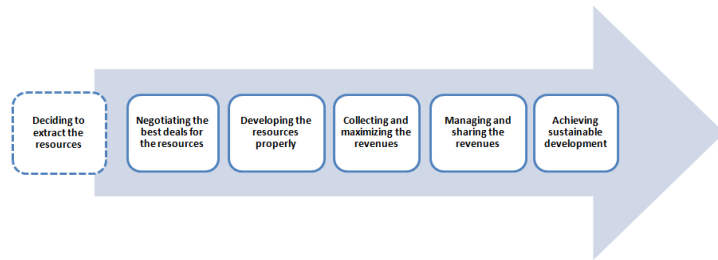


Value Chain Stage 1: Decision to Extract



Topics: Environment, Poverty, Indigenous Peoples, Local Communities, Land Management, Artisanal Mining, Gender, Unsafe Working Conditions, Impact Analysis

When exploitation for oil has proved successful or when mineral resources are discovered the question policy makers ask themselves is usually not *'Should we exploit the resource?'* but rather *'How (fast) are we going to exploit the resource?'* This section will illustrate that considering the first question (Should?) is a necessary prerequisite of the second question (How?). There are several factors that can together lead to the decision to leave the resources in the ground. This section explains the importance of **environmental** impact, **poverty** and social impact, artisanal mining and **indigenous** communities, and lays out how effective **land management** can minimize the risk of extractive industries extraction to local communities.

Potential Consequences of Extraction

Policymakers should be critical when determining whether or not it is in the interest of the country to extract its resources in the first place. The postponement and smoothing of the government's spending of resource revenues can be achieved by limiting the rate of resource depletion (The Natural Resource Charter, 2009).

Resource projects can have significant **environmental** effects. For example, extraction damages landscapes, produces waste, and pollutes air and sea, river and drinking water. The initial decision to extract should take into account the possible environmental consequences of development through an environmental assessment. If the decision is made to extract, the government should account for the environmental consequences in the development plan of the area. Throughout the life of the project environmental and social assessments should be executed, accompanied by a plan to minimize or mitigate possible adverse environmental and social consequences specific to the project (The Natural Resource Charter, 2009).

Other than environmental effects, extraction may also affect income and social groups differently. Special attention has to be paid to the effect on **vulnerable** and **low-income** groups such as women and artisanal miners. Understanding the impact of policy interventions on different groups is critical to designing effective policy strategies. When making the decision to extract, the effect of extraction on the welfare of different groups, with a specific emphasis on the poor and vulnerable. Similar analysis can be applied to other effects (such as the **environment**). Good practice would require that budget documentation include at least a simple analysis of the impact of the decision to extract on the environment and low-income groups.

Action for Parliament: Potential Consequences of Extraction

- Commission a study. Legislative committees can take advantage of local or international expertise on extractive industries by consulting with experts from universities or civil society organizations to conduct research on key issues. Such studies could examine the potential consequences of extraction on the poor and the environment.

Women and the Extractive Industries

The benefits and risks of extractive industries are often measured broadly at the community level, but fail to distinguish the different impacts on men and women. Evidence suggests that a **gender bias** exists in the distribution of risks and benefits in extractive industries projects: benefits accrue mostly to men, in the form of employment and compensation, while the costs, such as family or social disruption and environmental degradation, fall most heavily on women.

The development effectiveness and sustainability of extractive industries projects could increase significantly by taking into account how gender bias issues affect the sector and how extractive industries activities can benefit men and women more equally.

Source: "Women and the Extractive Industries" Fact Sheet, www.worldbank.org/eigender

Artisanal and Small-Scale Mining

Millions of people make their living through **artisanal** and small-scale mining, which provides an important, and sometimes the only, source of income. This part of the sector is characterized by low-income workers, **unsafe working conditions**, serious **environmental impacts** (see Box 10), exposure to dangerous materials, and conflict with companies and governments.

While considering resource extraction policy makers should know whether or not artisanal mining is taking place, what the scale of the activities are, and who is positively and negatively affected by artisanal mining activities.

Actions for Parliament: Artisanal and Small-Scale Mining

1. Initiate a field visit to the prospective mining area to investigate the situation. In so doing, set clear objectives and expected outcomes for the visit so that it can yield the most useful information about artisanal and small-scale mining.
2. Initiate a public awareness campaigns for small scale and artisanal miners, informing them about their rights and responsibilities
3. Review legislation on the rights of artisanal miners

Small-Scale Mining in Tanzania

In Tanzania small scale miners have lost many of their most productive areas to investors. Small scale miners' organizations as well as politicians have argued that the government needs to do more to secure the livelihoods of artisanal and small scale miners. A National Policy for Artisanal Small Scale Miners has been propagated. The licensing process has led to conflict between large scale miners and small scale miners in Tanzania. There is no planning and co-ordination on the distribution of land at the national level. Investors work with maps that have not been updated for years, and as a result large companies filed for licenses on what appeared to be an open area, but in fact had small scale miners operating on it.

Source: Land Tenure and Mining in Tanzania (Chr. Michelsen Institute, 2008)

Environmental Implications

Minerals and petroleum activities can have a significant **environmental impact**. Environmental risks and potential hidden costs from permanent environmental damage after extraction need to be considered (See Box 10). Good practice is the enforcement of adequate environmental and social regulations and the establishment of an independent authority charged with approving and monitoring environmental and social impact assessments (World Bank, 2009). The most successful examples of environmental and social impact mitigation involve early consultation and participatory practices at the local community level (World Bank, 2009). The consultation process with **local communities** has to start at the initial stages of a project, to minimize environmental and social impacts and ensure that the communities receive adequate compensation based on impact of the project on their livelihood. With early involvement in the process, communities' understanding of, and support for, the project is more likely and reduces the potential for conflict.

In Tanzania, **small-scale artisanal miners** have occupied the **forests** in a **nature reserve**, causing severe environmental destruction by felling old indigenous trees to dig up gold. Tanzanian mining laws require that all mineral prospecting and exploration be carried out under valid licenses, but none of these small-scale miners operating in the forest are licensed. MPs have visited the mining sites and the nature reserve for a firsthand feel of the extent and proportions of environmental damage. The Parliamentary Committee has convened a meeting of all stakeholders in order to come up with immediate interventions and long-term solutions to the small-scale mining problem (WWF, 2004).

Actions for Parliament: Environmental Implications

1. Initiate a field visit to the area to investigate possible environmental impact of mining or oil operations.
2. Start a consultation process with the local communities around the prospected areas to ascertain the communities' needs and concerns. Based on the findings propose recommendations to the government that address the communities' needs and concerns.

Extractive Industries, Communities and the Environment

Romania: "In 2000, the dam from a gold mine spilled 100,000 metric tons of toxic wastewater, killing fish and poisoning the drinking water of 2.5 million people"

India: "Bauxite mines and an aluminum smelter would displace three villages in an ecologically sensitive area inhabited by tribal people. Police fired upon a public protest"

Zambia: "Local communities in the Copperbelt suffer from asthma, lung diseases, and other health problems caused by pollution from copper mines and smelters"

Brazil: "Tens of thousands of small-scale miners work the Amazon region for gold, using mercury and little protective equipment"

Guyana: "A 1995 tailings spill sent 3 billion liters of contaminated effluent from this gold mine into Guyana's largest river"

Source: "Dirty Metals. Mining, Communities and the Environment", a report by Earthworks and Oxfam America (2004)

The Control, Use, and Management of Land

Alternative economic uses of **land concession** (such as **tourism**, **farming**, **forestry**, etc) should be considered and compared to the consequences of extraction. Analysis of the options for the use of the land

will have to consider employment creation, revenue generation, environmental sustainability, and social implications. How the **land** is currently used and what extraction means for that is also important.

There is frequently a lack of planning, legal or other frameworks to balance and manage possible uses of land. As a result, there are often conflicts around issues such as compensation, resettlement, land claims of **indigenous peoples**, and protected areas. The government is responsible for environmental standards and determining the rights of local communities.

The United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP) have held hearings as part of the International Expert Workshop on Indigenous People's Rights, Corporate Accountability and Extractive Industries. The goal of these hearings was to create a better mechanism to force extractive industries to comply with the provisions of the UNDRIP. One of the findings of the hearings was that according to Indigenous People the governments intend to craft or enact laws which serve the politicians' self-interest and are detrimental to the tribal communities.

In Peru tensions between Indigenous People and the state escalated into deadly **conflict** in June 2009, as **local communities** demonstrated and demanded to repeal 10 legislative decrees they consider dangerous for the rainforest, as well as their communities. The decrees would endanger reserved forest spaces to benefit investment in large extractive industries. After the protests, Parliament has repealed the decrees and is currently consulting all stakeholders (including indigenous peoples) on how to improve existing laws and avoid conflict. Peru suspects that the dissemination of information on existing laws, rights and government plans has been insufficient, which caused confusion and misunderstandings.

Another example is Cambodia, where the mining sector grew between the 1990s and early 2000s. Some negative impacts were reported as displacing small-scale miners, restricting access of local communities to areas they depend on for their livelihoods, violating communities' traditional lands, and poisoning water sources (www.globalwitness.org). Since 2005, an increasing number of large scale exploration licences were granted, and the fear is that the reported negative effects for the local communities will increase drastically. In Cambodia, two laws cover the management and exploitation of mineral resources: the Law on Mineral Resource Management and Exploitation (2001) and the Law on Environmental Protection and Natural Resource Management (1996). However, the Mineral Resource Management Law is weak and has a number of gaps including a lack of compensation for those displaced by mining operations. The law states that before entering any privately owned land for exploration or mining, the concessionaire must compensate the "private land owner" for inconvenience and damage to the land. "Private land ownership" refers to those with title on the land registry. Those with possession rights are normally not interpreted to meet these conditions, until they have transformed their possession rights into a title. Indigenous communal land titles are not included in the "private land ownership". This leaves those without the legal title - most Cambodian households - with little protection. By contrast, the Land Law gives indigenous communities the right to continue to live on and manage their traditional lands according to traditional customs, until they are able to get a collective title. Therefore any exploration or mining license granted on traditional indigenous land is unlawful if it impedes the community's ability to continue to manage the land according to their custom. Licenses have all been granted without the free and informed consent of affected communities (www.globalwitness.org).

Action for Parliament: Use of Land

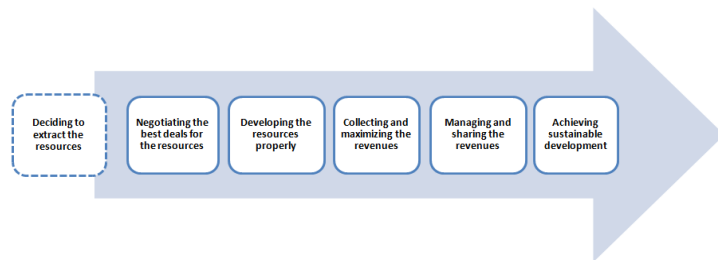
1. Initiate a committee study on the land allocation process
2. Organize a committee hearing on land allocation in resource-rich areas and utilize the findings from the hearing to inform debate within parliament on this issue.

Unrealistic expectations

The discovery of oil and other resources often create unrealistic expectations about future income that lead to sustained increases in public spending. Inflation and debt rise, while loans are secured (often on favorable terms) with the backing of unreasonable projections of future earnings.

The mining and minerals industry faces some of the most difficult challenges of any industrial sector – and is

Value Chain Stage 2: Contracts



Topics: Contracting and Licensing, Procurement, Competitive Bidding, Pre-Selection of Bidders, Terms of Contract, (re)Negotiations, Fiscal Regime, Local Communities, Local Content, Local Level, Environment, Public Goods, Planning, Infrastructure, Linkages to the Domestic Economy, Technology, (un)Employment, Public Disclosure, Contract Transparency, Private Sector, National Oil/Mining Company, Development, National Budget, Foreign Policy, Conflict of Interest

In this stage of the extractive industries value chain governments negotiate a contract with relevant firms. These **contracts** are crucial, as they establish how much the government will receive from the exploitation of their resources, and can also have important clauses for **communities** and the **environment**. This section will discuss the legal context of extractive industries contracts, best practices regarding the process of **procurement**, **licensing** and **negotiation**, the issue of contract confidentiality and transparency. Finally it will address how parliament can participate best in this stage of value chain.

Exploration and exploitation licenses

Legislation regarding extractive industry operations usually encompasses several standard principles:

- Resources belong to the state, and should ultimately benefit the citizens of the state;
- The right to explore and exploit the resources can be temporarily transferred to a person or company through a **license** or **lease**;
- The holder of the license or lease must act in accordance with predetermined conditions; and
- At the end of the license or lease the rights return back to the state (The World Bank, 2009).

The legal basis for the ownership of resources and their exploration, development, and production is usually established in the constitution. A sector law or code then sets out the principles of law. Provisions that do not affect principles of law or that may need periodic adjustments such as technical requirements, administrative procedures, and administrative fees, are set as regulations. A well-defined sector law usually includes a definition of the role of the state; security of title; freedom to operate on a commercial basis; access to resources; comprehensive environmental protection requirements; and a framework for **fiscal terms** (World Bank, 2009).

In most countries, rights are divided into exploration and exploitation licenses. Exploration licenses give holders the right to explore for resources that might exist in the granted area. If the resource has been discovered, access to the exploitation of the resource normally requires the granting of a license for exploitation. Governments usually grant exploration and exploitation rights in particular areas by means of concessions, leases, licenses, or agreements. Efficient and effective granting procedures are based on:

- A clear legal and regulatory framework;
- Well-defined institutional responsibilities; and
- Transparent and non-discretionary procedures (The World Bank, 2009).

Sound principles for the design of efficient contracts are needed, to inflict a number of requirements. First of all, exploration companies should have incentives to extract and to invest in both production and exploration. Second, contracts should be time-consistent, which reduces the company's risk of uncertainty of contract renegotiations or early determination. *Terms should be set in law* to the greatest extent possible, to not only enhance stability for the investor but also ensure equal treatment (The Natural Resource Charter, 2009).

Country circumstances vary significantly, and the contract's content and design should reflect this. The timing of payments, commitments in the form of local goods and services, or payment in the form of infrastructure or social service projects vary per country and per contract. For instance, a government faced with spending pressure can commit to an extraction-for-infrastructure contract (see also Box 20), if this maximises benefits for citizens.

Actions for Parliament: Exploration and exploitation licenses

1. Review and understand the existing legal framework for licensing and contracting: legislation should to the extent possible comprehensively include contractual terms and bidding and procurement processes and procedures. Within the legal framework, Member of Parliament or Parliamentary Committees can encourage transparency and non-discretion in bidding processes.
2. Parliamentary committees can request information from the government on which companies have been awarded with contracts
3. In some countries the Auditor General can conduct an audit on the awarding procedures of certain contracts, after which the Public Accounts Committee can review the Auditor General's report.

Fiscal rules

Fiscal rules are intended to limit the scope for discretionary intervention of politicians and should therefore be set in law to the greatest extent possible. However, at the same time fiscal terms need to be able to be responsive to changing circumstances. There has to be a clear strategy in the event that unforeseen circumstances (such as a sudden significant decrease in resource prices) cause actual spending or deficits to breach numerical targets. The fiscal regime should thus be structurally stable, yet responsive to changing economic conditions. When economic circumstances change, the fiscal regime should be changed to optimally capture resource rents (The Natural Resource Charter, 2009). A progressive fiscal regime, where the percentage of taxes and other payments to the government increases as the basis increases, can better adjust to changes in prices, volumes, and projects' operating conditions. If the fiscal regime needs to be changed, changes should be predictable and based on equitable principles. Best practices show that fiscal rules are more successful where they came about through broad political consensus (IMF, 2007).

The fiscal regime should be competitive so that it attracts businesses in good economic times as well as in downturns. Both the extractive company and the government should profit from extractive industries extraction. They should share an increase and a decrease in prices. In a downturn this can have a negative impact on the government's budget, but by providing incentives to private investors to stick around for the long run, the fiscal regime will benefit the government in economic upturns or an increase in resource prices. The government's goal should not be to find a way to make oil or mining companies pay as much taxes or royalties as possible. Contracts reflect a long-term investment of a company, and any initial investment of a company is high. Therefore, companies have to be able to make a profit, and keep part of that profit as an incentive for investment.

In any case, a strong and coherent legal framework for taxation and regulation needs to be in place before opening up the sector to competition. Recently, the Ghanaian Parliament urged the government to stop handing out licences until a decent regulatory framework is in place.

Actions for Parliament: Fiscal rules

- Review and try to understand the current legal framework and fiscal rules related to taxation and regulation of extractives companies and the private sector generally. Make sure that the fiscal regime is competitive and attracts business.

Promoting the Local Level/Local Content

Extractive industries development can also result in economic benefits at the **local level**. However, uneven distribution of benefits and costs within communities, and outsourcing affect **communities** negatively. In some cases natural resources extraction can generate social or cross-border conflict. While considering the decision to extract the employment and welfare consequences for local communities have to be taken into consideration.

The promotion of local content involves conditions on the use of host-country goods or services by the extractives sector. Most countries have a National Law or Code for Oil, Gas, or Mining activities, which means that regardless of individual contracts provided to national or international EI companies, exploration and/or extraction operations have to take place within this framework. Often there is a section within the Law or Code that deals with the promotion of local content specifically. Best practices show there are certain measures one can take to avoid conflict or local exploitation (Hackman, 2009).

The EI sector is characterized by large-scale, capital intensive, high risk investments, requiring high amounts of skill and sophisticated technology. Many countries at the time of discovery of their resources are not well prepared to carry out production on their own. This prevents them from exploiting the resources by themselves and keeping the profits within their own country. Exploitation often calls for the involvement of international **companies**. As a result, large portions of the profits generated will flow out of the host-country to be paid out to shareholders of the international companies. A huge amount of income is lost to the local community (Hackman, 2009). There are also limited opportunities in the form of **linkages to the domestic economy** to benefit from the extractive activity. This is because of the capital intensive, highly technical and export oriented nature of extractives activities. Therefore, EI activities do *NOT* generate much **employment** (Hackman, 2009).

In order to promote and encourage local content, it is useful for a country to specify a clear and unambiguous definition of what 'local content' means. There must also be an independent authority responsible for monitoring and ensuring that local content conditions are being met by companies as well as by the government.

The usual conditions or requirements for the promotion of local content are the use of domestically produced goods and services, the participation of a state oil company, the employment and training of locals and technology transfers to the domestic economy. However, there are challenges to the implementation of these four policy measures (Hackman, 2009).

- *Provision of Goods and Services by Locals* - Developing countries often lack the technology, highly-skilled labor force and capacity to provide certain activities, which makes the use of local goods and services for EI development difficult. Experience shows that the commitment of international companies to increase local content can be misleading (Hackman, 2009). There would be numerous opportunities for the domestic economy to benefit through non-core oil activities like hospitality services, office and residential accommodation, insurance, banking, etc. However, the long-term risk of these activities is that the EI resources do not last forever, so the labor opportunities will be lost when the country runs out of its resources. The government can also take steps to discover which new activities might be profitable to service the EI sector (Hackman, 2009).
- *Training and Technology Transfers* - Technology can be transferred in physical form through tools, equipment, and blueprints, but it can also be shared through skills and information transfers. Because most developing countries have little or no previous experience in extractive industries operations, there are difficulties in absorbing new technologies in the short run. In the

long run, however, the transfers can pay off and the locals can take over industry activities (Hackman, 2009).

- *Employment and Training of Local Staff* - The extractives sector is capital intensive, not labor-intensive. There are few opportunities for **employment** in core oil and gas related activities. Countries that begin oil and gas production must therefore be wary of expecting too much from the industry in terms of direct employment and income generation. Otherwise this can lead to conflict between the local and indigenous community, the companies, and the government (Hackman, 2009).

In order to promote and encourage local content, it is useful for a country to specify a clear and unambiguous definition of what 'local content' means. There must also be an independent authority responsible for monitoring and ensuring that local content conditions are being met by companies as well as by the government.

Actions for Parliament: promoting the local level

- Parliaments can hold hearings to ascertain the extent to which the local community is taken into account in the development of EI activities, and whether or not the promised measures for local content are feasible in reality.

Procurement & Negotiations

Because individual **negotiations** between the government and companies are ideally suited for corruption, the government needs to adopt a process that is more transparent and **competitive**. Competition is a good mechanism for governments to ensure maximum value for their resources. **Public procurement** systems should be open and competitive. Competition between companies will ensure that the government gets maximum value because companies compete in bidding for exploration and exploitation rights. Competition will select the most technically capable firm, as this is the most efficient and cost-effective firm that will place the winning offer (The Natural Resource Charter, 2009). Transparent processes can increase competition and raise the standards of work programmes. It can also lead to more investments.

A good solution is to auction the extraction rights by inviting bids on rates that companies would be willing to pay. An auction can force companies to reveal the true value of a project because of competition for the project of other companies (van der Ploeg, 2007). The purpose of an auction is to obtain the highest economic value for the nation by awarding contracts to the most qualified company offering the largest expected return to the government. The auction needs to be designed carefully, both in terms of selecting the bidding variables (e.g. royalty rate, production share, or profits tax) and the design of the auction process. Bidding procedures differ among countries. Some use rigid systems with only a few biddable parameters that affect the sharing of benefits between the country and the investors. In others, several terms are negotiable (The World Bank, 2009). The royalty rate could be conditioned on observable features such as basic geology and world prices. If bidding is on a single variable (such as total royalty) then other aspects of the mining contract such as risk sharing, knowledge transfer, and environmental safeguards have to be taken into account (The Natural Resource Charter, 2009).

However, sometimes an open bidding process is not the most suitable way to award licenses. In some cases there are not enough parameters already known because uncertainties are still high. In this case the project circumstances are not concrete enough to make an auction type of bidding process work. Flexible bidding can be tailored to the individual parameters of the project. This is especially important with projects with specific technical needs. Whichever system a country chooses, the selection criteria and reasons for the choice of a winning company should be explained publicly.

Because a certain degree of technical and financial capacity is required to carry out exploration, development, and production activities, the minimum capability that companies must demonstrate to be able to bid on the contract has to be previously defined. Therefore, a **pre-selection of bidders** should precede both an auction and face-to-face negotiations to ensure that companies are qualified. The notion of ‘minimum capability’ differs per project, and has to be defined in the development phase of the project (The Natural Resource Charter, 2009).

As much information as possible should be made public prior to the award of contracts, such as the **fiscal regime** under which firms will be operating, geological knowledge about the area, publicly available findings of survey work, and other information that is likely to increase transparency and will attract firms to the bidding/negotiation process. The rules and terms for **bidding** and negotiations should also be clear and publicly available (The Natural Resource Charter, 2009).

The relationship between the host-government and the company is likely to be long term, lasting in some cases up to several decades. The environment of volatile prices and uncertainties due to geology, technology and prices makes the contractual relationship complex. It is impossible to foresee and contract upon all possible future circumstances, and cover for the risks of uncertainty. Therefore, contracts need to explicitly recognize that during their term adjustments may be necessary to account for unforeseen circumstances. For instance, after a change in economic circumstances the fiscal regime or resource prices

are sometimes considered unfair for one of the two parties. However, such **renegotiations** should be infrequent and reasonable, so that both parties get a fair rate of return out of the project.

Actions for Parliament:

1. It is imperative for Parliament to oversee the procurement process for each new contract and/or license. For example, parliament can use question sessions to get clarity on the selection process and the qualities of the winning company.
2. In some countries, contracts have to be approved by parliament for them to come into effect (see the box below). If this is the case, parliament must have a good understanding of whether or not the awarding process has been fair and transparent, and the content of the contracts must be favorable to long term development of the country. Some donors or civil society organizations can help parliament analyze contracts.

Parliamentary approval of contracts

In most countries, the drafting and negotiation of contracts is the responsibility of executive branch ministries or state-owned enterprises. After this process, some countries require the final, negotiated contract or selected bid in an auction to be ratified by parliament for it to come into effect. Governments in a number of countries require oil, gas or mining contracts to be voted on publicly by the parliament.

The following countries require parliamentary vetting of contracts:

- *Azerbaijan*. The Azeri Constitution gives the Azeri Parliament the power to ratify or veto international agreements. Such international agreements include extractive industry contracts such as PSAs. All international agreements must be approved by the parliament, at which point they become Azeri law.
- *Egypt*. PSCs must have legislative approval to become operational.
- *Georgia*. Foreign investment contracts are international treaties and must therefore be approved by parliament.
- *Kyrgyzstan*. If a foreign legal entity or individual is a party to a PSA, it should be ratified by the parliament.
- *Liberia*. Parliament must ratify investment contracts after negotiation and signature by executive ministries.
- *Sierra Leone*. Parliament should have access to mining contracts before they are signed, though its powers are limited to an advisory capacity, i.e., it can suggest changes.
- *Yemen*. Contracts are made Acts of Parliament and become part of Yemeni law; this is required by its Constitution and the policy was recently upheld in an international arbitration proceeding against the country, after executive ministries signed and negotiated an extension to a PSA but the parliament vetoed it.

Quoted from: "Contracts Confidential", Revenue Watch Institute, 2009

Public Hearings on Contracts

In Liberia the contract renegotiation process for the country's major mining deals included debate, approval or deliberations of Parliament, media, CSO, and government. Parliament must ratify investment contracts after negotiations and played a large role in the renegotiations. The renegotiations were generally seen as successful for both government and the mining companies.

In Timor-Leste activities around licensing and contract awarding are widely heralded as robust and transparent. Contracts are published and parliament has organized public hearings before granting ratification.

Contract Transparency

Public disclosure of contracts between governments and companies in the extractive industries is necessary to track revenue streams. At the same time it is important to protect social justice and the environment. Extractive industry contracts involve large amounts of public resources and include fiscal, social, and environmental matters. Citizens should therefore be entitled access to the contents of these contracts. Opening these contracts to the public could help to reduce corruption and result in fairer contract terms. For instance, there is both growing government discontent with non-disclosed EI contracts signed over the past two decades which has led to renegotiations of contracts in several countries (BIC, 2007).

International support for contract disclosure as a standard of international best practice is gaining momentum. The International Monetary Fund (IMF) as well as several governments claim that public disclosure of contracts should be considered a standard of international best practices that all EI companies are required to live up to. The IMF's Guide on Resource Revenue Transparency (2007) recommends contract transparency and says that good practice requires that all EI investment contracts are publicly disclosed. The Fund argues that the government is in a better negotiation position if it was understood that contract outcomes would be disclosed to the legislature and public. Incentives for the government to disclose data or contracts are to confer a sense of public ownerships and increase social stability, and to earn international credit and credibility.

Companies and governments have usually kept contracts in the extractive industries secret. The private sector argues that the contents of these contracts must remain secret to protect confidential business information. They claim that disclosure may reveal the cost structure or pricing strategy of a company and affect their competitive position. The IMF, leading economists, industry experts, and even EI companies themselves are challenging this view. In its Guide on Resource Revenue Transparency the IMF claims that contract terms become accessible after signing, therefore little strategic advantage can be lost by contract disclosure (see also Revenue Watch's publication "Contracts Confidential").

As a matter of public policy, disclosure of contracts should be the standard requirement for all EI projects worldwide. It is necessary to have access to the full contract, a summary of the most important clauses will not do. Where information about the sector and contract remains confidential and is not accessible to the public, the reasons for this should be explained and justified.

Liberia has recently passed the Liberia EITI Act, which incorporates contract transparency. Timor Leste is committed to contract transparency as well. Other examples of countries that have disclosed contracts in the EI sector (be it on an ad hoc base) are Peru and Ecuador.

Recently, Ugandan MPs have demanded disclosure of oil agreements from the government based on the Freedom of Information law that was enacted in the country in 2005. In most countries, however, the drafting and negotiation of contracts is the sole responsibility of the executive branch.

Actions for Parliament: Promote Contract Transparency

1. Parliaments should request copies of negotiated agreements. This can be done through parliamentary questions: Oral or written parliamentary questions typically provide regularly scheduled opportunities for individual legislators to pose questions to executive leaders for verbal response. In some countries, government is not responsive to parliamentary requests. In this case, one of the options is for parliament to reform its standing orders and the constitution to give parliament the authority to censure or sanction ministers who withhold information.
2. Parliament can push for the drafting or passing of a contract transparency or access to information law.
3. Once contracts are made available, there are several things committees can do to improve their capacity to analyze the contracts and put forward recommendations for improving them. For example, reaching out to local, regional, and international experts who can help the committees go through the contracts. This type of assistance is sometimes offered by donors.
4. Parliament needs to liaise on a regular basis with the administrative agencies that monitor the implementation of the contracts. This will allow a constant feedback loop of information to flow from these agencies. This way parliament will be able to determine when companies and government have deviated from contractual terms. If it turns out that companies or the government have deviated from the contractual terms, parliament can start a plenary debate to address the issues.

The struggle of MPs for contract transparency in Uganda

In Uganda, two journalists have sought to compel their government's disclosure of multinationals oil deals, highlighting the challenges to public transparency. The case was originally filed by lawyer and Member of Parliament [Abdu Katuntu](#) under Uganda's [Access to Information Act](#), a legislation he introduced in 2005. Senior reporter Angelo Izama and Charles Mwanguhya Mpagi of Uganda's leading independent newspaper [Monitor](#) filed the case to appeal the refusal of Uganda's attorney general to provide them with certified copies of oil exploitation agreements—because of alleged confidentiality clauses in the documents—according to news reports. The journalists argued that the information was of public interest: Ugandans must be able to hold the government and its partners accountable for the exploitation of the oil. However, the Chief Magistrate said in his ruling that the petitioners had not proved either of the public benefit of disclosing the information to the public. The journalists, along with their partners the Open Society Institute's [East Africa Initiative](#) and [Human Rights Network Uganda](#) (HURINET), said they were considering appealing the ruling.

In June 2010, after almost two years of persistent demands by the legislators, energy and mineral development minister Hillary Onek finally tabled the agreements, but kept the details confidential. After his address, MPs were not allowed to debate the issue. MPs rejected calls to keep the agreements confidential. They wondered how they as representatives from the people, would keep quiet about the matter. The agreements have been committed to the committee on natural resources, which will continue the discussions.

Source: "Uganda: Govt to Take 80 Percent of Oil Profits"

<http://allafrica.com/stories/201006300153.html> and "MPs Refuse to Keep Oil Agreements Confidential" <http://allafrica.com/stories/201006291150.html>

National Oil and Mining Companies (NOCs and NMCs)

A **national company** or a **parastatal** is a company fully or majority owned by the government. NOCs account for more than half of the global production of oil and they control about 90% of proven oil reserves. Many countries choose to have National Oil Companies (NOCs) take responsibility for exploration, development and export of oil reserves, or have them partner with other companies to do so. In these cases the NOCs also pay tax and royalty or other forms of compensation to the government. The government has an interest in making sure the NOC is an efficient producer and accurately pays the amount of money owed the government for the public treasury (The Natural Resource Charter, 2009).

Operators usually invest in some kind of social or infrastructure building projects, which in the case of NOCs can be seen as being part of their national mission. The role of an international oil company (IOC) is different from that of an NOC. The NOC's role is linked to the national mission, while the contribution of an IOC to society will come primarily through regulation and taxation systems. The role of an international oil company (IOC) in a host country's governance is limited as it looks for economic results and operates in accordance with its contractual obligations and with national and international law. IOCs can choose to include activities to enhance its investments and public image through Corporate Social Responsibility.

In some countries an independent state agency has been set up to regulate both state and foreign companies and in some cases to award licenses where state and foreign companies are in competition. There are various types of arrangements mixing private and public sector companies operating in a country. There are countries where a fully state-owned NOC works together with private companies. For example, they can partner through joint ventures or as contractors. There are also countries where a partially privatized NOC works alongside local and foreign private sector companies (Chatham House, 2007). Commercial operations of the national oil company should be in open and genuine competition with other companies in order to avoid inefficiencies associated with monopoly positions (The Natural Resource Charter, 2009).

Because of the ownership structure of NOCs there is sometimes confusion between the ministry of petroleum and the NOC over responsibility for policy making, and the difference between the two entities. For example, the Minister sometimes sits on the NOC board. It is usually most effective if the operator focuses on operating, and the regulator focuses on regulating. National resource companies should not be charged with regulatory functions. Defining the role of NOC's in law can help avoid **conflicts of interest** (The Natural Resource Charter, 2009). In practice there exist several models of the degree of independence between the regulator, the NOC and/or the Ministry of Petroleum or Mining. Particular caution is needed to specify the boundaries of decision-making, approvals and regulation. The NOC needs to provide reliable information to government to enable the government to choose the best policies for the petroleum sector (Chatham House, 2007).

Many producing countries choose to have a NOC to achieve **national development** goals. It distinguishes them from **private companies** and guides their decision-making in specific ways. Usually the goals of an NOC include one or more of the following objectives (see Chatham House, 2007 for a more elaborative discussion):

- Maximizing revenues for the state (maximization of net revenues matters most, so an efficient use of resources is important).
- National control of the country's resources (the NOC is a key instrument to achieve greater national independence from foreign companies. The NOC is a political vehicle for independence. The operations and decisions of the NOC run the risk of becoming politicized).
- Implementation of economic **development policy** (this is most important where the level of economic development is low, poverty levels are high and service delivery of the state is poor).

- Promoting **social welfare** (in countries where poverty levels are high and service delivery is poor, NOC can support the community in which it is working).
- Providing domestic energy (most NOC are responsible for the supply of fuel to domestic power stations and sometimes they provide subsidized energy to consumers).
- Petroleum diplomacy (NOCs are sometimes used as a tool for a country's **foreign policy** when dealing with foreign governments or foreign companies. For example, NOCs may favor particular countries through investments).

The national development objective and the role of the extractives sector in the national development strategy should be clear and well communicated to all stakeholders. The mission and purpose of the NOC should be well defined, with transparent objectives aligned with the **national development goal**. Decisions within the NOC are best when made by competent technical and commercial management within a clear regulatory framework, a minimum of political interference and bureaucratic procedures. Corporatization of the NOC, stock exchange listing and international competition can all lead to greater transparency (Chatham House, 2007). If an NOC has several objectives, some of these can be in conflict with each other. Its national social obligations and commercial objectives can be in conflict. For example, pressure to absorb **unemployment** and buy local goods and services can burden the NOC and affect efficiency. The extractives industry can create jobs that are not competitive or sustainable and drive out other economic activities. As the capacity of the government grows, it should take over most social functions of the NOC so that the NOC can focus on optimizing resource development (Chatham House, 2007).

A balance must also be found between the fiscal contributions that the NOC makes to the national **treasury** (which can fund social welfare projects out of the **national budget**) and its own capital requirements to pursue its commercial role. Another point for caution is the lack of transparency and accountability regarding social spending of the NOC. NOCs may become politicized because of the way they allocate social spending, and it is often not clear which social programs are sponsored by the NOC (Chatham House, 2007).

In some countries the NOCs' expenditure must be presented for approval to the government. If money is allocated to the NOC through the government budget year by year, NOC investment and long-term planning becomes difficult. The preference for management of NOCs is a corporatized NOC with its own balance sheet and the right to retain revenue for reinvestment.

Nigerian Senate investigates claimed insolvency of national oil company

In July 2010 THE claims and counter claims over alleged insolvency of the Nigerian National Petroleum Corporation, NNPC, came to a head at a hearing of the Senate Committee on Petroleum Upstream, yesterday. The Senate Committee had summoned the NNPC boss and the Minister of State for Finance to ascertain the truth in a controversy over whether or not the NNPC was insolvent. The Senators, led by the committee chairman, expressed shock at the propensity of the Federal Government to direct NNPC to release funds without recourse to due process and then ordered the corporation to present its annual accounts since 1999. While expressing surprise that the NNPC budget was approved only by the board of directors, the Senate committee members also requested the Group Managing Director to return to the National Assembly with copies of the law authorizing such approval. The committee had been told earlier that when the NNPC first deducted funds from the Federal Account, N85 billion was involved.

Source: "Nigeria: Senate Wades Into NNPC Insolvency Imbroglia"
<http://allafrica.com/stories/201007221172.html>

Parliament
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2. Parliament needs to stimulate transparency in the extractive industries sector. In the case of NOCs, parliament needs to make sure that the NOC is subject to the same disclosures required of publicly held companies;
3. Parliament needs to make sure that the NOC's contribution to national development goals is made clear, and that the distribution of economic benefits reflects the national priorities set under the strategic framework;
4. NOCs can sometimes become political instruments. Parliament can make sure there is no conflict of interest between the state and the NOCs (see next paragraph)

Examples of Parliamentary oversight of national oil/mining companies

Zambia

In November 2000 the highly damaging report of the Parliamentary Economic Affairs and Labour Committee on the privatization of Zambia Consolidated Copper Mines came out. The executive strongly objected the report and used its majority in the House to vote against adoption. *(Source: P. Burnel, Legislative-Executive Relations in Zambia: Parliamentary Reform on the Agenda, Journal of Contemporary African Studies, Volume 21, Issue 1, January 2003, pages 47-68)*

Tanzania

Some senior officials acted inappropriately in giving oil exploration rights to China Sonangol International Holding Ltd in exchange for the latter's purchase of 49 per cent shares in the national airline. The officials acted against the government procurement regulations and procedures by in effect granting three oil exploration licenses on the soil of Tanzania as a sweetener to induce the Hong Kong-based firm to purchase the shares in the troubled Air Tanzania Corporation (ATCL). The Parliamentary Parastatal Organisations Accounts Committee (POAC) has found serious discrepancies that undermine performance of several public utilities, including ATCL, and the government is expected to give a detailed account to parliament this week on what transpired during the signing of the agreement. "Parliament needs to know how oil exploration rights can be exchanged for an airline," said the chairman of POAC. The chairman said for the better oversight of investments with public interests, which the government jointly operates with a private investor, parliament has agreed to extend its scope into public institutions. Under the current system, oversight powers are limited to parastatal organisations and companies in which the government owns more than 50 per cent of shares. Under the new arrangement, POAC will be called the Public Investment Committee, which will also be responsible for policy oversight of parastatals and investments. *(Source: "Chinese firm 'gifted' oil licenses" the East African - <http://www.theeastafrican.co.ke/news/-/2558/522146/-/view/printVersion/-/80q7nm/-/index.html>)*

Conflict of Interest

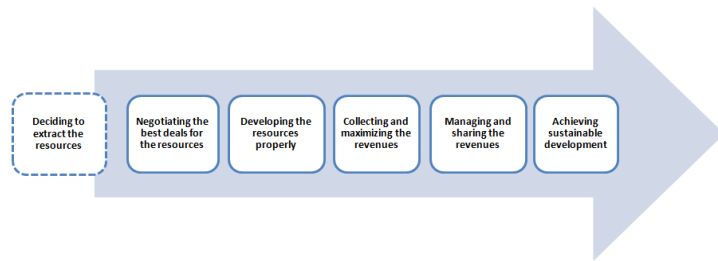
Corruption can occur when there is a known conflict of interest between a decision-maker's policy duties and his or her personal self-interest. Even if there is no evidence of improper actions, a perceived conflict of interest can create an appearance of impropriety that can undermine confidence in the ability of that person to act properly in his/her position.

In countries with weak ethical standards, legislators are just as likely as members of the executive branch to maintain business or personal ties perceived to be conflicts of interest. In Ghana, for instance, elected representatives and government ministers may serve on the boards of corporations over which they have direct or indirect oversight. In Tanzania, the 1998 Mining Act drops the provision that forbids that the Ministry of Mines officials cannot own shares in mining companies, creating a window for conflict of interest and corruption (NDI, 2007). In countries where oversight activities are conducted, legislative committees have turned to extractive industry companies to help finance extractive industry site visits, creating the impression of a conflict of interest (NDI, 2007).

Actions for Parliament: Code of Conduct

- Parliament should adopt a comprehensive code of conduct/ethics with an asset disclosure register and clear provisions related to the role of MPs and their staff with respect to NOCs and the EI sector more generally. This will help enhance the legitimacy of parliament to act as an effective oversight institution and build public confidence in the institution.

Value Chain Stage 3: Monitoring of Operations



Topics: Environment, Poverty, Indigenous Peoples, Local Communities, Land Concession, Land Management, Artisanal Mining, Gender, Unsafe Working Conditions, Closing Mines and Operations, Link to Domestic Economy, Contract Implementation, Infrastructure, National Oil/Mining Company, Operations, Private Sector Oil, Gas and Mining Companies

Once the legislative and regulatory framework are in place, and contracts and licenses are signed, operations can begin. EI operations generally require close compliance monitoring, which comprises both technical and environmental monitoring. If contracts are made public, it is essential for Parliament to make sure that both the government and the contracted company have complied with contract provisions, including existing rules and regulations. If contracts are not made public, it is essential for Parliament to make sure that both the government and the contracted party comply with existing rules and regulations, for example regarding environmental and social regulations. In most cases, extractives companies write quarterly or semi-annual compliance reports for the government.

Good practice encompasses enforcement of adequate environmental and social regulations as well as the establishment of an independent, competent authority charged with approving and monitoring environmental and social impact assessments and management plans and enforcing compliance. In accordance with good practice, the separation of roles among the ministry of environment or environmental agency, the environmental unit of the sector ministry and the state-owned company needs to be clearly established to avoid institutional conflicts and poor environmental monitoring. The environment ministry (or the environmental agency) usually retains full ownership of the clearance/permitting process. However, many countries have adopted the “one-stop-shop” approach, in which investors’ point of contact for all matters related to the implementation of petroleum and mining contracts or licenses is the sector ministry, which in turn secures the clearance for the relevant environmental authority. This arrangement can be effective in simplifying compliance monitoring and reducing investors’ cost of doing business.