Briefing Paper

Energy, Environment and Resources Programme
December 2020

# Fostering resilience in emerging oil producers

## Responding to COVID-19 and preparing for the energy transition


## Summary

- COVID-19 and the spring shock to oil markets had significant impacts on the emerging oil and gas producer countries that make up the New Producers Group. The crisis affected individuals, organizations and national plans for hydrocarbon sectors. The group held a series of discussions from March 2020 that aimed to assist governments in the development of crisis responses and strategies that could be adapted to an energy sector in transition.

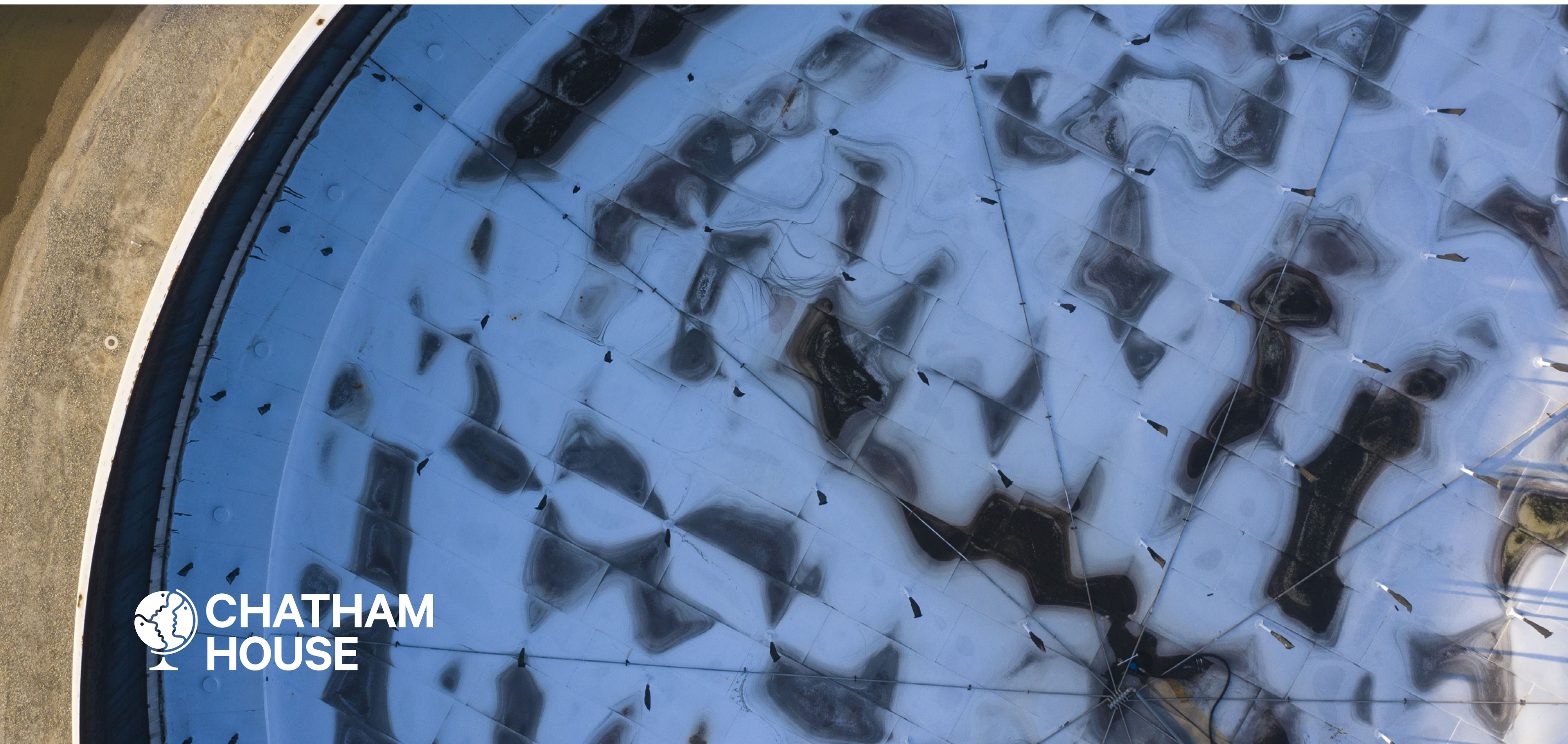
- In response to a crisis, the main priority is to understand its causes and review its impact. When much of public life shut down due to the pandemic in March 2020, it struck a blow to oil demand at a time when the market was already oversupplied. Oil prices fell sharply, which, together with the health crisis, prompted oil companies to reassess projects, upending operations in many countries.

- While oil prices recovered partially in the months that followed, the sector remains in crisis – particularly in the more expensive emerging oil and gas producer countries. Prior to COVID-19, oil companies were already more risk averse in response to investor pressure.

- The focus of the New Producers Group has turned to understanding what the new normal might look like post-crisis and in particular what impact the pandemic might have on the pace of the energy transition. The development of scenarios helped meeting attendees manage multiple uncertainties, such as the path of the pandemic, its economic impacts, policy responses and public support for the concept of building back better.



Valérie Marcel

CHATHAM HOUSE

- 'Boom time' is over for the oil sector. For emerging producers, the poor outlook means that there will be fewer projects and those that do go ahead will be low risk. But even in areas where continued oil company interest is likely, government planners should understand the risks associated with fiscal dependence on the petroleum sector and also with building up industry-specific local content.
- National investment in the petroleum sector should be considered in relation to the potential returns it can generate and the negative impacts it could have on other national objectives, such as climate goals, environmental wellbeing, and fiscal stability.

## Introduction

The impact of the coronavirus has deeply unsettled the governments of emerging oil and gas producer countries. The health crisis upset individual lives across the globe, and disrupted government agencies' capacity and planning. Oil companies have suffered badly and several major projects have been brought to a standstill. Lockdowns worldwide significantly restrained demand for oil at a time of historic oversupply in the market, which resulted in prices plummeting in April 2020. While oil prices have since made a partial recovery, the sector remains shaken. Questions abound about the long-term effects of COVID-19 on the world economy and energy demand. It remains to be seen how long national economies will take to recover and the extent of the impact.

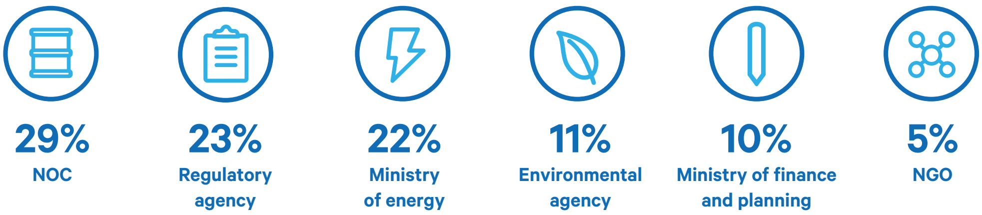
**The wide-ranging impact of the pandemic means governments must work to understand the new normal and adapt to it.**

The economic slowdown has caused dramatic shifts in consumer behaviour, specifically in relation to the use of transport. While there is still no consensus on whether the resulting fall in oil demand is permanent (versus deferred to when economic growth returns), signs are increasingly showing that demand has peaked.[1] There may well be another price cycle in future, but the current slump in the oil industry could be a dress rehearsal for the structural decline to come. This signals an uncertain future for the oil and gas sector of emerging producer countries and raises valid questions about the risks and rewards of the traditional resource development model.

1 BP (2020), *Energy Outlook: 2020 Edition*, https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/energy-outlook/bp-energy-outlook-2020.pdf.

When public life began to shut down across the world, the New Producers Group[2] undertook a series of virtual discussions with the governments of its 30 member countries. These discussions focused on fostering resilience at the individual, organizational and national levels and each brought together between 50–110 government officials from member[3] and non-member countries[4] (and in several cases included representatives of non-governmental organizations and industry). The remote format of these meetings meant that participants incurred no costs to attend, which enabled the more resource-constrained agencies, such as environmental protection agencies and sub-national governments, to participate to a higher degree than ever before. The officials actively involved in the group doubled during the series of meetings to 600 people. With environmental, planning, energy and finance agencies well represented, the meetings were good opportunities for cross-government debate and capacity-building on the strategic issues facing the petroleum sector.

**Figure 1.** Participant roles in the Fostering Resilience meeting series, March to September 2020




Source: New Producers Group.

These discussions, organized on a near weekly basis from March to July 2020, sought to understand the expected evolution of the health crisis, its impact on the oil market and emerging producers, and to identify appropriate responses and mitigation measures. This paper offers a digest of these discussions and expands on the implications of the crisis for emerging producers. It begins by describing the recent oil market disruption and its impact on emerging producers, as felt during the March to July period. From the outset, these meetings underlined the value of a robust risk management approach to deal with a crisis and uncertainty. The second half of this paper follows the basic four steps of a risk management approach and explores how governments can plan for crises with measures that protect their staff and their populations, provide effective communication and deal with disruptions in the oil sector. The wide-ranging impact of the pandemic means governments must work to understand the new normal and adapt to it.

---

**2** The New Producers Group is a collaborative network of governments from over 30 countries, coordinated by Chatham House, the Natural Resource Governance Institute and the Commonwealth Secretariat. The group helps new oil and gas producers manage their petroleum resources effectively and prepare for the world beyond oil and gas.
**3** Officials from Kenya, Namibia, Uganda, Tanzania, Ghana, South Sudan, Sudan, Mauritania, Malawi, Liberia, Somalia, Mozambique, Suriname, Belize, Turks and Caicos Islands, Colombia, Guyana, Jamaica, Trinidad and Tobago, Uruguay, Montenegro, Norway, Afghanistan, Iraq, Lebanon and Pakistan.
**4** These included Rwanda, Peru, Saudi Arabia, the UK, Nigeria, Senegal, Indonesia and Algeria.

The paper goes on to detail two scenarios that were elaborated to guide the online discussions on the impact of the crisis on the energy transition. While the paper demonstrates that the degree of policy collaboration at the global level will determine the course of the pandemic and economic recovery, it does not delve into national policies that could also significantly impact these – such as green recovery plans – or behavioural changes at the consumer level. Finally, the paper considers appropriate strategies for emerging producers that could fit with the new reality of the post-COVID-19 world, 'business as usual' is not a likely option.

## How the world has changed for emerging oil and gas producers

### Market disruption

The New Producers Group launched the Fostering Resilience in Crisis meeting series in a chaotic context. In March 2020, an oil price war between Russia and Saudi Arabia flooded the market with crude at a time when the COVID-19 pandemic caused demand to collapse. Some fundamentals were already in play: oil markets were oversupplied and stocks were at a historic high when demand plunged. In March, global oil supply outstripped demand by an average of nearly 6 million barrels per day (b/d) in the first quarter of 2020, resulting in an accumulated implied storage build-up of 2 billion barrels in 2020.[5] The situation worsened when airlines grounded their fleets and governments around the world imposed lockdowns and factory closures. These fundamentals precipitated a decline in oil price that reached a negative of -$37/b WTI on 19 April[6] for delivery the following month.[7]

Against this dire backdrop, 58 per cent of the governments and national oil companies (NOCs) that participated in the New Producers Group meeting on 30 March expected the price of Brent to recover above $30/b by the end of 2020. But significantly, half of those surveyed also believed that global peak demand for oil had been reached.

The initial optimism of the emerging producers now appears unwarranted. The second quarter of 2020 witnessed the greatest ever fall in global oil demand, down 16.4 million b/d year-on-year, and the largest reduction in production volumes in world oil history, by 14 million b/d year-on-year.[8] Economic forecasts in March pointed to a global GDP drop of 2.8 per cent for 2020, an estimate that seemed high at the time in contrast to the 1.7 per cent drop that followed the financial crisis of 2008–09.[9] But forecasts in June predicted a much higher 5.2 per cent decline

**5** Rystad Energy (2020), 'History's largest oil glut months away from topping world storage while tanker freight rates explode', press release, https://www.rystadenergy.com/newsevents/news/press-releases/historys-largest-oil-glut-months-away-from-topping-world-storage-while-tanker-freight-rates-explode.
**6** Kelly, S. (2020), 'Oil price crashes into negative territory for the first time in history amid pandemic', *Reuters*, 19 April 2020, https://www.reuters.com/article/us-global-oil-idUSKBN2210V9.
**7** The negative price was due to unavailable storage, which significantly increased the costs of selling the crude.
**8** IEA (2020), *Oil Market Report – July 2020*, https://www.iea.org/reports/oil-market-report-july-2020.
**9** IHS Markit (2020), 'COVID-19 Update: Few, if any, countries or industries will be immune to economic impact', https://ihsmarkit.com/research-analysis/covid19-update-countries-industries-economic-impact.html.

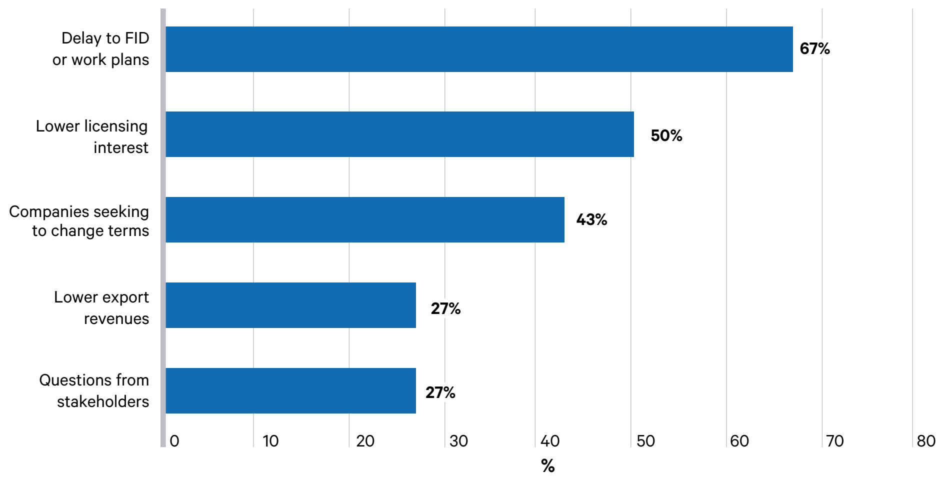
in global GDP for 2020, the most severe economic downturn since the Second World War.[10] In addition, the IMF expects economic recovery to be more gradual than previously forecast.[11]

There remains a great deal of uncertainty around the duration of the crisis with respect to health (globally and locally) and economic impacts (globally, locally and by sector). 'Black swans', low probability events that have the power to effect significant disruption, haunt government planners. As Pedro Gomez from the World Economic Forum put it during a New Producers Group meeting in April, 'we are simply in the dark. And when you are in the dark all the swans are black.'[12]

## Impact on emerging producers

With the fall in demand and reduced availability of finance, the crisis was expected to lead to delays in determining the commerciality of projects, shut-ins of higher cost projects, recourse to force majeure by suppliers and operators, delays to work plans, and contractor and service company bankruptcies. Such impacts were felt as early as March. While established producers were first impacted through the drop in export revenues, according to a New Producers Group survey, emerging producers in the pre-production phase were also affected through delays to final investment decisions (FID) and work plans, reduced interest in petroleum licences, and companies seeking to change agreement terms. Lower sector revenues diminished the budgets of several governments and NOCs and resulted in concerned stakeholders and citizens asking what the impact of the pandemic meant for the future of their country and its petroleum sector.

**Figure 2.** Poll of governments and NOCs on the impact of low oil prices, 30 March 2020




Source: New Producers Group.

**10** World Bank (2020), *Global Economic Prospects*, https://openknowledge.worldbank.org/handle/10986/33748.
**11** IMF (2020), *World Economic Outlook Update*, https://www.imf.org/en/Publications/WEO/Issues/2020/06/24/WEOUpdateJune2020.
**12** 'Government and Company Responses to the Crisis', Fostering Resilience in Crisis series, New Producers Group, 6 April 2020.

Many oil projects were too expensive to weather a downturn in price, and Wood Mackenzie estimated that 75 per cent of projects would not cover their costs if the price of oil stood at $35 per barrel.[13] Companies responded by honing in on projects promising shorter-term monetization, delaying work schedules on those that have a longer-term, uncertain payback – notably exploration projects – and deferring new projects.

More broadly, in the context of the energy transition, major oil companies have been withdrawing from exploration, particularly in frontier areas, as they rebalance their portfolios to diversify their assets. This trend has accelerated in the face of the recent collapse in demand. By August, seven of the world's top oil companies had downgraded the value of assets by $87 billion in the previous nine months.[14] Meanwhile, independents and exploration companies are filling the space left by the majors, but they, too, face investor pressure on environmental, social and corporate governance issues. These companies are exiting high-carbon projects and seeking to invest where they can undertake what they term 'responsible production' – lower carbon production without flaring.[15]

Half the surveyed participants in the New Producers Group meeting on 22 April, who hailed from 19 countries, had already observed instances where force majeure was invoked by oil company partners.[16] Roughly one-third of these participants were from countries at the production phase, one-third were at the post-discovery phase and the remaining third were at the exploration phase. The countries in highly prospective areas where important offshore discoveries had recently been made did not report oil company reluctance to invest, indicating companies' willingness to maintain activities where risk was low. Where operations continued, issues generally arose due to higher costs and delays resulting from procurement and staffing problems.

## Government responses to foster resilience

Discussions in the Fostering Resilience in Crisis series delved into how emerging producer governments could respond to disruptions and uncertainty in the future, and boost resilience in their people and organizations. Resilience refers to an ability to recover from a challenging event or perturbation and prepare for the next potential crisis. Recovery tends to involve reverting to where one was before a disruptive event – bouncing back – without resolving vulnerabilities to similar events. Resilience instead aims to rebuild with 'anticipation and

**13** Holland, B. (2020), 'Renewables could hold new appeal for oil, gas industry in $35-per-barrel world', *S&P Global,* 24 March 2020, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/renewables-could-hold-new-appeal-for-oil-gas-industry-in-35-per-barrel-world-57740984.
**14** Ambrose, J. (2020), 'Seven top oil firms downgrade assets by $87bn in nine months', *The Guardian,* 14 August 2020, https://www.theguardian.com/business/2020/aug/14/seven-top-oil-firms-downgrade-assets-by-87bn-in-nine-months.
**15** Panel discussion, Africa Oil Week, 7 October 2020.
**16** Force majeure clauses are contractual clauses that alter parties' liabilities and/or obligations under a contract when an extraordinary event or circumstance beyond their control prevents one or all of them from fulfilling those obligations.

"improvement" of essential basic structures and functions'[17] – bouncing forward. This understanding shaped the New Producers Group discussions. Among participants there was acceptance of the need for improvement of current systems in oil sector management, but less appetite for whole-system transformation.

Risk management systems enable organizations to build resilience to crises in four steps, by:[18]

1. Preparing for a crisis through a comprehensive risk assessment;
2. Producing crisis response and communications plans;
3. Adapting through a business continuity plan to maintain essential functions and using scenarios to prepare for a possible 'new normal'; and
4. Recovery planning and documenting lessons learned for future response plans.

Identifying and assessing new risks at each phase is a critical component of this system. The following section reviews how governments and NOCs in the New Producers Group handle risk management, their responses to the pandemic – specifically with regards to communications and legal challenges, scenario planning to understand the impact of COVID-19 on the energy transition, and prospects for emerging petroleum sectors – and policy responses that will foster resilience.

## Preparing for a crisis

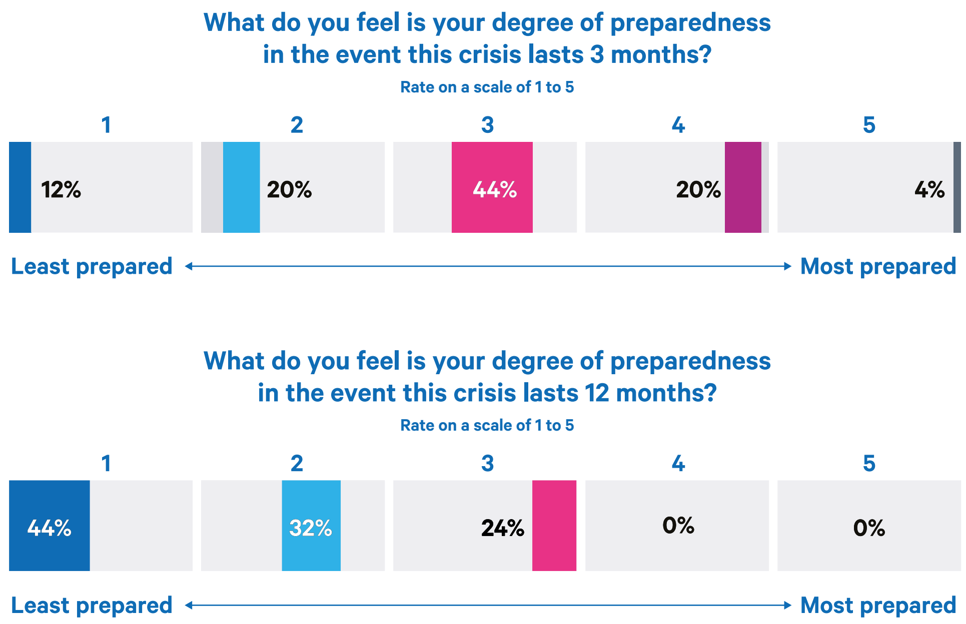
Risk management systems are generally weak in the public sectors of emerging (and often established) producers. In answer to a poll at the second meeting in the series[19] about the quality of current risk management systems, responses were very spread, with a small majority rating them as average and several ranking them as low or very low. When asked whether they were prepared for a three-month disruption due to COVID-19, most participants, who represented a range of government agencies and countries with very different levels of state capacity, believed they were. When asked if they would be prepared for a 12-month crisis, the majority were not.

Being prepared involves planning for disruption, assessing risks, establishing a response strategy and allocating resources to preparation activities. Past New Producers Group meetings often emphasized the value of institutionalizing a more critical, challenging function in evaluation processes to allow individuals and departments to ask, 'What could change and how would that impact our objectives?' Enabling and supporting this internal assessment of potential threats

**17** Lavell, A. , Oppenheimer, M., Diop, C., Hess, J., Lempert, R., Li, J., Muir-Wood, R. and Myeong, S. (2012), 'Climate change: new dimensions in disaster risk, exposure, vulnerability, and resilience', in Field, C. B., Barros, V., Stocker, T. F., Qin, D., Dokken, D. J., Ebi, K. L., Mastrandrea, M. D., Mach, K. J., Plattner, G.-K., Allen, S. K., Tignor, M. and Midgley, P. M. (eds) (2012), *Managing the Risks of Extreme Events and Disasters to Advance Climate Change Adaptation*, A Special Report of Working Groups I and II of the Intergovernmental Panel on Climate Change (IPCC), Cambridge University Press, pp. 25–64.
**18** Adapted from Robinson, L. (2020), 'Fostering Resilience During Crisis', presentation at the New Producers Group meeting, 6 April 2020.
**19** 'Fostering Resilience in People and Organisations', New Producers Group meeting, 6 April 2020.

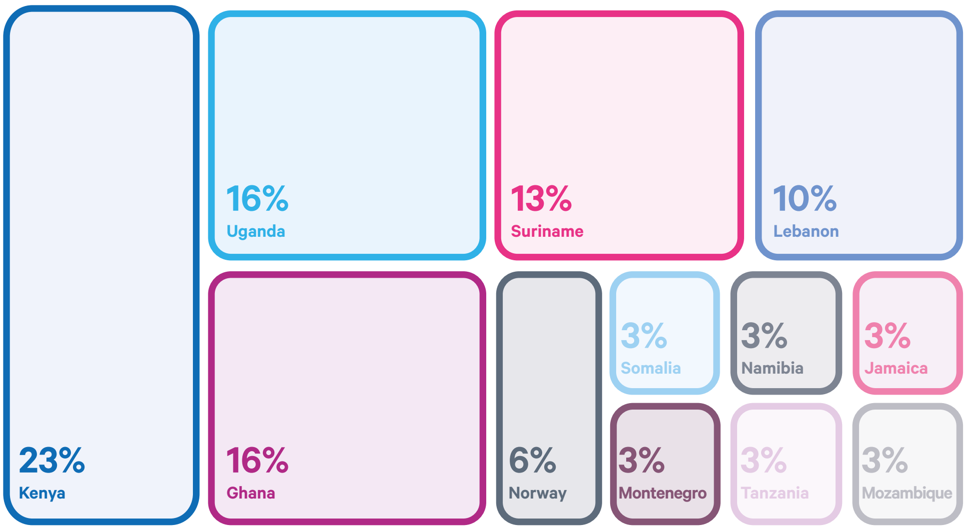
is difficult when it relates to a sector in which the public and governments place great hope. The growing awareness and recognition by the governments of the New Producers Group of the current and imminent impacts of the energy transition on their petroleum sector demonstrates the effectiveness of this approach.

**Figure 3.** Poll of governments and NOCs on crisis preparedness, 6 April 2020




Source: New Producers Group.

**Figure 4.** Nationalities of government and NOC respondents to the poll on crisis preparedness, 6 April 2020




Source: New Producers Group.

### Crisis response

When asked at a meeting on 15 April on 'Communications in Crisis' whether their more pressing concern was coronavirus or the oil price, 75 per cent of government and NOC participants answered the former. Their first concern was with the immediate impacts of the health crisis on themselves, their loved ones, the safety of staff and operations and their country. At the previous meeting on 6 April on 'Fostering Resilience in People and Organizations' participants asked about remote work systems and their impact on industry and organizational culture. Responses from experts highlighted the new cybersecurity and digital risks resulting from employees working from home.

**The effectiveness of responses to the various threats that emerge during a crisis can be improved with standard operating procedures.**

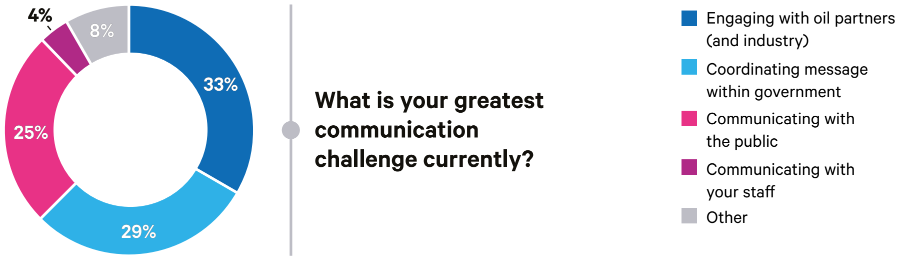
The effectiveness of responses to the various threats that emerge during a crisis can be improved with standard operating procedures. Previous discussions organized by the New Producers Group have noted how public sector organizations could utilize the effective procedures that oil companies tend to have in place. In discussing crisis response, the Fostering Resilience meeting series deliberated how governments could, in the COVID-19 pandemic, draw on company practices and knowledge with respect to sanitary and safety protocols.

At the meeting on 'Fostering Resilience in People and Organizations' on 6 April, a speaker from an oil major explained how his company prepared their general crisis response. In a crisis, this company first responds at the local level by focusing on people, it then takes actions at the regional level, followed by the headquarter level. An example of a local response to the coronavirus is to determine how to rotate staff on oil platforms while minimizing the risk of infection (e.g. work with suppliers on hygiene or reducing staff turnaround). A high-level support team, composed of the company's most senior executives, is deployed in cases of significant disruption to coordinate the response across the company (for example, closing offices globally or introducing a protocol for distributing COVID-19 test kits to where they are most needed across the business).

#### Communicating in crisis

A New Producers Group poll, on 6 April 2020, showed that the majority of member governments believed that communication was the most valuable intervention when managing a crisis. The importance of communication during the pandemic was noted in almost all the meetings in the series, whether it was related to communicating within an organization, between government agencies, or with industry partners, communities and the public. Government officials shared communication challenges they were facing in two communication clinics, held in April and in June.[20]

**Figure 5.** Poll of communication challenges, 15 April 2020




Source: New Producers Group.

During discussions representatives of an NOC highlighted their experience of 'communication overload' during the pandemic, which was a significant challenge. In a context of fear around COVID-19 and personal safety, and the wider backdrop of the oil price crash, the NOC was fielding a lot of queries. The communications department was on the frontline, handling external and internal questions. The department struggled to adequately respond to all the demands:

- The communication department aimed to reassure stakeholders about the organization's continuity and stability in the long term ('the organization is here to stay') and provide clarity about its plans in the short term.
- To achieve this the organization first needed to carry out a comprehensive review of its short and long-term plans. It would need to clarify the *content* of the messaging, before the communications department could carry out its role of shaping the message.

A second challenge related to communication became clear through the meeting series. Officials from a sub-national government noted that an operator had invoked force majeure due to the pandemic and halted operations. As a result, the community had major concerns about the future of the oil sector. A participant from a local NGO explained that when the '[central] government doesn't communicate, it leaves a space for everyone else to communicate'. The lack of communication from central government and the operators in this instance has led to a lot of speculation and 'conspiracy theories about China'. While the sub-national government may attempt to field questions from the local community, comprehensive and authoritative answers should really come from the central government. The discussions proved fruitful and suggestions included:

- The sub-national government could compile a list of questions from the community and local business leaders and share this with the appropriate officials at the national level (recognizing that paper requests tend to work better for officials).

**20** 'Communication in Crisis', New Producers Group meeting, 15 April 2020, and 'In-Depth Session on Communicating in Crisis', New Producers Group meeting, 8 June 2020.

- Once the sub-national government obtains the information from the national government, it can work on crafting the message for various local stakeholders.
- A verbal exchange with the officials at the national level can help to guide sub-national governments in their responses.
- Until they hear from central government, sub-national authorities can demonstrate to local stakeholders their concern by listening and collecting information and questions, for review at the national level.

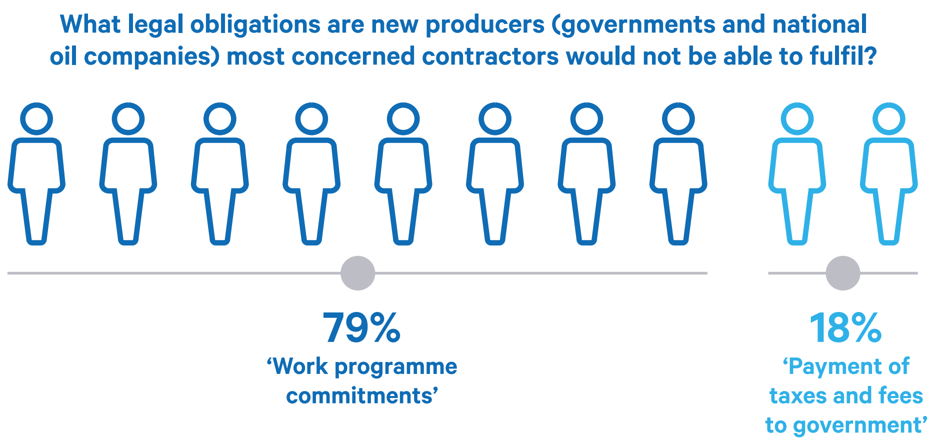
Participants also discussed strategies for inclusive engagement in a context where COVID-19 prevents in-person meetings and large gatherings. Members of the New Producers Group suggested that the communication priority is to identify relevant stakeholders and then engage them using their preferred means of communication (e.g. printed flyers, radio, WhatsApp). Alternatives are needed for remote communities that have limited access to the internet or mobile/computer devices.

### Force majeure and beyond: Navigating legal challenges during the crisis

The meeting on 22 April examined the challenges that new producers face in managing their agreements and relationships with contractors during an economic and health crisis. The discussion focused on the application of force majeure clauses and how governments can make decisions about disruptions to contracts and operations, which helped them navigate the current challenge and consider future crises.

During a discussion on the ability to fulfil legal obligations in the current context, 79 per cent of surveyed government and NOC participants were concerned that contractors would not carry out 'work programme commitments' and 18 per cent were concerned about the lack of 'payment of taxes and fees to government'. There was no evidence of concern in regard to the ability of contractors to implement health, safety and environmental protection measures, which could be attributable to their capacity in this area.[21]

**Figure 6.** Poll of legal obligations that most concerned government and NOC participants, 22 April 2020




Source: New Producers Group.

---

21 Survey of government and NOC participants, 'Force Majeure and Beyond: Navigating Legal Challenges during the Crisis', New Producers Group meeting, 22 April 2020.

Depending on how clauses in the contracts are drafted, force majeure may excuse the operator if it does not uphold its end of the agreement in regard to performance and delays, and it may even allow them to terminate a contract. However, the bar is set high. To invoke the clause, it must be physically or legally impossible for the company to meet its contractual obligations. New Producers Group discussions concluded that the COVID-19 pandemic was deemed likely to present a legitimate force majeure event in most jurisdictions, but that the oil market crash was not. In other words, poor commercial returns of a project cannot justify excusing an oil company from its contractual obligations. In calculating force majeure, governments and investors will seek to determine what work is impossible versus delayed as well as when and how to lift force majeure. Significantly, economic arguments are not considered in this calculation.

For governments facing a possible invocation of force majeure clauses, the New Producers Group suggested the following responses:[22]

1. Determine policy goals, such as whether to help operators to begin production sooner or to make room for different operators;
2. Understand the scope of authority to grant relief under law, licences, regulations and agreements as well as the procedural requirements;
3. Communicate with the operators to understand what they require, their plans and what measures are at their disposal; and
4. Assemble the necessary documentation to demonstrate compliance, in anticipation of a possible dispute.

## Understanding and adapting to the new normal: Scenario planning

There are more unknowns than knowns in the outlook for oil and gas beyond COVID-19. It remains unclear how long the pandemic and the disruption will last, how much of the loss of oil and gas demand is permanent or simply deferred, and how deeply the industry will be reshaped. Policy is the key to tackling many of these unknowns. National policies and international cooperation will have a determining impact on the duration and intensity of the global health crisis. Policy will also guide individual and industry behaviour when it comes to remote work, transport, and investment in energy efficiency or alternatives to petroleum. The degree of public recovery spending that is committed to the low-carbon economy and to the principle of 'building back better' will also play an important role. Technology breakthroughs are crucial to setting the pace of the energy transition, with regard to hydrogen, battery storage, and carbon capture, storage and use, for instance.

In order to structure the group's thinking about the impact of COVID-19 and the oil price crash on the outlook for hydrocarbons and alternatives, the New Producers Group developed two different scenarios in May 2020 (revised in June)

**22** Adapted from Stewart, P. (2020), 'Fostering Resilience in the wake of the COVID-19 Crisis', presentation at the New Producers Group meeting, 22 April 2020.

that created different outcomes for 18 months down the road, by the end of 2021. It was clear to the participants that each scenario depended on a different set of behaviour and policy choices. Of the surveyed participants who attended the meeting on 4 May, 81 per cent indicated that in scenario B, which focused on global cooperation, the public in many regions would likely want to build 'a new, sustainable economy', rather than focus on 'economic growth regardless of its costs'. Meanwhile, 62 per cent thought that if scenario A, which envisioned a regional, nationalist approach came to pass, that public funds would tend to be spent on 'rescuing old, "polluting" industries'.

#### Scenario A: Regional Dominoes

In this scenario, the COVID-19 pandemic hits regions and continents in succession over 18 months, starting with Asia, then Europe and North America, followed by Central and South America, Africa, Eurasia and returning to hit several regions or continents again in 2020 and in 2021.

The world broadly responds with national rather than international measures. Most countries, including major consumers of all forms of energy, adopt variations of supposedly temporary lockdown policies as the key strategy for reducing the spread of the virus. These include restrictions on the movement of people and trade, and tariffs on goods and commodities. There are widespread national retrenchments and limited international cooperation on managing the pandemic (i.e. scientific collaboration on vaccines, governmental assistance in managing the healthcare crisis in other regions or cooperation in managing economic consequences). At the end of the 18-month period, the pandemic is not resolved.

Many countries try to mitigate the economic effects of the lockdowns with massive interventions of government-financed cash, which reverse previous austerity programmes. But the global economy is hard hit by a recession, with a reduction of per capita GDP of 15 per cent across 80 per cent of countries. The oil price is extremely volatile during these 18 months, with an average of $20/b for Brent.

Debt is an overriding concern for developing countries, with limited access to finance and development aid budgets severely curtailed. Energy self-sufficiency is radically pursued in some large import-dependent countries, while others try to capitalize on bargain fuel prices for the short term.

#### Scenario B: Global Cooperation

In this scenario, the COVID-19 pandemic is a broadly global event, with some regions worse hit than others, but none insulated from its impacts. The first wave of contagion is contained in most countries in 2020. Half of the world is hit by a second wave in 2021, but it is less severe than the first. There are several initiatives to coordinate the management of the pandemic (notably with the development and distribution of a vaccine) and the pandemic is stopped.

Most countries impose restrictions on the movement of people, but these are limited in time and borders are not closed to trade. Over the whole period the developed world produces and consumes less. Those countries and industries that grew rapidly over the last 70 years are reluctantly switched to a slower track. The world is in recession, with 80 per cent of countries having an average per capita GDP reduction of 5 per cent. The oil price averages at $40/b for Brent.

Eighteen months into this scenario, aid and development finance are more constrained but increasingly aim at the dual objectives of fostering green growth and progress on nationally determined contributions (NDC).

### Impact on the energy transition

Three meetings in the Fostering Resilience series focused on the impact that COVID-19 and the oil price crash could have on the pace and outcome of the energy transition and appropriate government strategies to anticipate and adapt to these changes.[23] These discussions examined the prospects for the 'oil versus alternatives' and 'gas versus alternatives' transitions, and considered how they fared under the two scenarios.

## Some underlying assumptions about trends in motion before the pandemic hit shaped how various speakers interpreted the outcomes under each scenario.

Some underlying assumptions about trends in motion before the pandemic hit shaped how various speakers interpreted the outcomes under each scenario. One was optimistic about oil demand growth, while another expected that peak oil demand had already been reached. Leila Benali, chief economist at Apicorp, warned attendees 'not to trust economists, who are not used to modelling pandemics, acts of war or natural disasters that occur simultaneously and cause deep disruptions to the economy'. As another speaker noted, the pandemic is 'such an important, civilisational event that it throws energy models (developed to predict the course of the energy transition) out the window'. Participants therefore aimed to discipline themselves to rethink assumptions and conclusions.

NPG discussions concluded that the Regional Dominoes scenario would lead to a 'broken oil market', where volatility would make it difficult to invest in oil upstream. But it is also likely that in this scenario all investment would be challenged and indeed there were unresolved questions about how the rest of the petroleum value chain (e.g. petrochemicals, refining), EVs and biofuels would fare in comparison to upstream oil.

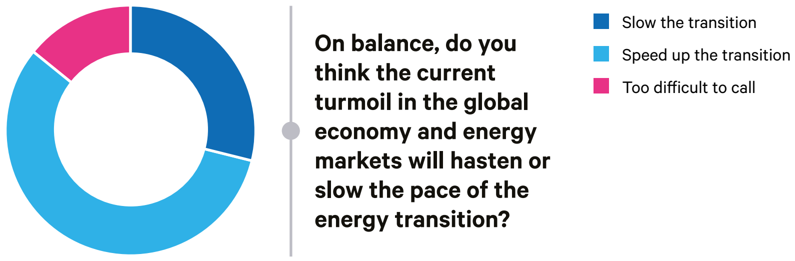
The Global Cooperation scenario would lead to a stronger recovery and give way to a 'repaired oil market', which would send clearer price and risk signals for investment in oil alternatives. In one speaker's view, those signals would be enough to allow the energy transition to proceed at a quicker pace than before the

**23** One New Producers Group meeting was held on the record: 'The Role of Finance on the Energy Transition', 15 June 2020. This meeting brought together a range of different actors in the investment community, from banking and international finance institutions to private equity capital and fund managers, to hear their perceptions of the relative risk of oil, gas and renewables in emerging markets in light of COVID-19 and the oil price slump. Recording available at: https://youtu.be/9Z7e5rsobYk.

pandemic. Some argued that lower gas prices in this scenario also make the bridge from oil to alternatives more affordable. But further discussions concluded that the future of gas in the energy mix depended more on policy signals than the market.

There was overall agreement that 'boom time' was over for the oil sector, even in the Global Cooperation scenario. It is clear that there will be fewer projects and that they will be the 'easier' ones (in terms of the investment framework for instance) with lower costs and risks. One industry strategist highlighted that offshore and deep offshore have produced decent returns and would continue to attract frontier exploration investments where the prospects are good. In addition, companies will be more selective in identifying these and total exploration budgets will stay low.

**Figure 7.** Poll of perceptions of impact on the pace of the energy transition, 30 July 2020




Source: New Producers Group.

**The role of finance in the transition**

Public support for a green rebuild of the economy after COVID-19 will depend on local or national economic circumstances (e.g. unemployment and existing commitments to the petroleum sector). Leila Benali pointed out that despite having a large part of the globe in lockdown, the reduction in emissions has not been 'where we would want it' – which points to the need for much more aggressive policies to support the transition. With improved economic prospects in the Global Cooperation scenario, it is likely this outcome would garner greater public support for stronger climate policies. There is currently a great deal of multilateral funding support for renewables in emerging markets. Paulo Martins, team leader at the European Commission, highlighted at the same meeting that the commitment of the Commission to renewables and the energy transition remained as strong as ever (with a doubling of guarantees for renewable projects in emerging markets proposed during the summer).[24] While budgets of European states would be constrained as a result of debt incurred during the pandemic, and particularly in the Regional Dominoes scenario, the Commission expects to rely more on the private sector as project economics become more attractive.

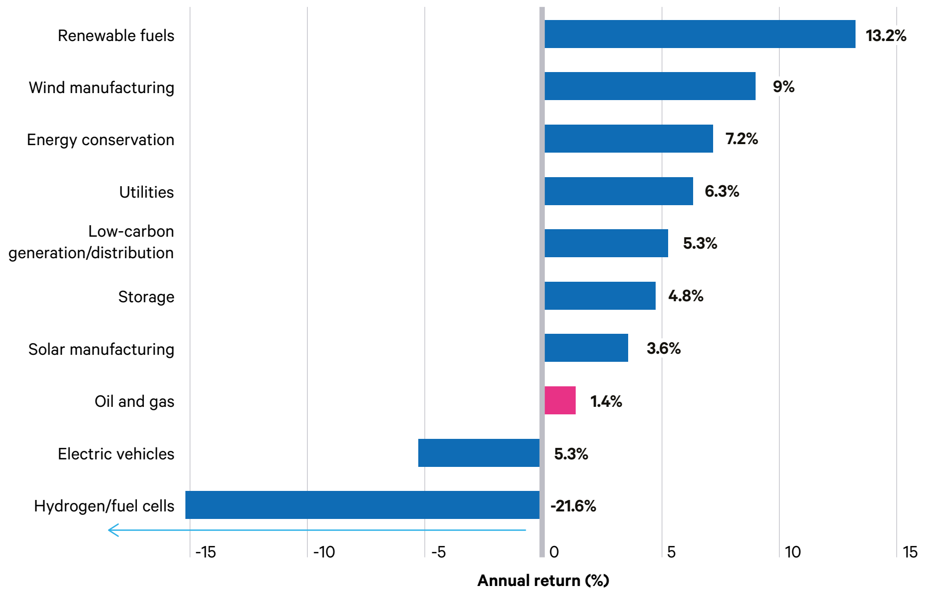
Lucy Heintz, a partner at Actis, spoke from the perspective of private equity capital, and explained that 'projects are getting better', as financiers and implementers learn from past investments about how to increase job creation and provide

**24** BNP Paribas (2020), 'A new green union for Europe', 16 October 2020, Investors' Corner, https://investors-corner.bnpparibas-am.com/investing/a-new-green-union-for-europe.

lower cost energy. She felt that COVID-19 was unlikely to affect the fundamentals for electricity demand. This was confirmed by a recent International Energy Agency (IEA) analysis, which noted that while electricity demand dropped quickly with confinement measures, it steadily recovered as measures were gradually softened.[25] She also highlighted that renewables will remain attractive as an asset class for investors because they are ethical, not subject to volatility, and have performed well. Ensuring cost reflective energy tariffs and providing clear frameworks for investment are the most important ingredients to support private-sector investment.

Independent adviser Beth Mitchell highlighted that there is a wide range of investors and each will look for different things. But overall investors have been disappointed in oil and gas company returns and now have a growing appreciation for the importance of carbon and climate risks (including litigation). Echoing this point, Atul Arya, chief strategist of IHS Markit, showed that investments in other energy sectors had produced greater returns and less volatility since 2015, with an average return in the range of 13.2 per cent for renewable fuels, 9 per cent for manufacturing wind power components, 7.2 per cent for energy conservation, 6.3 per cent for utilities, 4.8 per cent for storage and only 1.4 per cent for oil and gas – with electric vehicles and hydrogen fuel cells in the negative range.[26] A longer historical view to the pre-2014 period, in which crude prices were high, would show better returns for oil and gas, but the five-year snapshot demonstrates the current competitive space in the sector.

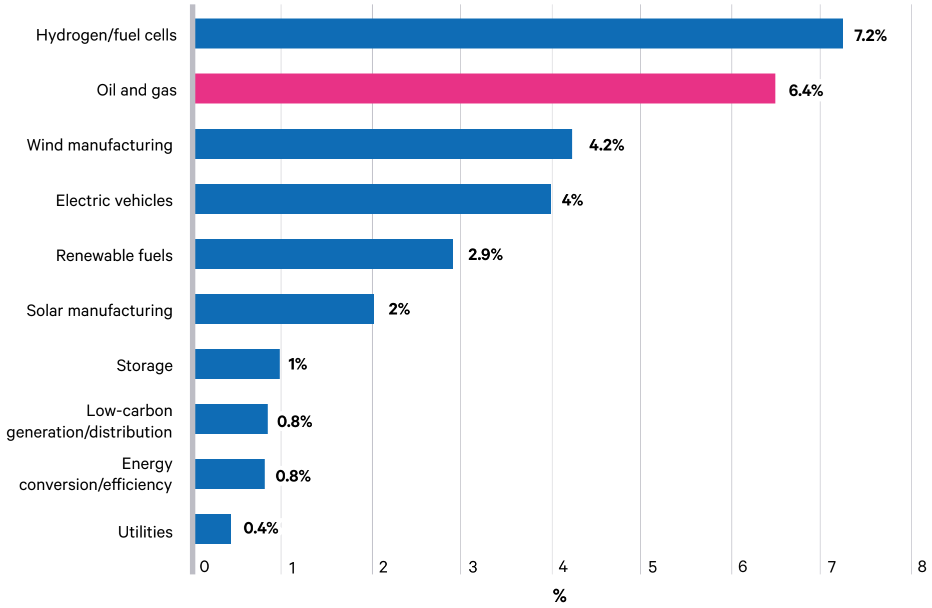
**Figure 8.** Average returns since 2015 by segment




Source: IHS Markit.

25 International Energy Agency (2020), 'Covid-19 impact on electricity', 20 September 2020, https://www.iea.org/reports/covid-19-impact-on-electricity.
26 Arya, A. (2020), 'Post-Pandemic Outlook for the Energy Sector', presentation at the New Producers Group meeting, 30 July 2020.

**Figure 9.** Volatility of returns since 2015 by segment




Source: IHS Markit.

In a major upset to past practices, investors in oil companies are now focused on returns, rather than the growth of reserves, as an indicator of future value. This has deep transformative potential for the sector. Large reserves can become a liability when they are exposed to being stranded. These trends are pushing international oil companies (IOCs) to increase investments in renewables, but also to reduce their costs and carbon footprint in petroleum projects. Indeed, it is worth noting that oil companies refrained from reducing renewable and low-carbon budgets in response to the crisis.

### Expected impact on emerging producers

The upstream sectors of emerging producer countries do not share the same vulnerabilities in regard to the energy transition. Prospectivity, production costs and scale of discoveries will have a big impact on the outlook for the upstream sector and the number of barrels produced. The potential for gas to be developed in the countries of the New Producers Group will depend on cost (and foreign exchange convertibility), proximity to export markets and the size of their domestic markets. In regard to the expected long-term COVID-19 impact on the demand for natural gas exports survey responses were spread, bolstering the view that the outlook was market specific.

But even in areas where continued oil company interest is likely, governments should anticipate and plan around lower revenues per barrel and continued price volatility. There are significant associated risks with fiscal dependence on petroleum revenues.

Governments will also face evolving domestic expectations, for example, regarding access to energy, air quality and management of climate impacts, which could change their policy objectives and increase domestic interest in cleaner alternatives. During a meeting on 11 May, when asked about priorities for their power markets after the COVID-19 crisis, twice as many government officials believed ‘increasing the share of renewables in the energy mix’ was more crucial than providing ‘gas for power’.

The outlook is more negative for upstream sectors where discoveries are isolated (single discoveries or far from demand centres), and where costs are high or in frontier basins with uncertain prospects. Carbon intensity is another factor that would limit the attractiveness of certain areas or projects. Companies, big and small, are exiting high-carbon projects. Listed companies – especially those from Europe – face higher investor expectations and regulatory obligations to capture gas and methane and stop flaring. Meanwhile, in most emerging producer countries (and indeed even in established producers) infrastructure to transport and make use of these products does not exist and it is often not commercially viable to invest in its development.

At a meeting on 30 July, it appeared that the investment slowdown had not significantly shifted member countries’ ambitions for the sector. More than half of those surveyed (63 per cent) indicated that they were more ‘optimistic about the outlook for oil and gas post-pandemic than in March 2020’. This was despite 57 per cent of that group feeling that on balance ‘the current turmoil in the global economy and energy markets would hasten the pace of the energy transition’. This meeting was attended by 44 per cent of participants from countries at the production phase, 36 per cent at development phase, and 20 per cent at exploration phase.

## Recovery plan: Future resilience

### Attracting investment

If the new normal after the pandemic resembles the outcome of the Regional Dominoes scenario, disruptions to existing projects will persist due to health and trade issues that prevent normal operations and curtail new investment. Government organizations will also be impacted by employee health and morale. Licensing in this context could mean a race to the bottom, where competition for investor money leaves countries with poor deals that do not generate value for the country.

In the Global Cooperation scenario, the still ailing but recovering world economy and more supportive policy environment will send better investment signals. But these will likely favour cleaner alternatives, which benefit from capital availability and public support, especially if policies emerge to mitigate climate change. As for oil and gas companies, they will look for lower carbon projects with higher and faster returns. Against the backdrop of the energy transition, companies will want assurances that any discoveries can be quickly monetized. If they are keen to support environmental, social, and corporate governance goals and reduce energy poverty, as well as increase the share of gas in their portfolio, they may also look for projects that increase the availability of gas on the domestic market. Governments can anticipate this by working now to improve their regulatory framework, clarifying the role of utilities and other state-owned enterprises, ensuring currency convertibility, and confirming that the gas will not require heavy subsidies to be affordable to domestic consumers. Better regulatory and market environments will also benefit emerging producers by supporting renewables projects in their countries.

Improving the regulatory environment to appeal to investors should not come at the expense of careful oversight of project development. A 'race to the bottom' in terms of work plan reviews and environmental impact assessments will not guarantee future investments and, even if successful in the short term, it is not sustainable. Governments should optimize the review and oversight process of projects by improving coordination across agencies; ensuring that environmental (and other oversight) agencies are empowered, well-resourced and prepared to carry out their responsibilities; and developing guidelines and policies to direct the process in a predictable and clear manner.

### Prospects for local content

The Fostering Resilience meetings tackled the prospects for local content during and after the pandemic. Some government officials felt the crisis would lead to a strengthening of local content initiatives because governments would push harder for companies to use local goods, services and skills to alleviate domestic economic hardship. Practically speaking, with government measures or company policies preventing expat staff from travelling to host countries, local skills are more attractive. The disruptions have also revealed the risks involved in concentrated supply chains, where a few countries dominate the production of food, solar panels, electronics or oil and gas. Localization of supply chains can reduce risks related to trade disruptions, but they carry a new set of risks if local suppliers cannot meet industry standards. Furthermore, in a cash-constrained and economically uncertain context, companies will not develop the capacity of local suppliers unless it makes economic sense. To support localization of supply chains during and in the aftermath of the pandemic, companies will need:

- Supplier information – notably required certifications and evidence of financial solvency;
- Government support for suppliers: domestic small and medium-sized enterprises require financial support (loan assistance, interest rates), assistance with raw material imports, support for remote working (e.g. online learning, loans for computers), support with health and safety (including sanitary) guidelines and standards, and investment in R&D to boost local manufacturing; and
- More flexible local content targets.

As for governments, vocational centres and local suppliers, each needs a clear understanding of expected demand for goods, services and skills in the petroleum sector in order to prepare. At the meetings, governments noted that oil companies are not providing sufficient information on future demand. Better knowledge of both demand and supply is a key area in which government–company cooperation can lead to improved outcomes.

In order to make contracts more accessible to local suppliers, discussions at the New Producers Group meetings revealed examples where oil companies unbundled large contracts into smaller scopes of work that could be sub-contracted out. This was seen as a very promising avenue for local participation. However, a poll taken during the meeting on local content indicated that only 13 per cent of participants had witnessed any unbundling of contracts since the start of the pandemic. There still exist obstacles related to the operator capacity required to oversee sub-contracted work. Also, some contracts could not easily be unbundled because the operator had awarded them to a specific contractor that they had entrusted to manage the procurement.

The potential for emerging producers to localize a significant share of oil company expenditure depends on several factors: the scale of petroleum resources, the resilience of their projects to lower oil or gas prices, and the readiness of their supply base to provide the skills, goods and services that oil companies need.[27] Investing significant resources in developing a supply base for the petroleum sector is a risky endeavour in a context of increased uncertainty, particularly where oil production is some way off and likely to be expensive. 'Building back better' in this context may involve a focus on developing infrastructure, skills, goods and services that can be used not only by the petroleum sector but also by other sectors of the economy.

## Conclusion

The world has changed quite dramatically in 2020, creating significant pressure on existing oil and gas projects, especially those in developing countries counting on their petroleum sectors to increase national prosperity. Agencies responsible for the petroleum sector, finance ministries involved in planning, and country leaders will need to adjust their ambitions and acknowledge the risks inherent in this volatile sector. It is important for them to understand the changes, work with different scenarios to support their planning, and update their policies and systems. A more fundamental re-evaluation of policy goals may also be called for.

An assessment of the prospects for a national petroleum sector in this changing environment should prompt a government-wide review of sector objectives and of its potential to create long-term value for the country. National investment in the petroleum sector should be considered in relation to the potential returns it can generate (in economic growth and revenues) and the negative impacts it could have on other national objectives, such as climate goals, environmental protection and fiscal stability. This also concerns investments in NOCs, capacity-building, local content development, and in acquiring greater stakes in upstream assets. When petroleum agencies coordinate with finance, planning and environmental agencies, and when the objectives of the petroleum sector are thoughtfully embedded into the national development agenda, the resulting strategies will be more resilient and prepare new producer countries for the future.

**27** The New Producers Group produced a report that clarifies the appropriate scale of ambition for localization depending on the expected demand of the projects and the readiness of the national economy. See Marcel, V., Tissot, R., Paul, A., and Omonbude, E. (2016), *A Local Content Decision Tree for Emerging Producers*, Research Paper, London: Royal Institute of International Affairs, https://www.chathamhouse.org/2016/07/local-content-decision-tree-emerging-producers.

This series of meetings on fostering resilience connected governments, albeit remotely, at a time of great uncertainty for the industry, for nations and for individuals. These meetings helped officials from the group navigate this crisis, by exposing them to different viewpoints and sometimes shedding a harsh light on their aspirations for the sector. It is clear that some emerging petroleum sectors will not take off. An early understanding of this will help countries avoid wasting investments in resources that will not provide a return.

## About the author

**Dr Valérie Marcel** is an associate fellow in the Energy, Environment and Resources programme at Chatham House and project lead for the New Producers Group. She is an established expert on national oil companies, petroleum-sector governance and emerging strategic issues shaping the energy sector. She is the author of *Oil Titans: National Oil Companies in the Middle East* (Chatham House/Brookings, 2006). She advises governments in sub-Saharan Africa, the Eastern Mediterranean, South America and the Caribbean on petroleum sector policy and governance. She is deputy chair of the governing board of Renewable Energy and Energy Efficiency Partnerships (REEEP) and is a member of the World Economic Forum's oil and gas strategy council. She previously led energy research at Chatham House and taught international relations at the Institut d'études politiques (Sciences Po) Paris, and at Cairo University.

## Acknowledgments

The author is grateful to Glada Lahn, Antony Froggatt, Professor Paul Stevens and Laura Robinson for their thoughtful reviews of the paper and encouragement. Many thanks are also due to the anonymous peer reviewers for their helpful and timely comments, to Anum Farhan for her thoughtful inputs and to Michael Tsang for his expert editing. The author is indebted to long-time project partners, Patrick Heller and Naadira Ogeer, the speakers and hundreds of participants in the Fostering Resilience in Crisis meeting series. Their contributions and willingness to share their national experiences made the series a fascinating and enjoyable activity during a period of worry and uncertainty.

Cover image: An oil storage tank at the Phillips 66 Los Angeles Refinery Carson Plant in California on 21 April 2020.
Photo credit: Copyright © Bloomberg/Getty Images

ISBN 978 1 78413 439 6

This publication is printed on FSC-certified paper.
designbysoapbox.com

Independent thinking since 1920

Chatham House, the Royal Institute of International Affairs, is a world-leading policy institute based in London. Our mission is to help governments and societies build a sustainably secure, prosperous and just world.

CHATHAM HOUSE

**The Royal Institute of International Affairs**
**Chatham House**
10 St James's Square, London SW1Y 4LE
T +44 (0)20 7957 5700
contact@chathamhouse.org | chathamhouse.org

Charity Registration Number: 208223