

# CHAPTER 5 – [www.eisourcebook.org](http://www.eisourcebook.org)

## 5.3 Policy Priorities

Experience suggests that to be effective, EI sector policies should be part of a strategic vision based on consultation with a broad base of stakeholders and should provide direction and clarity on key sector issues.<sup>1</sup> The way in which social, economic and political objectives are combined in such a vision will inevitably be country-specific. It may also need to be revisited and critically reviewed. As the ministry of one of the most successful petroleum producers, Norway, has noted, “governments must be willing to consider whether established principles and the prevailing policy framework create the right incentives for enhanced value creation, and possibly adapt policies to ensure that resources are not wasted”<sup>2</sup>.

Once there is reasonable certainty that resources exist, an element of that strategic vision should be the horizon for exhaustibility<sup>3</sup>. If the resource horizon is likely to be short, the vision needs to assess how government expenditures can be sustained once resource revenues end. If it is projected as long, the main challenge is likely to be the management of revenue volatility since experience tells us that the price of the resource will certainly fluctuate.

The resulting policy statements are often stand-alone documents, but they may also be found in summary form as preambles to sector legislation<sup>4</sup>. There are important differences between oil, gas and mining policies which also have to be taken into account.

It is perfectly possible for a government to postpone or to omit the design of a strategic vision and implementing law and to proceed to negotiate a large contract. Some do. One compelling reason why this may happen is the time it takes to adopt a special law. The risk of this ‘contract-first’ approach is that such an individual contract – which in both mining and hydrocarbons can exert an overwhelming influence over the whole economy – will fail to address national plans and priorities once these emerge, and that it may be viewed by citizens as lacking legitimacy. This

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<sup>1</sup> Liebenthal, A., et al. (2005). *Extractive Industries and Sustainable Development: An Evaluation of the World Bank Group Experience*. Washington, D.C.: World Bank Publications, p. 5.

<sup>2</sup> Ministry of Petroleum and Energy (2002) Oil and Gas Activity: Report No 38 to the Storting (2001-02) p.19 (unofficial English translation).

<sup>3</sup> P Daniel, S Gupta, T Mattina and A Segura-Ubiergo, Extracting Resource Revenues, Finance & Development, September 2013, 19-22.

<sup>4</sup> The Memorandum to the Ghana Minerals and Mining Bill (2006) provides an explanation of the changing policy priorities that made necessary certain provisions in the new law. The Mozambique Petroleum Law (2000) states that its adoption is to ensure “greater competitiveness in the petroleum sector and guarantees the protection of rights and assets of participants in Petroleum Operations”.

lack of a 'social license to operate' may provoke tensions among the communities located in the immediate vicinity of the project and may well fuel demands from subsequent governments for renegotiations. Where several contracts have been awarded on this 'first come, first served' basis, the result is likely to be a patchwork of diverse contract terms, hard to monitor, of varying quality in terms of their benefits to the host government and located outside of the main legislative framework that the country eventually puts in place.

### 5.3.1 Oil, Gas and Mining Policies: Contrasts

**Oil** A key element of any oil policy will include a decision on the kind of partnership envisaged between the host state and foreign oil companies. Its shape will depend upon the level of knowledge about petroleum reserves in the country. If little is known about their existence, a priority will be to ensure that foreign investors develop an interest and that a measure of competition may develop. If however resources have been found in significant quantities, the attraction of capital will usually be a much easier task and the question will be more one of ensuring that the terms of cooperation reflect this promise.

Estimates of the resource horizon will also play a role. A government with substantial reserves relative to the population may wish to extend the horizon far into the future: "Control over the tempo of operations has been one of the more central and permanent objectives of Norwegian petroleum policy"<sup>5</sup>. For governments with a shorter resource horizon in prospect, the priorities are likely to include: maximization of production, including by enhanced recovery techniques; attraction of further investment, especially in smaller fields; encouragement of sustainable spin-off impacts on local industry and its development on the international stage.

The international dimension of oil policy is greater than with gas or mining. Markets are international and capital flows highly globalised. This means there is an impact on a government's decisions from both pricing trends and the kind of signals to investors given by other states in comparable circumstances.

Transparency has increasingly become prominent in oil policy, as the 2012 National Petroleum Policy of Liberia shows: "(t)he absence of transparency and accountability in the petroleum sector would not only result in lack of good governance, but would also affect the implementation of Liberia's development agenda negatively"<sup>6</sup>. The overlap between an oil policy and other policies, particularly environmental and

<sup>5</sup> F Al-Kasim, *Managing Petroleum Resources*, Oxford Institute of Energy Studies, 2006, p.189.

<sup>6</sup> National Petroleum Policy 2012, p.7.

social ones, has also become more important. Policies have to be able to address the costs of decommissioning and of liability for pollution from various oil-related activities. The Liberian Policy is emphatic: “The Government may not, by contract or otherwise, bargain away the right of future governments to impose applicable health, safety or environmental regulations on licensees or contractors”<sup>7</sup>.

**Gas** In sharp contrast to oil, gas policy has to be comprehensive in scope, extending ‘from wellhead to the burner tip’<sup>8</sup>, if development and production are to be encouraged. Once discovered, even in large quantities, commercial development of natural gas may *not* follow, especially in countries where there is insufficient domestic gas infrastructure and markets do not exist. The reasons may be rooted variously in the assessments of ‘sufficient’ reserves; an inability to identify viable long-term gas markets, locally and/or abroad, if exports meet the national interest; or in difficulties in the development of construction projects for local processing and transmission facilities. Governments also need to prioritize between the different markets and uses of gas to obtain the highest possible added value for both the country and the investors. Both of these considerations (the potential for export projects and the types of domestic gas uses) will depend greatly on the estimated amount of available gas reserves in the country. A Liquefied Natural Gas (LNG) project is only likely to be considered when significantly large reserves exist while local gas-fired power plants need only relatively small reserves.

These considerations imply a policy that is forward-looking and also one which permits adaptation to the respective gas resources potential and expected gas demand of the country.

In this context, typical policy objectives are: to encourage gas exploitation and production under a fair fiscal regime; and to actively promote domestic use of the produced gas. Demand for gas to generate electricity in favour of more polluting alternatives, such as coal, is a strong driver to gas development. Domestic gas commercialization also has enormous potential for resource-rich countries in terms of direct economic benefit, economic diversification, and local content through power generation and or industrial consumption.<sup>9</sup> A number of African countries like Mozambique and Ghana have included this in their policy planning (see **Chapter 6** for discussion of Gas Master Plans). This should lead to provisions in the relevant legislation:

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<sup>7</sup> Ibid, p.19.

<sup>8</sup> H LeLeuch, ‘Natural Gas Guidance Note: Brief’: [www.eisourcebook.org/documents.php](http://www.eisourcebook.org/documents.php)

<sup>9</sup> Kellas, G. (2010). Natural Gas: Experience and Issues. In: Daniel, P., Keen, M., and McPherson, C. (eds.). *The Taxation of Petroleum and Minerals: Principles, Problems and Practice*. London: Routledge, pp. 163-183.

- to allow longer periods for appraisal and for production of gas discoveries than for oil;
- to require mandatory joint development and exploitation of gas discoveries between several licensees when justified;
- to define specific fiscal incentives for promoting gas activities and principles for gas pricing as well as specific provisions for unconventional gas; and
- to state the priorities for gas uses, especially between viable domestic and export uses.

Errors in policy-making would typically include:

- treating gas in the same way as oil in the principal legislation without providing specific provisions for the encouragement of gas activities;
- adopting regulations that do not limit flaring of gas or do not impose gas re-injection when such re-injection would increase the oil and condensate recovery; and
- giving priority to exports of gas over domestic uses in highly populated countries with potentially limited gas reserves.

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**Mining** Policies for mining often include diverse principles covering (1) technical subjects such as the calculation of mineral reserves or conduct of exploration and exploitation; (2) higher level principles such as the need to put in place an efficient and effective cadastre system, land tenure and stable and transparent financial codes and taxation regimes that are specific to mining; and (3) subjects in mining but not unique to it, such as the management of social and environmental risks and impacts, maximization of social and economic benefits from mining activities and enhancement of development opportunities from mining. An example of a policy document that falls into the latter category is the ‘Broad-Based Socio-Economic Empowerment Charter for the South African Mining Industry’<sup>10</sup>. Similarly, the Minerals Strategy of Sweden, one of the largest mineral producers in Europe, adopted in 2013, places a strong emphasis upon the harmonious development of mining with the environment, cultural values and other business activities. The Mining Policy of Ghana (2010) expressly encourages “a more proactive role for women in decisions relating to minerals and mining at the national, local and firm level”<sup>11</sup>.

<sup>10</sup> Department of Mineral Resources. 2010. <https://www.westerncape.gov.za/Text/2004/5/theminingcharter.pdf> (last visited 15 March 2016), and note the Assessment of this Charter (<http://www.dmr.gov.za/mining-charter-assessment-report.html>) (last visited at 15 March 2016).

<sup>11</sup> Kazakhstan Joint Economic Research Program (2013), Legislation for Allocation of Mining Exploration Rights: Report 1, Allocation of exploration rights for mining in a sample of major global mining countries, p.52.

Consistency between the mining policy and other related, existing policies is important to achieve. These will include fiscal and environmental policies and policies for other land use. Where policies on fiscal, environmental or social matters do not exist, an overarching policy on mining could include mining-related fiscal, environmental protection and social mitigation policies as well as provision for the interaction between mining and other land uses.

A multilateral initiative on mining and sustainable development, the Intergovernmental Forum, has produced a Mining Policy Framework. It contains six Themes, including Post-Mining Transition and Artisanal and Small-scale Mining. The aim is to provide developing countries with a policy framework or model that incorporates “best practices required for good environmental, social and economic governance in the mining sector and the generation and equitable sharing of benefits in a manner that will contribute to sustainable development”<sup>12</sup>.

### 5.3.2 Ten Common Issues in EI Policy-Making

Some issues are commonly encountered in setting policy priorities. Ten of them are reviewed below.<sup>13</sup> Each one of these issues is discussed in greater detail in this chapter, or in **Chapters 6 or 7**.

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#### Ownership in Practice

The practical consequences of sovereign resource ownership depend in large part on the policies that a state adopts for the participation of EI sector companies, foreign and domestic. Nationalist sentiments and concerns for safeguarding sovereignty have made foreign private investor participation contentious in many resource-rich states.<sup>14</sup>

Policy statements relating to resource extraction usually start by recalling and re-affirming sovereign rights over the ownership and development of petroleum or

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<sup>12</sup> Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development, Overview of the Mining Policy Framework (presentation to the African Mining Indaba Conference, Cape Town, 5 February 2013 by Paul Masanja, Tanzania Minerals Audit Agency).

<sup>13</sup> However, this list of issues is not exhaustive. Detailed intentions under each of these, and other possible policy headings, would normally be provided by implementing legislation, model contracts, contract award procedures, regulation, and fiscal regimes.

<sup>14</sup> See Mann, H. (2002). *The Right of States to Regulate and International Investment Law*. Geneva: International Institute for Sustainable Development (IISD).

mineral resources. Such statements typically call for the EI sectors to be developed in a manner consistent with the maximization of near-term benefits to, and long term interests of, the state and state development priorities. Increasingly, they are accompanied by declarations about the manner in which income is to be distributed; in decentralized systems, revenue management is of great importance. So much so, that some petroleum laws promise a dedicated law on revenue management. Articles 4, 5 and 6 of the Somali Petroleum Law<sup>15</sup>, for example, states:

“Petroleum income will be distributed between central federal government, the Regions and Districts of Somalia for the benefit of the whole country (Art 4).

The government will create a law to distribute shares of petroleum income to the federal central government, Regions and Districts of Somalia where the petroleum can be found, and that law will be approved by the Transitional Federal Parliament in due course (Art 5).

The central government shall establish plans for non-petroleum Regions and secure their shares of petroleum income to improve their development” (Art 6).

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In states that have federal systems of government – such as Australia, Canada, Iraq or Nigeria, different approaches to the allocation of sovereign powers over petroleum activities and revenues have emerged. Here questions arise such as: what is to be the division of powers and responsibilities, first between the centre and other political and administrative sub-divisions, and secondly between ministries, departments and agencies of the centre and sub-divisions, in respect of the following major areas as they apply to extractive industry activities?

By way of response, some federal systems have chosen to devolve significant operational control to sub-governmental or private entities, while others have taken a more restrictive approach to the devolution of sovereignty authority over natural resources.

In a small number of states, the competent authority is not the national government but a sub-national entity. In Argentina and Canada, provincial authorities award licenses and impose taxes on exploration and mining activities.<sup>16</sup> At the national level, a key question for policy makers relates to the manner in which the legal and

<sup>15</sup> Transitional Federal Government of Somalia, Petroleum Law of Somalia, Law No XGB/712/08 dated 06/08/2008 and President’s Office Ref JS/XM/182/06/2008, 7 August 2008: Source Book ref:

<sup>16</sup> In Canada, the federal government retains authority over income taxation while royalties are a provincial responsibility.

constitutional frameworks constrain the discretion of national authorities in the design or allocation of contracts or licenses and their subsequent operational control.

Another aspect of ownership may be the need to address existing or latent disputes with neighbouring States on who owns what territory. This commonly affects inland and offshore water spaces, and may require intervention by international courts or tribunals for independent resolution of the state-state dispute. More often than not, this concerns offshore waters (see **Box 5.8**).<sup>17</sup> As the technology for carrying out EI operations has improved, such areas have become accessible for exploration and exploitation. The law too has evolved considerably over the past few decades, in terms of treaty and case law. This applies not only to offshore hydrocarbons resources but also to minerals accessible through deep-sea mining.

## Sector Roles and Responsibilities

The roles of the sector ministry, its agencies, and the national resource company (NRC), if there is one, are of the greatest importance. These institutions are typically mandated to implement and oversee sector strategy. Other critical entities include the ministries of finance (taxation) and environment (social and environmental protection), and the revenue collection authority. These non-sector-specific entities are often tasked with achieving optimal operational benefits among the various sub-governmental or sector-specific agencies. In practice, this is very difficult to achieve and an overlapping competence is often found among state entities, creating potential for confusion (see discussion in **Chapter 6**).

## National Resource Companies (NRCs)

While not without controversy, NRCs remain popular in most petroleum-producing states, and also in a growing number of mineral-producing states. Their governance and roles, which may include both commercial and non-commercial objectives, may be the subject of separate legislation, such as the Nigerian National Petroleum Corporation Law, or emerge from a merger of existing domestic companies such as led to the creation of Pertamina in Indonesia or nationalization as led to the creation of PDVSA in Venezuela. Controversy tends to be sharpest in relation to the NRCs'

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<sup>17</sup> For an overview of the literature on maritime delimitation disputes see Cameron, P. (2006). *The Rules of Engagement: Developing Cross-Border Petroleum Deposits in the North Sea and the Caribbean*. International and Comparative Law Quarterly, Vol. 55, pp. 559-586.

links to the host state, where management and budgetary interference is common, or when there are different views about the kinds of relationships that lead to optimal outcomes in a particular country context. Where a new NRC is envisaged, capacity building is inevitably an important issue. To date, NRCs have been much more common in the petroleum sector than in mining (see **Chapters 6 and 7**).

## Private Sector Participation

Participation of the private sector is one of the most important issues to be addressed in any sector policy statement. Among resource-rich states such participation is common, with notable exceptions being the petroleum sector in Mexico (for 75 years until 2014) and a number of Middle Eastern states.<sup>18</sup> For policy makers in many former colonial states, the historical memory of unhappy private sector involvements – even if they occurred decades ago - will play a significant role in shaping the legal and contractual frameworks today.

However, few states have found it possible to resist the advantages of risk sharing, financing, and technical and managerial skills transfer that comes with foreign participation. Norway, for example, had a very public debate on whether or not to open its petroleum sector to foreign investors and eventually decided to permit foreign involvement for many of the reasons just given.<sup>19</sup>

## Exploration

Although the exploration phase generates valuable information for the host government and investors, it nonetheless remains a financially high risk undertaking. Thus, the question about *whether or not the government should assume this risk is an important policy issue*. Faced with such risks, governments have four basic options: (1) they can develop the resources themselves; (2) contract private petroleum and mining companies to develop the resources for fees; (3) auction the right to develop the resources to a private company; or (4) adopt a combination of any of the aforementioned alternatives. More often than not, governments enter into agreements with private companies to explore and develop the resources at

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<sup>18</sup> Even in the Middle East, several companies have engaged private sector participants: for example, Persian Gulf states such as the United Arab Emirates (UAE). The rationale for such participation is access to cutting-edge technology and a sharing of technical and financial risks.

<sup>19</sup> Gylfason, T. (2004). *Natural Resources and Economic Growth: From Dependence to Diversification*. Discussion Paper. London: Centre for Economic Policy Research, pp. 26-27.



their own costs and risks. This option is particularly attractive where a government or its NRC does not possess the essential technical know-how and skills to develop the resources themselves.<sup>20</sup>

## Local Content

Policy statements increasingly outline expectations with respect to local content as governments seek to maximize impacts from resource development in the wider economy. Local content requirements seek definable linkages between core sector investments and operations on the one hand and local employment and economic activities on the other. Policy makers are likely to experience strong pressures from local business or communities to promote such content. However, such pressures can present issues for both host governments and foreign investors as the necessary skills for some petroleum and mining operations may not be available in the state concerned (see **Boxes 5.3 and 5.4; Chapters 2 and 4**).

## CEPMLP Fiscal Objectives

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Fiscal objectives are normally the focus of intense attention at the detailed implementation level, but at the policy level they typically emphasize both revenue sharing and safeguarding of incentives for efficiency and investment. These dual objectives are often simultaneously pursued and must be balanced against each other for optimal results. However, such a balance will be affected by global or regional market conditions and by perceptions about what is the 'going rate' in similar country contexts (see **Chapter 7**).

## Revenue and Expenditure Management

There is a growing recognition of the particular challenges resource wealth can present to macroeconomic management. As a result, many policy statements issued by governments spell out intentions with respect to the saving and investment of resource revenues (including the possibility of resource funds) and to their expenditure. Examples of states that have developed policy statements in this regard

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<sup>20</sup> Tordo, S. (2007). *Fiscal Systems for Hydrocarbons: Design Issues*. Washington, D.C.: World Bank Publications, pp. 5-6.

include: Norway, Kuwait, Iran, Timor-Leste, Chile, and Papua New Guinea. Some of these policies are summarized in **Chapter 8**.

## Social and Environmental Concerns

Strategies for protection of the social and physical environment usually feature prominently in EI sector policy pronouncements. Their focus often goes beyond measures aimed at the mitigation of adverse consequences and extends to the kind of resource-led development measures discussed elsewhere (see **Chapters 2 and 4**). These include the promotion of net benefits and the distribution of those benefits between the poor and the elite, between men and women, and among other disadvantaged groups such as the elderly and children (see **Chapter 4**). The challenge here is to ensure that these policies are 'joined up' to the policies specifically aimed at EI sector development and that implementing agencies coordinate. Often they do not.

## CEPMLP Local Context and Commitments to Investors and Civil Society Centre for Energy, Petroleum and Mineral Law and Policy

The overall regime for the EI sector must, or should be, sensitive to investors' concerns about long-term investment security. Where the context is one of past nationalization or frequent unilateral changes to contracts, investors will usually expect the policy and related legal framework to signal a changed investment climate. Similarly, there needs to be a proactive communications approach to civil society to ensure that there is an accurate understanding of the government policy for the EI sector (particularly important for the mining sector). This can correct misinformation and fill information gaps.

Investors will be sensitive to a general problem that is sometimes referred to as the 'obsolescing bargain'.<sup>21</sup> Once a large-scale investment is made in largely immovable assets, the investor faces a risk that the government may unilaterally change the terms of the investment regarding shareholder agreements, taxes and tax rates (increasing project-specific or sector-specific taxes) or in the most extreme case nationalizing a project. The risks are typically larger in states with small economies and only one large minerals or petroleum operation.

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<sup>21</sup> Economists also refer to the 'obsolescing bargain' as the 'time inconsistency problem'.

These risks can often be reduced by increased transparency and accountability related to a combination of national legislation and contracts that are binding under international law and arbitration. The obsolescing bargain problem can also be reduced by commitment technologies such as shared commitments relating to private-public partnerships for major infrastructure that supports the minerals and hydrocarbons operation. International Finance Institutions (IFI) funding of the project or its infrastructure can also reduce risk since there would be IFI sanctions on governments who do not keep their obligations under legal agreements to which IFI's are signatories (see **Chapter 4**).

**Once the major policy decisions have been taken, governmental authorities need to agree on exactly what is to be awarded, to what end and the manner of award. Typically, rights will be awarded on the basis of procedures in laws or regulations rather than being negotiated in agreements or contracts. This promotes transparency about the licensing process, gives some protection against corrupt practices in which rights might be obtained by bribes and mitigates the asymmetry of information and capability that can arise between inexperienced officials in small governments and highly experienced and skilled company negotiators. The following section addresses laws for oil, gas and mining activities.**

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