

CHAPTER 5 – www.eisourcebook.org

5.2 Eight Key Challenges

Most attempts to develop a framework for EI policy, law and award of rights will face at least some of *eight* key challenges:

- 1. Knowledge of the Resource** However clear the legal character of ownership, it will usually be much less clear what the host state actually owns: the existence, size and distribution of the reserves and their potential for extraction are likely to be uncertain in most cases, leading to some guesswork in policy design, and for companies a hedging of the exploration risk. As knowledge grows, some of the initial assumptions may turn out to be way off the mark, leading to policy instability;
- 2. Legacy Issues.** It is rare for there to be no existing framework in place, or elements of one. Some transitional arrangements will need to be put in place for existing right-holders, including state companies, and overlaps and inconsistencies between laws need to be identified and removed. The challenge may differ in character between say a framework for offshore hydrocarbons and on-land mining operations, which may date back a very long time; even so, there may be long-standing boundary issues to address with neighbouring states;
- 3. Sources of Volatility.** The stability of the policy framework will be vulnerable to other unknowns than geological ones. These include the expected level and trend of future oil, gas and minerals prices, affecting the price at which they will be sold, competition from other countries that supply oil, gas or other minerals, and for the investor the risk that the country experiences a political realignment with impacts upon a major EI development. Given these unknowns, the policy and legal framework will have to be flexible enough to allow for a managed development of the sector.;
- 4. International Competition.** Some framework elements will be influenced by the need to compete with neighbouring states in attracting foreign investment, so a task to be initiated is to find out what the regional and even international 'going rate' is that a government in similar circumstances might offer;
- 5. Learning from Practice Abroad.** Experiences of how other countries have fared with certain contract forms, fiscal regimes and techniques can yield new knowledge about them. Some form of comparative review would be

considered normal practice. The increasing complexity of international taxation underlines the importance of knowledge exchange;

- 6. Public expectations.** The management of expectations, especially among local communities, needs to be addressed while the framework is under development; if not, there is a risk of serious challenge or worse, undermining, at a later stage;
- 7. Mining and hydrocarbons.** Where both sectors co-exist, it is crucial to appreciate that there are important differences between the two sectors: in legal regimes, these differences are evident in contract forms and methods of award. Designing and operating a framework in one sector is unlikely to provide a model for the other; and
- 8. Gas.** Within the hydrocarbons sector there are major differences between oil and gas, especially evident after the initial phase of exploration. The policy and legal framework has to be adapted to take into account the very different forms of long-term contract and infrastructure that are required for natural gas development.

A conclusion from this overview of the common challenges facing policy-makers is that any policy for the extractive sector has to be understood as a dynamic construct, not as a set of principles that unfold 'like a straight line'. Rather, policy will take a zig-zag pattern in a country and policy-makers will need to adapt and adjust their approach as they learn from experience and respond to market developments. What worked in the past may fail in the future.