious country, and one representing an international oil company, to take part in a simulation including negotiation and agreements on key contract parameters that would lead to different results: in terms of higher government take, or higher company investment rate of return (IRR) or higher local community rents.

The starting premise of the simulation shows that the country has recently developed and ratified petroleum legislation with the assistance of international experts. This legislation enables the use of production sharing contracts and a contract template has been developed. This year the Ministry of Energy aims to open negotiations based on mutual agreements for two exploration blocks. The contracts are awarded in the form of exploration licenses, which in the case of discoveries of commercial quantities would allow the award of an exploitation license limited to the zone of the discovery.

With this basic information available to the two groups, the group members selected six representatives each to form a negotiating team who were to use the theories developed in the previous session in a simulated contract negotiation. Each group received the instructions from their ministry (for the governmental team) and their board of directors (for the oil company team) respectively, which formed the basis for their negotiations.

The negotiation was conducted in three rounds, the first round leading to an agreement on the legal framework and contract clauses. The second round went into detail on the data available to the oil company and any technical difficulties that may arise in the exploration process. Finally, the third round discussed the terms of reference.

After this simulation, both groups were invited to examine their negotiation strategies to determine how their arguments were developed, and how they could have done better. The negotiation framework established in the previous session offered a valuable tool for the teams to clearly define their objectives and the value scale enabled them to differentiate core issues with less important issues in order to find a possible agreement zone.

Plenary IV: Ensuring an Effective Rent Collection

Lecture 9: Petroleum Tax Administration

– Charles McPherson, Fiscal Affairs Department, IMF

Transforming oil wealth into development depends on many factors such as sector management, tax design, tax administration, revenue management, and expenditure management. The challenges in tax administration transpire because much of the tax revenues are consumed by the government bureaucracies.

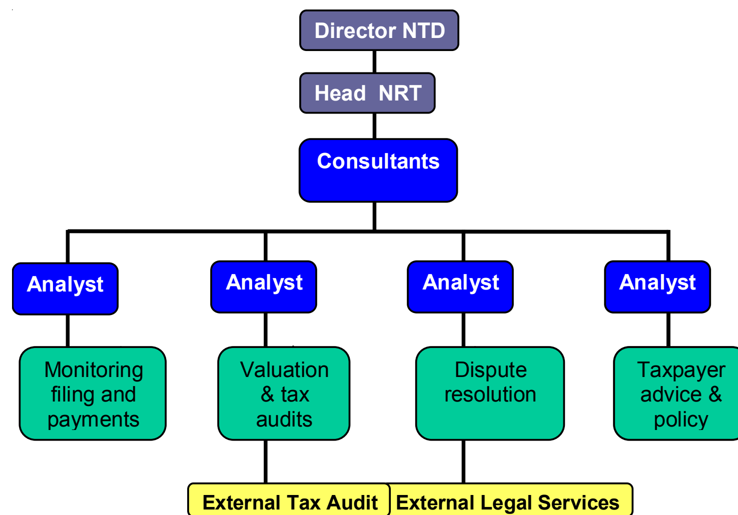
The petroleum sector has some special features with regard to tax administration due to its large scale, complexity, and volatility. Because it is a highly international industry, a significant asymmetry often exists in capacities between governments and international oil companies. The routine functions of a tax administration is to register taxpayers, process the returns, collect the taxes, and respect accounting standards such as international accounting standards (IAS) and generally accepted accounting principles (GAAP). The taxpayers require clear and accessible legislation and regulations and need to have access to explanatory materials; whereas the tax collector needs operational information, contractual agreements, and a valuation of prices and costs. While these elements are part of routine administration, some problems may arise due to poor accounting systems, perhaps due to a lack of information technology knowledge. The existence of multiple agencies and multiple taxes compounds the problems.

On top of these routine functions, tax administrations should also determine the volume of oil by metering and quality analysis, determine the price with the market value as the overall goal, and finally determine costs by using cost categories, ringfencing, transfer prices, and establishing environmental and abandonment costs, as well as provide a sound framework for audits and appeals.

There are several types of audits (physical, cost, tax) which entail some audit choices (full or selective audit). Another key question is whether to keep audits in house or outsource them. To contribute to a long-term development strategy, tax modeling can be used for long-term forecasting, cross-checking the audit results, and evaluating the agreements. This also provides a cross-check on any possible

audit results. To incorporate these basic principles in a transparent and capable tax administration, a basic institutional structure is needed in addition to capacity building in tax administration.

FIGURE 4: BASIC INSTITUTIONAL STRUCTURE



LECTURE 10: CAPACITY BUILDING

– TROND KUBBERUD, PARTNER AND MANAGING DIRECTOR, INTERNATIONAL PETROLEUM ASSOCIATES NORWAY (IPAN)

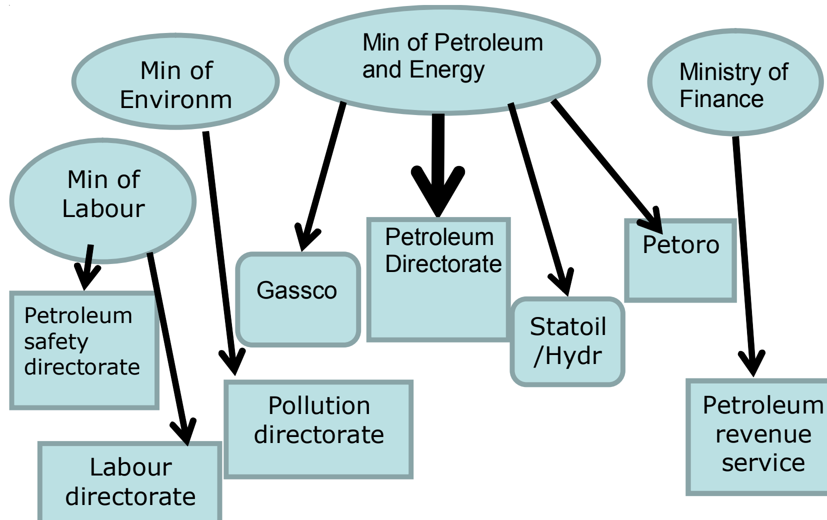
Responsible resource management should be the goal for any oil-producing country. Responsible management encompasses a wide array of policies starting with an efficient exploration process which allows companies to discover resources at the lowest possible cost and to ensure profitable development giving high rates of recovery at a low aggregated cost. The short-term view would be to get the biggest share, while the goal should be to maximize the aggregated whole, for which governments need to consider economies of scale and scope. While such profit maximizations are very important, high standards for health, safety, and environment also need to be observed.

Key challenges for oil-producing countries are to optimize the role of their resource in securing the national energy supply while managing the petroleum sector's impact on the national economy. Any resource management philosophy should start from the basic premise that the country is the owner of the resources and thus has

ultimate responsibility for their management. In order to manage these resources effectively, the government has to organize the sector for responsible management by aligning economic incentives for oil companies with national petroleum policy objectives, develop trust and cooperation between the industry and government, and train government agencies.

The Norwegian model for managing the national petroleum sector differs from the classical framework in that several ministries and agencies work together to accomplish previously defined goals, with a well-defined notion of competencies between each actor in the Norwegian petroleum sector.

FIGURE 5: THE NORWEGIAN SYSTEM TODAY



While the Norwegian model can offer some valuable insights, there are no 'best practices' or one-size-fits-all model. Each country must take into account the national context and government capacity before implementing a model of their own. When a significant discovery is made in a country, the key lesson is that countries need to start immediately, but progress slowly.

LECTURE 11: AUDITING OIL COMPANIES AND STATE REVENUES

– ALEXIS MAJNONI D'INTIGNANO, SENIOR MANAGER, KPMG PARIS/AFRICAN DESK

The auditing of petroleum information relates to both the public and the private spheres, with several accounting norms and proce-

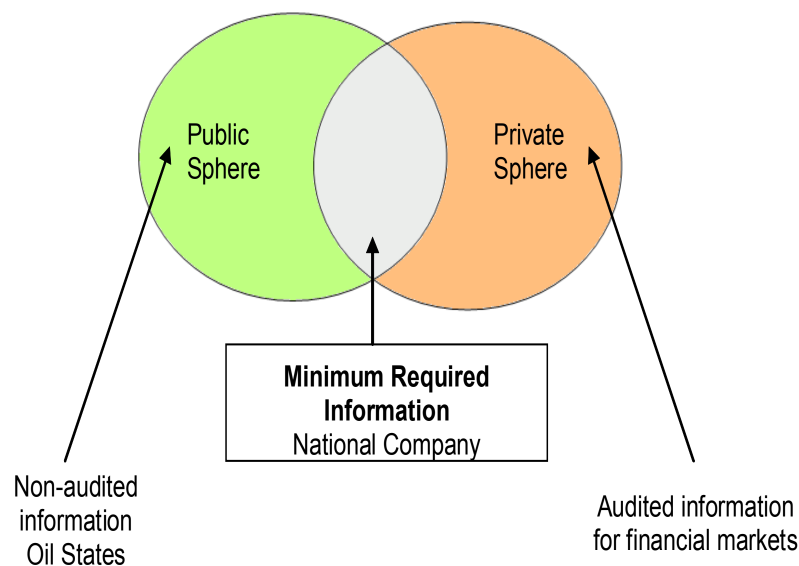
dures to follow. The financial information applicable to petroleum activities can be broken down into three distinct fields:

(1) *Petroleum environment*—considers the petroleum legislation, petroleum and mining contracts, and the level of state participation

(2) *Revenues and activities*—several factors need to be examined: state oil revenues, petroleum reserves, annual profitability of the oil rent and the accounts of the notional company.

(3) *Other factors*—projected evolution of reserves, establishing funds for future generations, and how these public oil revenues are used.

FIGURE 6: TYPOLOGY OF FINANCIAL INFORMATION APPLICABLE TO PETROLEUM ACTIVITIES



For each of these three actors, several elements are publishable and auditable, while others are not. While the laws pertaining to the petroleum sector are generally published, they are not the subject of an audit. The auditor comes into play when examining the revenues and activities of the actor. The EITI is a form of audit on the revenue collection, however, an audit on the actual use of these revenues is

not required. In order to undertake a successful audit in the petroleum sector, many accounting standards need to be observed.

A contentious issue with these audits is whether the results should be made publicly available, as some of the information contained in the audits is considered confidential.

Figure 7: Accounting Standards

IFRS 6/ IAS 16 /FAS 19: Financial Accounting and Reporting by Oil Producing Companies
FAS 69: Disclosures about Oil and Gas Producing Activities
IAS 37 /FAS 143: Accounting for Asset Retirement Obligations
IAS 36 / FAS 144: Accounting for the Impairment or Disposal of Long-Lived Assets
IAS 23 /FAS 34: Capitalization of Interest Cost
IAS 21 /FAS 52: Foreign Currency Translation
IAS 12 /FAS 109: Accounting for Income Taxes

Lecture 12: Case Study: Petroleum Sector Transparency in the Republic of Congo,

– Florent Okoko, President of the Executive EITI Committee, Republic of Congo

The petroleum sector in the Republic of Congo falls under the Ministry of Hydrocarbons which has elaborated a regulatory framework including a hydrocarbon charter, a framework for production sharing contracts, and the establishment of a national oil company. In addition, a special cell within the Ministry of Finance also deals with hydrocarbon policies.

The national oil company's accounts are audited, as is the commercialization of the oil. A refining complex has also been created, whose accounts are audited. It also submits itself to a strategic, financial, operational, and economical diagnostic. In accordance with Congo's adherence to the EITI, the revenues the state derives from oil are also audited and those reports are published on the internet.

The publication of these audits is done in several steps. On the basis of the oil contracts, revenues, and commitments are analyzed and through the EITI the revenues declared by the state are compared to the payments declared by the oil companies. However, while the

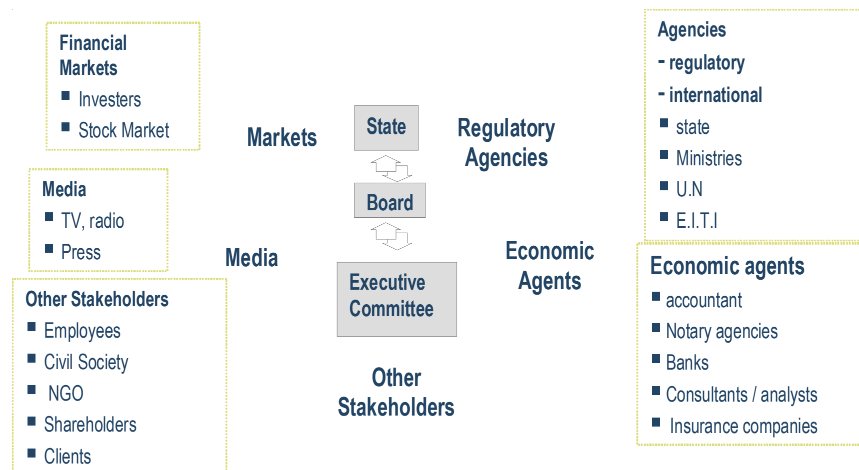
reports are usually published on the Internet, not all of this information is accessible. Their confidential nature restricts Congo from publishing all information. Instead of publishing a detailed audit report, they prefer publishing summaries. The contracts themselves are not published; however, the law on contract award procedures is published in the official journal. The rationale behind withholding detailed information is the insufficient capacity within civil society actors to interpret these reports correctly.

Lecture 13: Corporate Governance of Oil and Gas Companies

– Emmanuel du Boullay, FINCA

The evolution of corporate governance principles goes hand in hand with several major corporate crises throughout the 20th Century. In 2004, the OECD elaborated a code of corporate governance taking into account the most recent evolutions in the matter as an indirect result of crises such as Enron, Vivendi, or the internet bubble. Corporate governance refers to the relationship among governing bodies (management, board, shareholders) and to values and behaviors necessary to build a sound company; such as trust, balance of powers, control, responsible behavior, and transparency.

Figure 8: Corporate Governance Stakeholders



Governance contributes to establishing norms and values that underpin the macroeconomic environment. Without good governance, foreign and national investors will be doubtful whether to invest in a

company. Governance also contributes to an increased efficiency which leads to economic growth. It can be defined on two levels: corporate and management. Corporate governance defines the relationship among shareholders, the board, and management; while management refers to the relationships between directors and subsidiaries to the parent company.

Good corporate governance refers to a company which operates within the legal framework and respects the OECD principles. It also leads to a reduction of risks and identifies and solves any possible conflict of interest among actors. Corporate governance impacts many different actors, from economic agents, financial markets, media, and regulatory agencies.

Corporate governance of oil and gas companies is important for developing nations as the companies often represent an important share in the country's economy, their performance has a profound impact on the lives of the general population and also provides many direct or indirect employment opportunities for the economy. The board is a central actor in any governance program and its mission should be to review and guide company strategy, appoint directors, and control the integrity of financial information declared to the stockholders.

Plenary V: Participant Country experiences

1. Algeria:

Algeria's oil reserves currently stand at 15.5 billion barrels, and 65 trillion cubic feet of gas. The national oil company Sonatrach oversees production and exploration activities in the country. Medium-term prospects for 2012 are to produce 2 million barrels per day and to open new zones for exploration with a licensing round. The standard contract is a production sharing agreement although two high risk contracts do not follow this procedure. Algeria has implemented a fund to diminish the impact of oil price volatility.

2. Burundi:

Burundi is still in the exploration stage in the oil sector. Since 1960, the first tests have been made, with seismic tests occurring onshore in 1968, and offshore in 1983. The AMOCO convention of 1984 regulates the seismic prospection and drillings.

3. Cameroon:

Cameroon produced 85,000 barrels per day in 2007 and 12 oil companies are active in the country, four of which that are currently producing. The government retains 20 percent participation through the national oil company. Proved reserves stand at 250 million barrels of oil and 127 billion cubic feet of gas and several new zones have been opened for exploration. The award of contracts will be exclusively through invitations to tender, conforming to the new petroleum law. Cameroon acknowledges two contract types: concessions or production sharing. Oil currently represents 27 percent of GDP. Cameroon has adhered to the EITI since 2005 and has published two reports.

4. Democratic Republic of Congo (DRC)

The DRC is currently producing about 25,000 barrels per day and three oil companies are active in the country. Projections for 2010 call for a production of 20 million barrels per year with three new zones currently being explored. The standard contract is a production sharing agreement and blocks are awarded through competitive bidding. Oil currently represents 40 percent of the state budget and no natural resource fund has been created as of yet. DRC has not published any EITI reports.

5. Equatorial Guinea

Oil production currently stands at 300–400,000 bpd and is expected to continue at that level. Private companies handle production through production sharing agreements with the national company GEpetrol. Contracts are awarded through direct negotiations. Oil currently represents 80 percent of government revenues.

6. Gabon

Gabon started producing oil in 1958 and is currently producing about 240,000 barrels per day with 23 oil companies active in the country, seven of which are producing. Gabon's future as an oil state depends on future offshore discoveries. The country is in the process of launching a tenth bidding round for offshore blocks. Several contract types exist in Gabon: concessions, production sharing, or service contracts. Oil represents 50 percent of GDP and 80 percent of export revenues. Gabon has published three EITI reports and has set up a fund for future generations.

7. Ghana

Ghana is not yet producing hydrocarbons but announced the discovery of oil in commercial quantities 65 km offshore in July 2007, the confirmed volume of this discovery being 500 million barrels of oil. Two private companies are conducting exploitation in partnership with the national company. Production is anticipated to commence in 2010. For new exploration zones, most contract awards will follow competitive bidding procedures, although Ghana will allow direct negotiations in certain circumstances. A national company was set up to be the commercial arm under the Ministry of Energy.

8. Mauritania

Mauritania possesses two significant basins for oil production which together represent a total of 131 blocks. The country has developed a sound legal framework for exploration and production activities. Each production sharing agreement is the subject of a specific law. Since 2004, the fiscal regime has been simplified and in 2006 the government has signed a law to manage petroleum revenues. Contract awards are regulated by decree which stipulates that all contract awards have to go through a competitive bidding process to ensure the Mauritanian state obtains the most favorable conditions possible. Nevertheless, all blocks to date have been awarded through direct negotiations, due to the lack of offers resulting from

insufficient available data on the blocks. The institutional framework is made up of a General Directorate of Hydrocarbons which develops petroleum policy; the Cadastre Directorate, which controls the management of blocks; and the Department of Environmental and Petroleum Management, which was created to provide oversight on environmental issues. Finally, a national oil company was also set up, which mainly manages state participation in the oil sector. Mauritania has adhered to the EITI since 2005 and has published two reports.

9. Nigeria

Nigeria started producing crude for export since 1958. The country is the largest African oil producer and has a population of about 140 million people. The current volume of oil production is about 2 million barrels per day, while gas production stands at about 7.billion standard cubic feet. Eight new fields will be awarded through a competitive bidding process. Nigeria uses several contract types: joint ventures, production sharing, or service contracts. The national company is responsible for the sale of crude oil and gas. It is also involved in refining and distributing petroleum products. Oil represents about 80 percent of gross domestic product, while the oil price volatility is being addressed by saving excess revenue from oil in special accounts known as stabilization funds. Nigeria has adhered to the EITI since 2005.

10. São Tomé and Principé

São Tomé and Principé are still in the initial stages of petroleum activity and has two separate zones of resource management: the Joint Development Zone with Nigeria (JDZ) and the Exclusive Economic Zone (EEZ). The JDZ is managed by the Joint Development Authority composed of four executive directors (two from each country), appointed by the heads of state. For the JDZ, two public licensing rounds were organized and six of nine blocs have been awarded. Four production sharing contracts have been signed. Until now, the signature bonuses are the only revenues obtained from petroleum activities. The fiscal framework is relatively attractive due to a flat income tax of 40 percent on profit oil. There is no activity up to date in the EEZ. The legal framework has been elaborated including a revised petroleum law, a production sharing contract model, and a new tax law, should be approved by the government in mid 2008. In 2004, São Tomé and Principé have adopted a new revenue management

law which defines the mechanisms for the use of oil resources in a transparent and accountable manner. The oil revenues will be deposited in a special account hosted abroad.

11. Angola (See Lecture 6)

12. Republic of Congo (See Lecture 12)

13. Central African Republic (did not present)

Plenary 6: Transparency, Governance, and Economic Planning

Lecture 14: Extractive Industries Transparency Initiative Implementation

– Tim Bittiger, Regional Director, EITI International Secretariat

In the value chain discussed in earlier lectures, the EITI comes up in the tax and royalties collection stage, which is a key element of the value chain. The EITI is a country-led effort and represents a tripartite coalition of governments, companies, and civil society. Currently 22 countries have adhered to the EITI and several other countries have submitted their applications. Large transnational groups such as the G8, the G20, and the European Union support the initiative, in addition to 39 major companies and 50 investors.

Candidate countries must first set up a tripartite EITI committee that oversees the work of auditing the payments and bonuses and are publishing this data in regular EITI reports. The reports should then be explained and made available to the general public.

The international secretariat has recently been created to oversee the EITI process and methodology, as well as to provide a regional and global platform for discussions. The EITI is gradually expanding to include not only the oil and mining sectors, but also forestry. There are many benefits for countries adhering to the EITI: an improved investment climate; more efficient tax administration; an incentive for good governance; and increased responsiveness to the citizens of the candidate country.

Adhering to the EITI is a voluntary choice of governments. Once this political will has been expressed, the country is invited to implement and study the six criteria developed by the EITI. The candidate country has to oblige the private and public companies active on its soil to publish their payments.

Essential to the EITI is to develop partnerships, both on a national level, among the three parties involved in the committee, and on an international level with an exchange of experiences among member countries and strong international support from bi- and multilateral institutions.

Lecture 15: Governance and Corporate Ethics

– Jean-Pierre Cordier, Total-Paris

After economic liberalization and the opening of new markets, multinational companies had to review their organizational structure to comply with new corporate governance standards. Self-regulation became essential to survive in this 'new economic disorder.' When the internal structure of the company was revised, multinationals also needed to re-examine their responsibilities in the areas where they are active, leading to the notion of corporate social responsibility. Corporate governance principles have gained momentum over the past 15 years with increased calls for accountability and respect for the rights of shareholders. After several reports on a national level, the OECD has elaborated its corporate governance principles in 2004 which serve as the major guideline for companies. The board is a key player in corporate governance, and has a responsibility toward the shareholders and other stakeholders. To preserve the interests of its stakeholders, the board must submit itself to rigorous ethics.

A company has to act on three areas of interest:

(1) What needs to be public – transparency and a sound legal framework.

(2) What needs to be understood – more responsibilities to be transferred to the company and mitigating reputational risks.

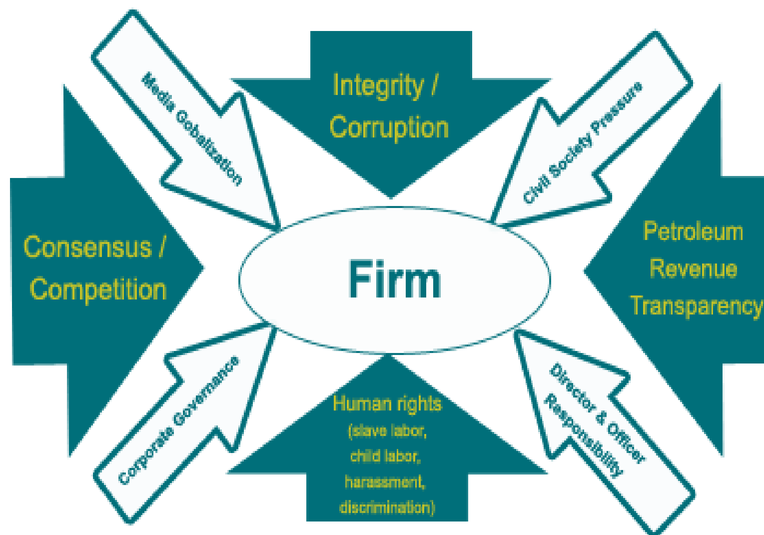
(3) What needs to be done – specifying rules that guide corporate governance such as developing a code of conduct.

Growth and sustainability can only be conceived when there is a common set of norms and principles that guide the actions of corporate actors continually. A code of conduct is necessary to develop these principles and to make sure they are available to and understood by all actors. The executive management and the board are responsible for its dissemination.

There are four factors external to the company that drive the need for sound corporate governance: calls for integrity, for transparency in the oil sector, respect for human rights, and dealing with the competition.

Figure 9: Actors and Expectations

Four Focus Areas



Corporate governance also relates to the principle of fair competition. In order to foster the growth of international trade, national and international regulatory bodies have laid down rules to prevent any distortion of competition among economic players. These rules ensure that companies enjoy full freedom within their market and guarantee that each company can freely determine its behavior. The aim is to maintain healthy market competition so that part of the generated profits are returned to the customer in the form of lower prices, a greater choice of products, and technical progress.

Lecture 16: Commodity Savings Funds: Asset Allocation and Spending Rules

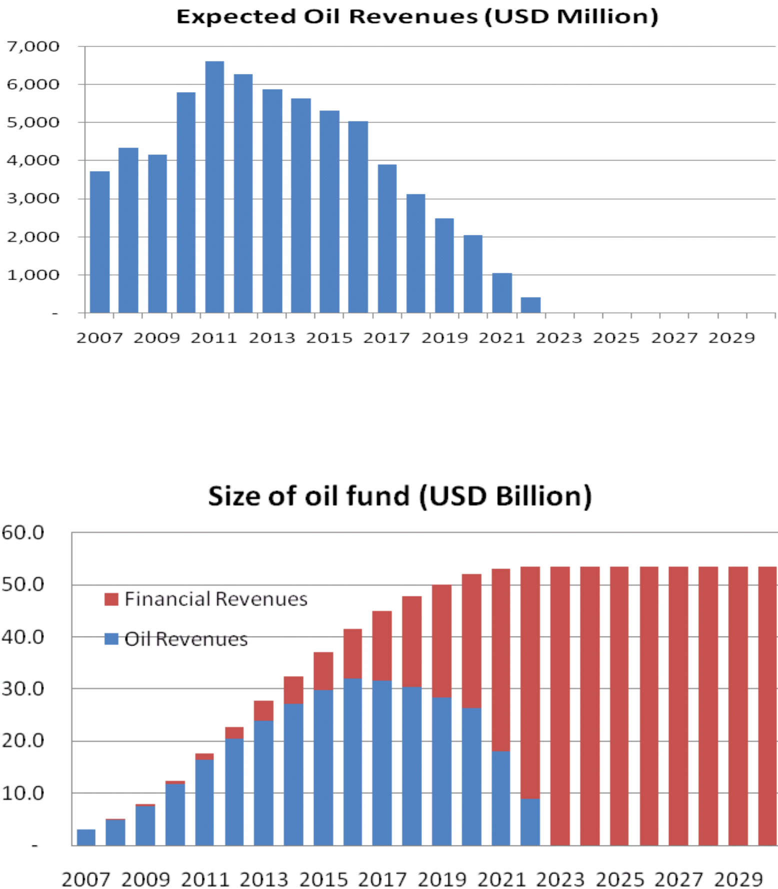
– Stephane Piot, Lead Financial Officer, Sovereign Investments Partnerships, World Bank Treasury

When considering setting up a commodity fund, countries face three important design questions: (i) which spending mechanisms will be used; (ii) how to allocate assets; and (iii) how the fund will be managed. A number of countries have adopted the use of oil or commodity funds where a portion of government revenues from oil, gas, or other commodities is saved. Those fund rules separate oil revenues from budgetary spending which stabilizes the impact of commodity revenues and allows for the conversion of non-renewable re-

sources into earning financial assets. Typically funds have one of two or both purposes: to stabilize or dampen the effect of oil revenues on the fiscal budget or to accumulate savings for current and future generations to ensure intergenerational equity as oil and gas is typically depleted in 20 to 50 years.

Several oil-exporting countries are seeing their production decline and may have only one chance to get it right. Establishing a fund can mitigate the risks associated with a stark drop in oil production or oil prices.

FIGURE 10: EXPECTED OIL REVENUES AND SIZE OF AN OIL FUND



The path from oil to equities means investing in a financial portfolio of stocks and bonds that reduces the risk associated with oil production significantly while at the same time improving total income. Stocks and bonds usually do well when oil and gas prices are falling. The World Bank Treasury has developed an analytical framework that models revenues from both hydrocarbons and fund investments that allows policy makers to test the impact on revenues, the size of the fund, and the spending amount over time of alternative spending or saving assumption, and alternative asset allocations.

Several institutional characteristics need to be in place for successful long-term public wealth management. The political commitment to achieve long-term objectives needs to be articulated in a clearly defined legal framework that depoliticizes the management of the fund. Ensure ownership of risk and return profile of the portfolio consistent with fund's macro objectives at the highest level. Specialized institutional arrangements for the implementation of investment policy decisions need to be created within civil service budgetary, procurement, and salary restrictions. Finally, independent oversight and control need to be established that allow for a high degree of transparency.

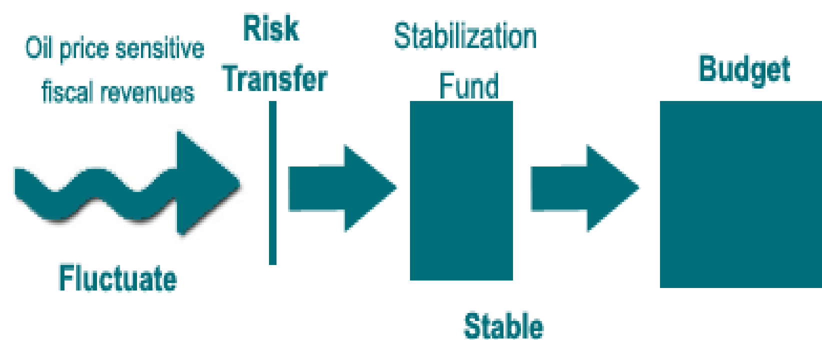
Lecture 17: Managing Oil Price Risk with Derivatives

– Ivan Zelenko, Head of Structured Finance and Derivatives, World Bank Treasury

Oil-exporting countries typically derive a large share of their fiscal revenues from oil sales. This high exposure to oil price volatility seriously challenges fiscal policy and often leads to the shelving of planned projects, higher savings and lower investments, and a wasteful use of the oil 'windfall.' Exporting countries need to set up policies to insulate their budgetary revenues from such oil price shocks. The objective of an oil price stabilization policy is to reduce an economy's vulnerability to oil price shocks and to smooth the fluctuations in oil fiscal revenues over the short to medium term at minimal cost, subject to a tolerance for downside risk, and concerned with upside gains. Oil revenues above a certain reference price are saved in the fund. The fund pays to the budget to ensure stable oil fiscal revenues based on the reference price.

Nevertheless, stabilization funds also have shortcomings: the initial capitalization and the reference price should be properly set to avoid either exhaustion or over-accumulation but the reference price is difficult to determine as oil prices do not exhibit a natural long-term average. It could, however, be defined as a moving average. Stabilization funds also require robust governance rules. Much of the risk can be transferred to markets using oil derivatives. These derivatives enable hedging or insurance resource management strategies and do not require that capital be immobilized.

FIGURE 11: TRANSFERRING RISKS TO MARKETS WITH OIL DERIVATIVES



Good governance also refers to a clear separation of roles and accountabilities. The hedging board sets policies, ensures accountability and reviews results, and should be the 'owners' of the hedging policy. The hedging committee then selects and implements hedging strategies consistent with the objectives and risk tolerance of the board. Hedging execution teams comprise traders and analysts while control teams should be responsible for monitoring performance and reviewing the strategy based on commodity market changes.

Closing Remarks and the Next Steps

The event received strong support from high level Gabonese government representative: Minister of Energy, Casimir Oye Mba opened the seminar and Paul Toungui, Minister of Finance participated in the closing session. The evaluation by the seminar participants and organizing partners proved to be very satisfactory. Participants were given the opportunity to suggest areas of improvement and themes of interest to them for future seminars, which have been taken into account in the development of the next steps when discussed by the organizing partners.

The organizing partners and representatives from Bank of Central African States (BEAC), Economic and Monetary Community of Central Africa (CEMAC), and Economic Community of East African Countries (CEAC) agreed to push continued cooperation and organize two seminars in Libreville over the next 12 months. Two themes are currently under consideration: the first event being a two-day seminar in December 2008 on sovereign funds and funds for future generations, targeted at participants from West African ministries of finance and planning, central banks, and civil society. The second seminar would focus on the EITI and its recent developments, with the participation of parliamentarians from West African countries.