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The Extractives Industries

Investment in the EI sectors (oil, gas and mining) has features that present particular challenges to policy makers. They arise from the outset, at the policy design and legal framework stage, and are evident in subsequent stages to the management and allocation of revenues – and ultimately, the sustainable development of these resources. Some, perhaps many, of these features are common to all three sectors, such as the extraction of resources from under the ground or the sea-bed[1], their ultimate exhaustibility, or their exposure to a high degree of price volatility. Others are unique to each sector. For example, oil and gas are very alike at the upstream stage (exploration and production), but natural gas takes on distinct 'network' characteristics in its transportation and distribution phases. From a commercial point of view, oil is riskier to find than the mineral deposits typically sought by mining companies but once found in commercial quantities, that risk is reduced relative to the commercial risk of producing mining deposits (although that does not apply to the environmental risk). Gas is different again, with its risk profile requiring a complex, highly expensive infrastructure and a detailed contractual regime to support it. Effective management in the public interest requires recognition of both the common and the unique features of EI in the design of sector policies and institutions.

This Chapter critically examines the fundamental characteristics of EI sector investment, from a perspective that gives priority to public policy making and the design of appropriate institutional arrangements in the public sector. It identifies the common features, the key differences between EI sectors and the investment dynamics. Its focus is on the relationships that governments have or seek to have with investors in the EI sector rather than on how governments themselves can respond to the challenges and opportunities of *natural resource-led development* (the subject of **Chapter 2**). Some features of this investor-state relationship are relatively constant over time, while others are more dynamic, such as industry structure, showing significant changes and greater complexity in recent years, not least due to companies from emerging markets making strategic investments aimed at securing future supplies of energy and minerals.

[1] In this sense, the 'extractives' industries by definition stand in contrast to the renewable energy industries which typically rely upon natural resources located above the *surface* (wind, solar power, for example).

There are many aspects of this investor-state dynamism that present challenges to policy advisers and decision makers in resource-rich states. For example:

What kind of company or pattern of companies is best suited to achieve a country's policy on extractives and development generally?

The choice is wide. Alongside long established companies from the OECD countries there are state owned enterprises (SOEs) from Malaysia, South Korea and the Middle East, and new players from China, Russia, Brazil and India, all making significant impacts. Significant diversity of ownership and financing structures has emerged from the resulting south-south pattern of investment, with the use of resource-for-infrastructure deals being one example of this. Moreover, the growing number of so-called junior or mid-cap companies as investors means that a focus by policy makers and their advisers on the 'super-major' companies that long dominated the EI sector is now inappropriate. This diversity is also evident in the destinations of investment, the points along the exploration to extraction cycle and across key energy and other minerals commodities[2]. A further element of complexity in investor-state relations is presented by the international character of investment in the oil, gas and mining sectors. More than ever before, there are opportunities for investors to structure their operations, on- and offshore, to take advantage of this context. As a result, national tax and regulatory authorities face greater challenges in regime design, in monitoring and enforcement.

[2] See background paper to Rents to Riches book by Kaiser and Vinuela: Rents for the Future? (author's copy), p. 3.