

GOOD GOVERNANCE OF THE NATIONAL PETROLEUM SECTOR

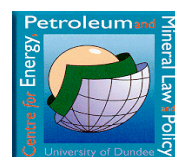
INTERIM REPORT

Prepared by Keith Myers and Glada Lahn

Edited by Valerie Marcel, John Mitchell and Willy Olsen

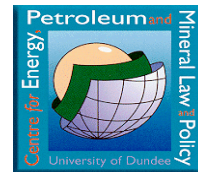


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Edited by Keith Myers and Glada Lahn
With contributions from Valerie Marcel, John Mitchell,
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EXECUTIVE SUMMARY

The Good Governance of the National Petroleum Sector project was developed jointly by Chatham House and the Centre for Energy, Petroleum and Mineral Law Policy (CEPMLP) at the University of Dundee. The aim of the project is to better enable national decision-makers to govern the exploitation of their hydrocarbon resources for the greatest socio-economic benefit. To achieve this, we are providing a forum for national oil company (NOC) and ministry of petroleum representatives to meet with counterparts in other producing countries and exchange views on governance. The project is unique in being *informed by the experience of oil and gas producing countries* and *developed by the producers themselves*.

The process includes:

- Engaging producers in constructive dialogue about the objectives, challenges and practicalities of good governance through a series of workshops, producer case studies and research on specific governance issues;
- Establishing as broad a consensus as possible on what constitutes good governance;
- Surveying current governance practice worldwide, describing key governance arrangements and identifying what is necessary for their effective implementation;
- Using the results of workshop and survey findings to produce a practical guide to assist producers in improving petroleum sector governance;
- Publicizing the guide globally. The guide will be a conduit through which to engage more producers in developing the good governance dialogue.

Since its launch in February 2005, the project has convened representatives from 16 countries, which collectively produce 47% of the world's oil, together with international oil company (IOC) representatives in two workshops. This interim report summarizes the findings to-date and outlines the project's next steps.

The producer dialogue we facilitated in 2005 has helped to establish common understanding and bridge cultural differences. Participants have agreed on the key actors involved in governing the petroleum sector, namely, the State/Government, People and Society, Operators and Investors. However, in each country these actors take particular forms and interact with one another in particular ways. The research, workshops and case studies have established that, whilst there is no single, ideal model for petroleum sector governance, there are certain essential functions and universal principles which transcend national boundaries. The functions are: 'Policy', 'Strategy', 'Operations' and 'Monitoring and Regulation'. The universal principles of good governance are:

- Clarity of goals, roles and responsibilities
- Enablement to carry out the role assigned
- Accountability of decision-making and performance
- Transparency of information
- Sustainable development for future generations

The five principles and four functions provide a structure for thinking about governance issues. Each broad principle encompasses several specific issues relevant to petroleum sector governance. These are given in the table below.

Table 1. A framework for thinking about governance issues

Responsibility	Enablement	Accountability	Transparency	Sustainability
Assignment of goals, roles and responsibilities	Delegation of decision-making authority	Holding decision-makers to account	Transparency of data between government and operator	Sustainable resource management
Policy and strategy	Capacity building	Benchmarking NOC performance	Transparency beyond the sector	Revenue management
The regulator and its function	Rationalizing NOC national and commercial goals	Incentives for greater accountability	Justifiable confidentiality	Education within and outside the sector
The purpose of an NOC	Fiscal relationship of NOC to State	Role of parliament and civil society	Transparency in licensing	Support for the non-oil economy
Relationship between NOC and State	Incentivizing the NOC to perform	Evaluating non-commercial spending	Transparency in procurement	Role of corporate social responsibility
The IOC role	Making the regulator effective	Impact of stock exchange listings	Incentives to make transparency initiatives work	
	Requirements for governance reform	National vs international accountability		

The case studies presented at our second workshop explained the practical aspects of some of the issues above from the producer’s point of view. They demonstrated that the country context - in terms of culture, politics and level of development – is critical in determining the organization of the petroleum sector and its priorities. Governance arrangements may need to be reevaluated as this context evolves over time.

The next step in the project is to use the principles and functions as a framework for inquiry leading to the delivery of a “guide to good governance of the national petroleum sector” which will take into account the diversity of producing countries.

With the help of participants, project organizers will conduct a survey of current practice in selected producing countries, codify several key arrangements or ‘types’ of practice and identify the requirements, actions and behaviour necessary to make each one successful.

In parallel to the survey, project organizers will offer a series of in-country briefings in order to broaden participation in the project, test current assumptions and begin capacity building. Participants at our third workshop in April/May 2006 will discuss and build on issues raised by the survey and generate recommendations for the guide. We will then compile the draft good governance guide over the summer and seek official endorsement from producing countries in Autumn 2006.

BACKGROUND AND CONTEXT

In developing countries with substantial oil and gas resources, good governance of the petroleum sector is key to generating wealth, creating a sustainable economy and fostering long-term human development. Producers are concerned about dependence on volatile oil revenues and the current high oil prices have both raised the stakes and increased public expectations. The difficulties of managing oil revenues efficiently and fairly, the requirements of economic liberalization and pressure from evolving international standards, have contributed to an increasing focus on petroleum sector governance.

However, there is as yet no international standard or measure of good governance for the petroleum sector. The International Monetary Fund (IMF) has published a general code of practice on fiscal transparency and the World Bank publishes a set of national governance indicators. International initiatives such as the Extractive Industries Transparency Initiative (EITI) and Publish What You Pay (PWYP) have focused only on one aspect of petroleum governance - revenue transparency - and neither initiative originates from the producers themselves. Producers have until now lacked a forum which takes into account their specific circumstances and development agendas.

There is a wide range of producer experience. Some countries have successfully overcome or bypassed the problems of the *rentier state* while others face substantial challenges and are in the midst of their own reform programmes. There is thus great interest from producers in learning from one another and in sharing best practice. The Good Governance project addresses this by bringing producers together in dialogue to develop practical guidelines for good governance, informed by the experience of oil and gas producing countries and developed by the producers themselves.

The purpose of this Interim Report is to document progress to-date, draw preliminary conclusions and lay out the plan for delivery of the guide to good governance of the national petroleum sector.

AIMS AND OBJECTIVES

The aim of the project is to better enable producing countries to govern the exploitation of their hydrocarbon resources for the greatest national socio-economic benefit.

Primary objectives:

1. To bring together producers in constructive dialogue about the governance of their national petroleum sectors;
2. To establish as broad a consensus as possible on what constitutes good governance;
3. To produce practical guidelines that set out what producers can do to improve governance;
4. To disseminate the guidelines to principal actors around the world.

Additional outcomes will include further insight into common challenges and barriers to progress in producer countries and increased understanding amongst stakeholders, enabling greater coordination between them in addressing governance problems.

METHODOLOGY AND PROGRESS

The project is being organized by a small team of senior energy and governance experts (see annex for biographies). They are being assisted by a stakeholder advisory committee composed of representatives from the main producing regions. The establishment of principles and formulation of the good governance guide will be based on a producer-led process of self-examination, experience sharing and consolidation. This process will be achieved through a series of high-level workshops, participant working groups and in-country seminars. Project organizers structure the project, conduct research, compile reports and provide workshop facilitation. Feedback and input from the project's participants is encouraged at every stage. We seek the engagement of as many producing countries as possible in the project and their official endorsement of the published guidelines.

Work to date

To date, two workshops have taken place: the first in February 2005, establishing consensus among participants on the principle objectives of good governance; the second in September 2005, where case studies and discussions focused on 'lessons learned' from the practical experience of producing countries. The participation and dialogue so far has fulfilled objective 1. This report, together with the workshop summaries, document our progress toward achieving objective 2.

The four position papers¹ presented at Workshop I, producer case studies from Workshop II and the summaries of both workshop discussions are available on the project's website www.chathamhouse.org.uk/goodgovernance.

At the first workshop, we formed a stakeholder Advisory Committee whose role it is to offer guidance and help to promote the project.

At present, the project's participants include representatives from:

- ✓ 16 producer countries: Azerbaijan, Brazil, Colombia, Egypt, India, Iran, Kazakhstan, Kuwait, Libya, Malaysia, Mexico, Nigeria, Norway, Saudi Arabia, Trinidad & Tobago & Venezuela
- ✓ Several international oil companies
- ✓ Multilateral finance institutions
- ✓ Development agencies
- ✓ Local non-governmental organizations (NGOs) and NGO coalition representatives concerned with petroleum sector governance

¹ Myers, Keith (2005): 'Government Goals and Policy: The role of the oil and gas sector'; Marcel, Valerie (2005): 'The NOC Mission and Strategy'; Stevens, Paul (2005): 'Promoting Economic Development through the Oil and Gas Sector' and 'The Management of Revenues'.

INITIAL FINDINGS

THE IMPORTANCE OF THE NATIONAL CONTEXT

Producer case studies show that the national context has a huge influence on how governance functions are implemented and organized. Our first conclusion is that there is no single optimal model for oil sector governance. Important national factors include:

- v National political system and culture – in particular, the way in which authority and influence are exercised – the degree to which decision-making power is centralized and to what extent there is open debate. This will affect the distribution of responsibility for the sector and expectations regarding transparency and accountability.
- v The historical dimension – the way that the petroleum sector has developed and ideological perceptions of its role in society. This will affect expectations of the public goods provided by the sector.
- v Level of national development – this will influence development priorities, the administrative structure and regional development linkages. Under this heading we can highlight three important sub-factors:
 - ♣ Dependence of the economy and of government on oil revenue – this may affect the autonomy of the national oil company
 - ♣ State institutional capacity – how well equipped/ skilled/ informed each actor is to carry out their role. This affects the scope of the national oil company's role in non-core activities.
 - ♣ Degree of diversification of the economy – this may affect the operators' responsibility to contribute to building local capacity. It will also dictate how much political interest the sector will attract.
- v Evolution over time - the needs of society, the market and the lifespan of the resource evolve, changing the role and nature of the oil sector.

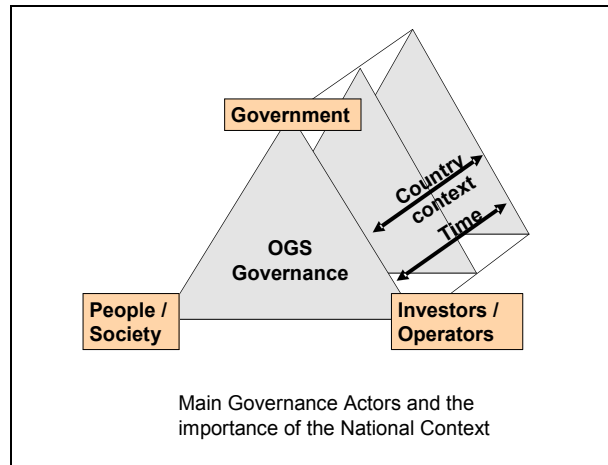


Figure 1. Actors in petroleum governance

Figure 1 shows the three main groups of actors in petroleum governance – Government, People/Society and Investors/Operators. The balance of power and the dynamics of the relationships between actors depends on the national context and evolves through time.

Actors in petroleum governance can be divided into three groups (see figure 1). Government actors can include the executive, ministries, the central bank, a petroleum council, official regulators, local authorities etc. People and society may be represented by parliament, civil society groups etc. The investor/operator grouping includes the national oil company (NOC), local private sector companies, international oil companies (IOCs) and financial institutions. The relative importance of each actor and their interactions with each other vary with the national context and with time.

There is, however, general agreement that four key governance functions exist whatever the arrangement of actors or political context. These are:

- √ Policy
- √ Strategy
- √ Operational decision-making
- √ Monitoring and regulation

KEY GOVERNANCE FUNCTIONS

In this section we provide interim definitions for the four governance functions required in the national oil and gas sector. Development of a common language is important as there is often confusion as to what these functions mean. In each case we are referring to the function at a national, sector level rather than at a corporate level.

POLICY

Public policy typically comprises a set of objectives, laws, plans, political actions and standards of behaviour that aim to achieve goals in the national interest. As petroleum is a national resource, its exploitation requires policy to ensure maximum benefit to the country and its society. The petroleum sector also operates within a national policy agenda which sets out national goals, priorities and direction. In addition to policy specific to the petroleum industry, broader public policy may impact on the oil and gas sector. This could include, for example, measures to encourage private sector involvement or increase the employment of nationals.

STRATEGY

The strategy function concerns how the oil and gas sector will deliver national policy goals (e.g. the pace and means of oil and gas development, the programmes to build local capacity, priorities for the use of scarce resources, responses to uncertainty etc.). The distinction between policy and strategy functions is important, but is often unclear and this will be the subject of further investigation in the next phase of the project.

OPERATIONS

Operational decision-making involves managing the more short-term, on the ground industry operations within the strategic framework. The organizational model for the operations function will reflect the role and degree of autonomy of the national oil company, the role assigned to international oil companies and the organization and effectiveness of the regulatory function. There is sometimes confusion as to which decisions are operational and which strategic when responsibilities are unclear.

MONITORING AND REGULATION

The monitoring and regulation function provides assurance that policies are being adhered to and that national goals are being achieved. Monitoring and regulation includes financial and technical oversight, the auditing of data and the holding of agencies to account. It may also include the setting of industry standards and performance measures.

THE PRINCIPLES OF GOOD GOVERNANCE

In addition to identifying four key governance functions, we have established agreement on five high level principles which will be used to develop a set of requirements, measures, and objectives that will form the basis of the good governance guidelines.

1. CLARITY OF GOALS, ROLES AND RESPONSIBILITY

Whatever the organizational model for governing the petroleum sector, there is consensus among producers that *clarity of goals, roles and responsibilities between agencies* is crucial. Lack of clarity can lead to conflicting agendas, duplication of effort and policy paralysis. For each policy, strategy or operational decision there has to be clarity on the intended outcome of the decision, who will be involved in making it and how. Those involved in the decision-making process should

know who is responsible for providing input, recommending a course of action, approving the decision, implementing the decision and monitoring the implementation.

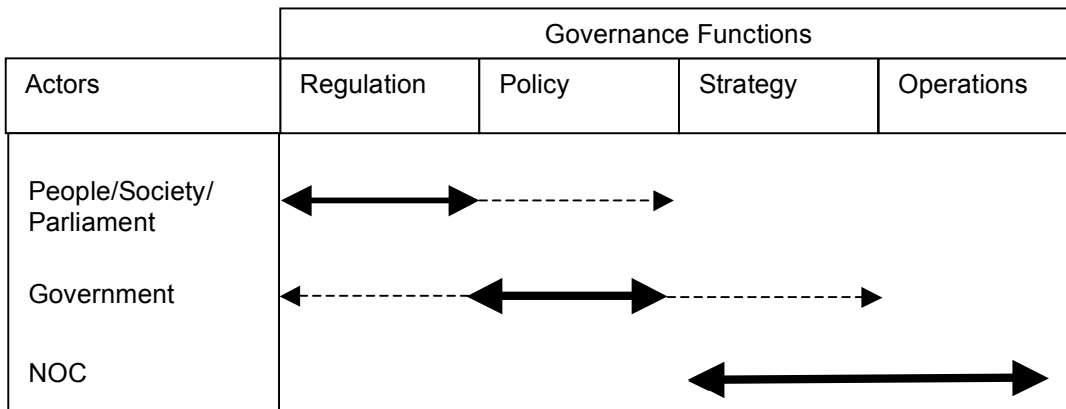


Figure 2. A demarcation of roles in petroleum sector governance

Figure 2 shows a possible demarcation of roles between the principle actors in oil and gas sector governance. People delegate responsibility for policymaking to government who, in turn, delegates responsibility to operating companies to carry out oil and gas operations. The people/society hold government accountable for the policies. Government holds the operators accountable for implementation of those policies.

Key issues are:

- ✓ The assignment of goals, roles and responsibilities
- ✓ The boundaries between policy and strategy-making
- ✓ The regulator and its function
- ✓ The purpose of an NOC
- ✓ The relationship between NOC and State
- ✓ The IOC role

There was general agreement that government should set a *national development policy agenda* within which the role and objectives of the petroleum sector are defined. Setting such a policy agenda plays an important role in aligning actors behind a shared **vision**. Roles and areas of responsibility can then be reinforced by both formal processes (bylaws, constitution) and informal processes (training, information, values and practices). The NOC cannot function efficiently without a defined role and mission and this is the government's responsibility

There is often confusion between the ministry of petroleum and the NOC over responsibility for policy and strategy making and what the difference is between the two. For instance, if the minister sits on the NOC board of directors, s/he must distinguish between the role of *sovereign*

owner (on behalf of the people) when setting energy policy and the role of *company shareholder* (seeking profit and value-creation) when engaged in commercial decision-making.

Where to situate industry regulators and what powers to assign them are crucial questions for many producers, especially those undergoing a change such as opening up the sector to competition. It was agreed that the optimal arrangement would allow the operator to concentrate on operating and the regulator to be objective about compliance. However, the degree to which the *regulator must be separate from the NOC or from the ministry of petroleum* is controversial.

The effectiveness of the regulatory function depends on the capacity of the regulator and the willingness of other actors to defer to its authority. The right balance must always be drawn between the need for control through regulation and the need for operational efficiency. A number of organizational models are followed. The Norwegian and Malaysian models are often seen as different ends of a spectrum. Norway separates policy (Ministry), regulation (National Petroleum Directorate, Petroleum Safety Authority, State Pollution Authority) and operations (NOC) into separate entities. In contrast, the Malaysian model has no ministry. Policy, regulation and operations are housed in separate departments of a single national oil company whose head reports directly to the Prime Minister.

Achieving national development goals is feasible without an NOC but many producing countries choose to have one. The issue then becomes how much autonomy to give it, how commercially orientated it should be and how it can evolve with changing national needs².

The IOC role in a host country's governance is clearly limited - they seek to achieve an economic result and operate in accordance with their contractual obligations and with national and international law. What IOCs choose to do in the country beyond their contractual and legal obligations falls into the category of corporate social responsibility (see 'Sustainability' below).

2. ENABLEMENT TO CARRY OUT THE ROLE ASSIGNED

Enablement is a major issue for producers. To carry out the governance role assigned to it, each actor in the petroleum sector must have the necessary means in terms of authority, financial resources, information, human capacity (skills, knowledge, experience etc.) and supporting processes. For example, the NOC may require a greater degree of managerial and financial autonomy from government to function in a commercially effective manner. In terms of capabilities, there is often a mismatch between where skilled people are concentrated (in the operating companies) and where else they are needed (in the ministry, regulator or broader government).

Key issues are:

- ✓ Delegation of decision-making authority
- ✓ Capacity building
- ✓ Rationalizing national and commercial goals for the NOC
- ✓ Fiscal and budgetary relationship of NOC to State

² See Marcel, V. (2005) 'Good Governance of the National Oil Company', Chatham House. Available at <http://www.chathamhouse.org.uk/pdf/research/sdp/GGjmc.doc>

- √ How is the NOC incentivized to perform
- √ Making the regulator effective
- √ The requirements for governance reform

Delegating decision-making authority and helping to reinforce each other's capacity to perform are the first steps in the process of enablement. Particular precautions must be taken regarding the boundaries of fiscal systems, decision-making, approvals and regulation. These in turn require a high level of transparency and inter-agency communication (see transparency below).

For an NOC, national social obligations and commercial objectives can be in conflict. Producers agree that, as the government's capacity grows, it should assume most social functions of the NOC so that the NOC can focus on optimizing resource development. The NOC/operator, for its part, needs to provide reliable information and transfer knowledge to the government. This enables the government to choose the best policies for the petroleum sector.

NOCs are sometimes exposed to policy volatility that disrupts the implementation of long-term strategic plans. A degree of financial and decision-making autonomy can shield the NOC from policy volatility but must be balanced against the need for accountability (see below). If allocated money year by year within the government budget, NOC investment and long-term planning is difficult. The clear preference for many NOC managements would be a *corporatized NOC* with its own balance sheet and the right to retain revenue for reinvestment. Likewise, operational decisions are likely to achieve the best results when made by competent technical and commercial management within a clear regulatory framework and a minimum of day-to-day political interference or bureaucratic procedures.

To enable the regulators to regulate the industry, they must be given authority, a strong regulatory/legal framework and have the knowledge, experience and skill to do the job. However, this must be balanced by the danger of 'over regulation', inhibiting the operator's competitiveness.

How to reform systems of governance towards greater enablement is perhaps the greatest challenge. This will be an issue addressed in the survey of current practice and at the third workshop.

3. ACCOUNTABILITY OF DECISION-MAKING & PERFORMANCE

Accountability of decision-making and performance provides assurance to society that decision-makers (individuals and institutions) are identified, that they explain their decisions to a higher authority, and that their performance is assessed objectively. Accountability is at the heart of good governance. Without it, corruption and malpractice can flourish and good practice can go unrecognized. Accountability requires clear delegation, capable institutions and mechanisms of enforcement. In the petroleum sector, the operators are accountable to their shareholders (in the case of an NOC, this is the government, to which society entrusts natural resources). The government is accountable to society.

Key issues are:

- √ Mechanisms for holding decision-makers to account

- ✓ Benchmarking NOC performance
- ✓ Incentives for greater accountability
- ✓ The role of parliament and civil society
- ✓ Evaluating CSR/National mission spending
- ✓ The impact of stock exchange listing on corporate accountability
- ✓ National v regional/ international accountability

Mechanisms for ensuring accountability include regulation, performance contracts, disciplinary processes, industry audits, channels of communication with society and the law. A performance contract between government and operator may foster accountability by making performance targets and standards explicit. A system of benchmarking to compare performance between NOCs is recognized as potentially helpful in encouraging improved performance. However, this would be challenging to formulate due to the wide variety of geological and political contexts in which NOCs operate and the lack of transparent data.

Encouraging more accountability within a system, while likely to gain support from the general public, will draw resistance from some within the sector. To reform a system towards greater accountability, compliance incentives may be required. External benchmarking, anti-corruption initiatives that publicize results, competition and market mechanisms (i.e. external borrowing, selling debt, stock exchange listing) are some of the measures we have discussed.

Where a parliament and/or civil society groups exist, they can play an important role in accountability. Their involvement can increase people's understanding of how the oil and gas sector can benefit them and provide valuable checks and balances on practice. The media is considered an important monitoring and investigative instrument in many countries. Specialist parliamentary committees can be part of the auditing process and special interest NGOs can help to communicate society's expectations to the sector. Parliamentary powers to hold the sector to account and the relationship between concerned NGOs and agencies within the sector will differ from country to country and require further exploration.

In addition to their core business, operators usually invest in some kind of social or infrastructure-building projects. For the NOC, this can be understood as 'national mission' spending, for IOCs, it comes under corporate social responsibility. It was agreed that this investment should address the country's development priorities. Therefore, measuring its effectiveness in terms of those priorities is essential (see also 'Sustainability' below).

The boundaries of corporate accountability, the applicability of foreign financial reporting obligations relating to bonds and equity in foreign markets, and national versus regional accountability have not been covered in the discussion to-date, but may be explored further at a later stage.

4. TRANSPARENCY OF INFORMATION

Transparency not only removes the cover for corruption, but also allows rapid intervention to correct problems in the system, and builds trust. This principle is about ensuring that sufficient

information is made available to relevant actors in order to *enable accountability and resilience* of the system. In our discussions, a distinction was drawn between internal (amongst institutions directly involved in petroleum governance) and external (sector to public) transparency.

Key issues are:

- √ Transparency of data between government and operator
- √ Transparency beyond the petroleum sector
- √ Justifiable confidentiality
- √ Transparency in licensing
- √ Transparency in procurement
- √ Incentives to make transparency initiatives work

There has been broad consensus over the necessity of internal financial transparency between ministry, treasury and NOC (including petroleum revenue, the NOC budget and expenditure). Where IOCs are spending money from joint ventures on community projects, the government will require information to ensure that there is value for money and coordination with other policies.

Questions remain over what other information should be divulged externally: Are there reasons that some information should be shared only between government and company? What should be made available to a parliament/general public? Two big incentives for government in disclosing data are a) conferring a sense of public ownership, and therefore increasing social stability and security and b) earning international credit and credibility. It is accepted that corporatization of the NOC, stock exchange listing, international competition can all lead to greater transparency.

Publishing the criteria for assessing bids, holding open bidding rounds for both exploration licensing and tendering, and publishing petroleum agreements can both raise public confidence in the system and improve the financial benefit for the producing country. Nevertheless, transparency of licensing alone does not guarantee the most beneficial contracts. This will depend on how well-devised the bidding criteria are.

More transparency tends to be accepted by producers as positive on condition that publication is accompanied by explanation and education to minimize the potential for misunderstanding and the political use of figures. Everyone agrees that the data should be presented in a useful and meaningful way and be comparable from year to year. Petroleum sector data disclosure (geological and financial) should include commentaries and be backed up by education programmes to increase the public, parliament or government bodies' capacity to understand the information and interpret it. The media can be instrumental here.

Where a sector is being reorganized for greater transparency, several requirements were noted: checking processes to highlight any discrepancies in the data being disclosed; mechanisms by which information can be shared in a neutral way to prevent any new accounting or regulatory agency from becoming a 'data sink'; and fostering mutual trust in order to decrease any sense of threat to agencies revealing numbers.

5. SUSTAINABLE DEVELOPMENT FOR THE BENEFIT OF FUTURE GENERATIONS

As a capital-, rather than people-, intensive industry, dependent on finite resources, sustainability should be at the heart of petroleum sector policy-making. Sustainable development policies aim to meet the needs of the present without compromising the well-being of future generations.

The key issues include

- ✓ Sustainable resource management
- ✓ Revenue management
- ✓ Commitment to education within and outside the sector
- ✓ Support for the non-hydrocarbon economy
- ✓ Corporate social responsibility and the IOC role

For the NOCs, the careful management of petroleum production and minimizing environmental impacts are considered part of their principal contribution to the sustainable development of their country. IOCs can assist by sharing good environmental practice and technology. The impact of international agreements, such as the Kyoto protocol, on national level decision-making is at present unclear for many producers and has yet to be discussed.

It is widely accepted that prudent management of petroleum revenues is vital in order to neutralize the effects of windfalls during times of high oil prices and ensure long-term prosperity³. Intergenerational investment funds are considered useful, provided they be protected from short-term political exploitation. By providing guarantees that future governments will be constrained in their expenditure decisions, present governments can choose better, more far-sighted policy options. For these effects to work, withdrawal procedures should provide for high levels of transparency.

Education, training, experience and business opportunities at operating level can feed into the development of the nation as a whole, growing human capital, promoting the local private sector and helping to diversify the economy away from petroleum. NOC linkages with IOCs for knowledge, skills share and technology transfer can be designed in a mutually beneficial way.

On the issue of how the industry can create such opportunities, producers agree that policy-makers must set the operator *fair and realistic local content targets* adapted to the local skills base and supported by an implementation plan. Enforcing a quota or offering too large a subsidy on local services could discourage competition and lead to inefficiency. Thus policy-makers should begin with a thorough assessment of current capabilities and consultation with the operators.

For the NOC, outsourcing for services and privatizing non-core activities may help to diversify the country's economy, making it more resilient. However, evaluating the effectiveness of this

³ See Stevens, P. (2005) 'The Management of Revenues', Chatham House. Available at <http://www.chathamhouse.org.uk/pdf/research/sdp/GGps.doc>

strategy would be complex because one would first have to draw the line between oil and non-oil economies and assess the extent to which one is dependent upon the other.

The voluntary role that the IOC plays in the national development agenda is usually termed corporate social responsibility (CSR). At its most basic, we can see CSR as the operator's delivery of goods beyond tax for the host country and the mitigation of risk and legitimacy to operate for the company. Requirements for constructive CSR strategies agreed so far include: finding a common interest between commercial and national development needs; coordinating projects with the relevant levels of government and community recipients. The IOC will need to take into account the political and development environment of the host country and make a careful assessment of the potential impact of a CSR project. Further work will look at how best to coordinate local government, national government and the company's core business interests.

FUTURE WORK PLAN

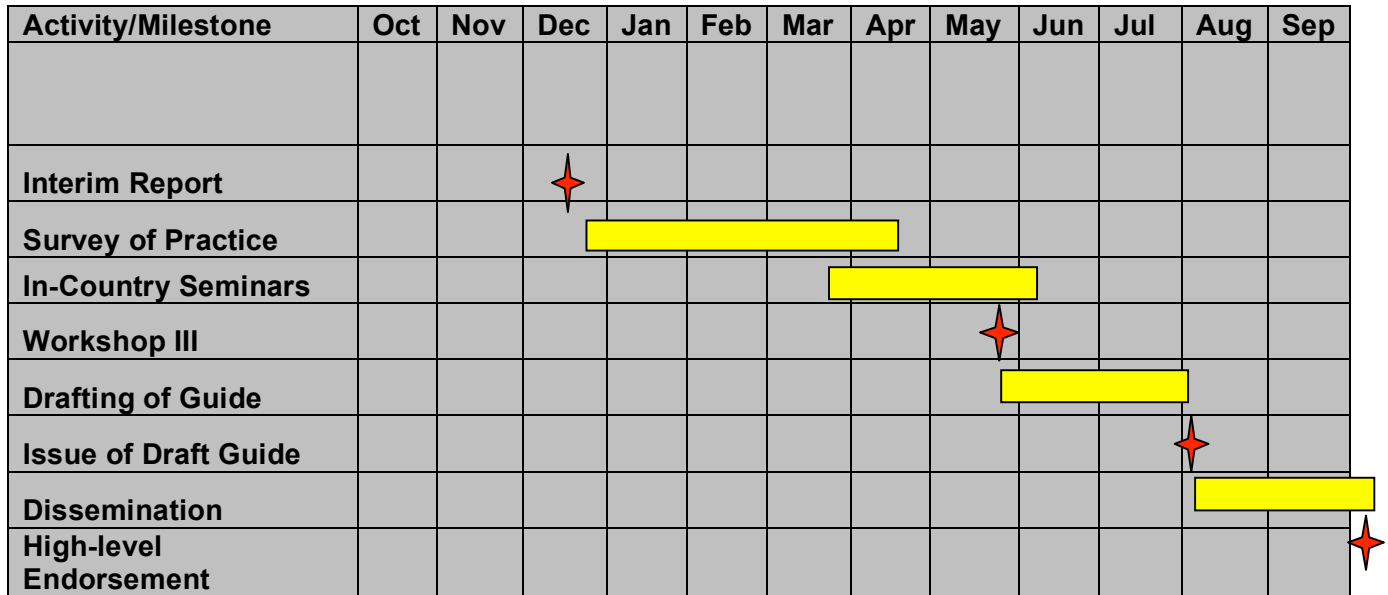


Figure 3. Summary chart showing project activities and milestones

1. ISSUE INTERIM REPORT ONLINE (EARLY DECEMBER 2005), PUBLISH (JANUARY 2006)
2. SURVEY OF PRACTICE (DEC 2005-MARCH 2006)

Project organizers will focus in detail on a set of issues under the themes of roles and responsibility, enablement, accountability, transparency and sustainability. Each set of issues will cover:

- **Survey** of current governance practices
- **Identification** of major trends in practice
- **Analysis** of the implications for governance of this practice
- **Requirements** for good governance under specific conditions

We have established a set of key questions to be explored for selected countries. These questions are summarized in the table below.

Table 2. Issues and questions for the survey of practice

Governance Principles	Governance Functions			
	Policy	Strategy	Regulation and Monitoring	Operations
Clarity of roles, goals and responsibility	1) What is the purpose of the NOC? Is this defined within an official document (constitution, national policy, law, public declaration)? 2) Decision-making boundaries: a. Who sets what objectives with regard to: capacity levels, production volumes, pricing, HSE and technical standards, investment levels,			

	<ul style="list-style-type: none"> b. Who has control over appointments, investments, commercial decisions (such as pricing and production levels), financial flows, appointments and investments (e.g. government as a whole, supreme petroleum council (SPC) if any, ministry, and NOC boards and management, parliament)? What are the processes for making these decisions: Who has input, who has executive authority, who needs to approve? c. What defines the relevant decision-making authority (e.g. law, article of incorporation, administrative action, ad-hoc orders from government)? <p>3) Where are the various regulatory functions located in the sector, including economic regulation, HSE and auditing?</p> <ul style="list-style-type: none"> a. How are the functions distributed between the regulator, the ministry and operator? <p>4) Is the sector undergoing any kind of governance reform? If so, how does this affect the responsibilities of the players involved?</p>
<p>Enablement to carry out the assigned role</p>	<p>1) Does everyone have the sufficient capacity to perform their role? If not, what is required?</p> <p>2) How long on average does it take to make decisions on: appointments, investments, pricing and production levels, financial flows, appointments and investments. Are there ever any substantial delays? If so, how could they be avoided? How could the decision-making process be made more efficient?</p> <p>3) How can the NOC meet both national and commercial goals in a complimentary fashion?</p> <ul style="list-style-type: none"> a. At what point does the NOC become ‘a State within a State’? <p>4) What is the fiscal and budgetary relationship of the NOC to the State?</p> <ul style="list-style-type: none"> a. What incentives are there for the NOC to perform effectively? b. Are there incentives for the NOC to continually improve its performance? If so, what are they?

<p>Accountability of Decision-Making</p>	<ol style="list-style-type: none"> 1) How does accountability of the national petroleum sector work in practice? <ol style="list-style-type: none"> a. What are the mechanisms by which the NOC and the oil and gas sector in general are held to account at local, national and international levels? b. Is there a performance contract between government and NOC and how does this help with accountability? c. What role could international benchmarking of NOC performance have in accountability? What are the practical challenges for meaningful benchmarking? d. How is operational and financial information validated? What audit and inspection mechanisms are most effective? e. How does stock exchange listing impact on NOC accountability? 2) What are the consequences of accountability? <ol style="list-style-type: none"> a. What incentive model is used for the NOC's management – compensation, bonuses, status etc.? b. How is non-compliance or underperformance dealt with? 3) How does the State know that non commercial CSR/national mission spending achieves its goals? <ol style="list-style-type: none"> a. How do governments coordinate and measure the success of national mission spending by NOCs and CSR spending by IOCs? 4) What is the role for parliament and civil society, if any? <ol style="list-style-type: none"> a. What role do civil society and parliament play in accountability? b. What are the challenges involved and how can they be overcome? 5) How is civil society capacity built and to what extent can, or should, the petroleum sector play a role in building civil society capacity?
<p>Transparency of information</p>	<ol style="list-style-type: none"> 1) What is the government's disclosure practice? <ol style="list-style-type: none"> a. Are petroleum data disclosed? b. And to whom? c. Is the government announcing new discoveries? 2) Reservoirs <ol style="list-style-type: none"> a. Are reservoir data disclosed? b. And to whom? 3) License or production sharing agreement awards <ol style="list-style-type: none"> a. How transparent is the license process? b. Who is responsible for the awards, the NOC or the ministry? c. Are signature bonus payments and work commitments made public? 4) Impact assessments <ol style="list-style-type: none"> a. To what extent does the government require the oil companies to initiate economic and environmental impact assessment and consult with civil society during the process of planning a project? b. Is the information made available to the public? c. Are annual safety and environmental data made public?

	<p>5) Petroleum revenues</p> <ol style="list-style-type: none"> a. Are oil revenues disclosed by the government? b. Are the financial accounts of the NOC disclosed and if yes – how? c. Are the oil companies told to disclose their payments to government? d. Is parliament involved in discussing the revenue payments? <p>6) The national oil company</p> <ol style="list-style-type: none"> a. Is the NOC involved in formulating and implementing policy? b. Does it play the role of regulator? c. Is it releasing public audited accounts? d. Does it pay taxes and dividends – and are the payments made public? e. Does the NOC have non-petroleum related responsibilities?
<p>Sustainable development for the benefit of future generations</p>	<p>1) Sustainability of the resource. Who defines these very long-term objectives and what are the criteria?</p> <ol style="list-style-type: none"> a. Are there conflicts between the government’s desire to secure the annual budget and sustainable management of reserves? b. Is there an optimal rate of depletion for the reserves and will that optimal rate vary between an NOC and an IOC? c. Is the issue of sustainable management of reserves different in countries with a low ration of reserves per capita? <p>2) Human development and support for the non-petroleum economy (e.g. local purchasing, education programmes).</p> <ol style="list-style-type: none"> a. What is the policy to maximize local content and diversification? b. How far are specifications prescribed in detail by the government (e.g. employment and purchasing targets) c. What education programmes does the NOC provide? Are these for petroleum-industry employees/ scholarships only? d. Are any incentives offered by the sector to encourage students to take up employment in their home country? <p>3) How do you define corporate social responsibility and how is it different for IOCs and NOCs, if at all?</p> <ol style="list-style-type: none"> a. How do IOCs coordinate with local government, national government and NOC? b. Where the NOC carries out national mission spending, how does this relate to the government’s social programmes?

3. IN-COUNTRY SEMINARS (February, March, April 2006)

The project team will deliver a series of in-country seminars in order to:

- Disseminate learning
- Build capacity
- Solicit feedback on the substance of survey’s conclusions
- Reach out to new participants

4. WORKSHOP III (expected May 2006)

- The survey's results and pending questions will be presented to the next main workshop (possibly with producers speaking to particular points in each study) for inclusion in the guide.

5. DRAFTING THE TEXT

- Small group to draft text of the "guide to good governance of the national petroleum sector" (consulting participants en route).

6. REVIEW PROCESS

- The text will be reviewed by the Advisory Committee and selected participants.

7. DISSEMINATION OF INFORMATION

- Publicize and circulate the draft guide, focused on gaining support for a high level/ ministerial endorsement in Autumn 2006.

8. HIGH LEVEL MEETING (Autumn 2006)

- Meeting of senior officials from producing countries and endorsement of proposed guide.

SPONSORS

We would like to thank the following sponsors for their support and continuing involvement with the project. Please note that the project is guided by participants and the advisory committee and sponsors do not hold any special influence over its direction or content.



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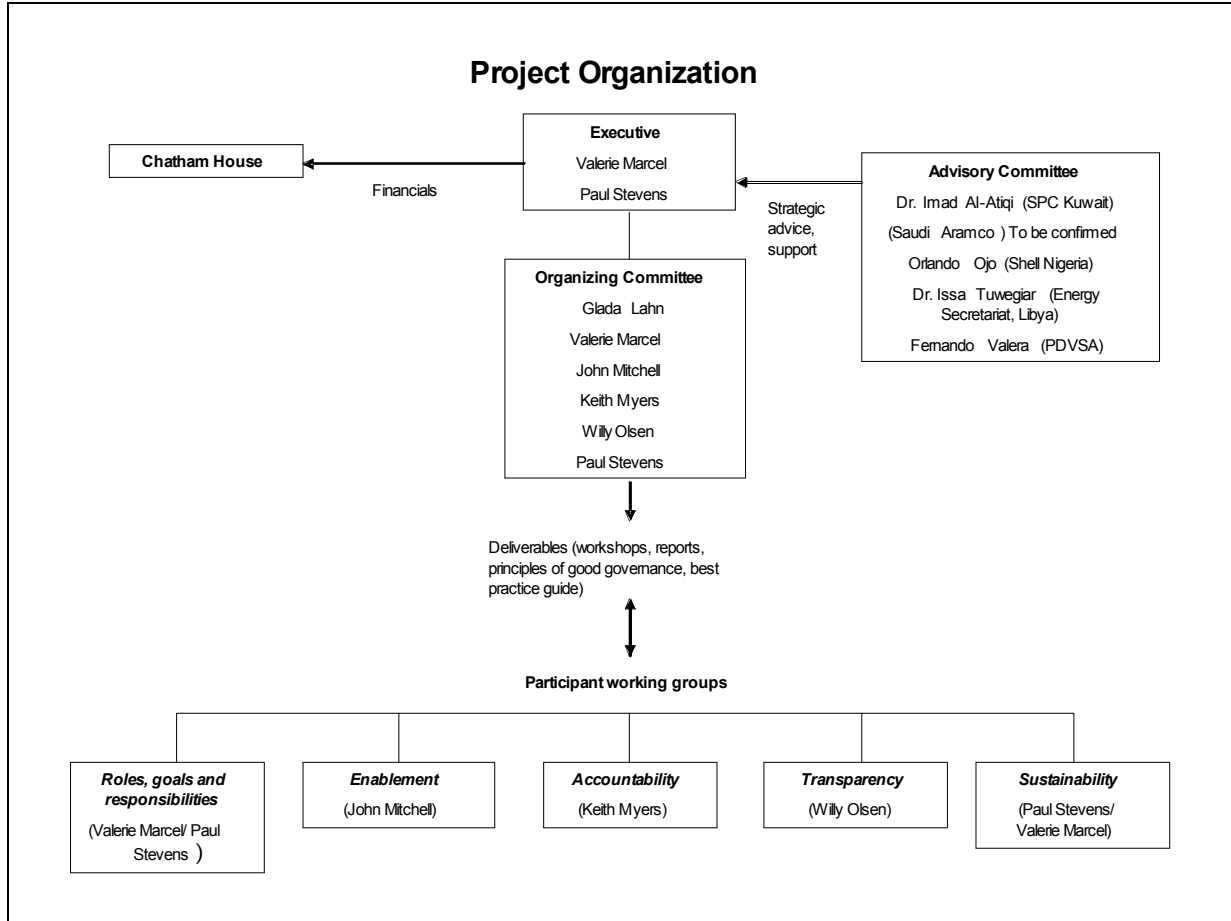


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PROJECT ORGANIZATION⁴



⁴ Please note that the composition of the Advisory Committee has now changed, refer to the Good Governance website <http://www.chathamhouse.org.uk/pdf/research/sdp/GGorg.pdf> for updated details.

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Dr Valerie Marcel, Principal Researcher in energy for the Energy, Environment & Development Programme (EEDP) at Chatham House (Royal Institute of International Affairs). Since arriving at Chatham House in 2002, Valerie has led energy research at the institute and published on the geopolitics of energy and threats to oil-market stability in the Middle East. She has just completed a book entitled *Oil Titans: National Oil Companies in the Middle East*, to be published in January 2006. This examines the development, character and changing missions of five major NOCs, within their economic and political contexts. In her research for this, she conducted over 120 interviews within ministries and national oil companies. Valerie was previously Adjunct Professor in International Relations at the Institut d'études politiques de Paris and taught political science at the University of Cairo.

Professor Paul Stevens, BP Professor of Petroleum Policy at the Centre for Energy, Petroleum and Mineral Law Policy (CEPMLP) at Dundee University. Paul has been with CEPMLP since 1993. He teaches courses in petroleum policy, international developments in energy policy and energy economics. He was educated as an economist and Middle East specialist at Cambridge and the School of Oriental and African Studies. Between 1973-79, he taught at the American University of Beirut interspersed with two years as an oil consultant. Between 1979-93, he was at the University of Surrey where he was a founder member of the Surrey Energy Economics Centre and joint creator of the Third World Energy Policy Studies Group (ESRC funded). Paul has worked as a consultant for many companies and governments including standing as an expert witness in the US-Iranian Claims Tribunal at the International Court in The Hague (1984-1992).

John Mitchell, Chatham House, Associate Fellow, Energy, Environment and Development Programme, Chatham House (Royal Institute of International Affairs). John retired in 1993 from British Petroleum where his posts included Special Adviser to the Managing Directors, Regional Coordinator for BP's subsidiaries in the Western Hemisphere, non-executive director of various BP subsidiaries, and head of BP's Policy Review Unit. In 1976, he was an academic visitor in the Faculty of Economics at the University of Cambridge.

Recent articles and short papers: Producer-Consumer Dialogue: 'What can energy ministers say to one another?', Chatham House 2005; 'Energy Investment, Quantity or Quality', article in Asia Pacific Review, 2004; 'Iraq's Oil Tomorrow' (with Valerie Marcel), RIIA 2003; 'The Changing Geopolitics of Energy', RIIA 2003; 'Renewing Energy Security', RIIA 2002.

Dr Keith Myers, Associate Fellow, Energy Environment and Development Programme, Chatham House (Royal Institute of International Affairs). Author of 'Petroleum, Poverty and Security' Chatham House Briefing Paper, 2005. Also founder and Managing Director of Vianah Venture Management and Senior Associate at Wood Mackenzie Energy Consultants. Keith has extensive experience of the oil industry and its effects on the societies in which it operates in Africa, having worked for over 10 years for BP as a senior geologist and commercial adviser and lead negotiator for Angola and Southern Africa Business Units. He obtained his PhD from Imperial College, London.

Willy Olsen, Associate Fellow, Energy Environment and Development Programme, Chatham House (Royal Institute of International Affairs). Educated as an economist, Willy spent 15 years as a journalist and editor in Norwegian Broadcasting and newspapers and 23 years in the oil industry

working for the Norwegian State Oil Company (Statoil) in a number of positions including Senior Vice President for Government and Public Affairs. Currently an advisor to INTSOK - Norwegian Oil and Gas Partners, a foundation owned by the Norwegian Government and the oil and gas industry, Member of the Advisory Boards of the Russia and Eurasia Programs at RIIA from 1993 – 2002 and Governor on the Board of the Oxford Institute of Energy Studies.

Glada Lahn, Research Assistant, Energy Environment and Development Programme, Chatham House (Royal Institute of International Affairs). Glada joined Chatham House in early 2004 to assist Dr. Marcel with research on national oil companies in the Middle East. She has since collaborated on energy security and North-East Asian energy cooperation projects. Most recently, she co-wrote a briefing paper on 'Russia's oil and gas exports to North-East Asia' with Dr. Keun-Wook Paik. Previously, she was Senior Researcher at the Gulf Centre for Strategic Studies, specializing in governance reform in the Arabian Gulf countries. Glada studied Arabic and international relations at the School of Oriental and African Studies in London and the University of Damascus. She also works as a freelance Middle East/Energy analyst.

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