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Critical Issues for a Revenue Management

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Resource Curse

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Chapter 11: What are the critical issues for a revenue management law?

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Introduction

In this chapter, we set out a number of elements that need to be addressed in any oil or mineral revenue management law, analyze the key issues, and provide some alternative solutions. Since a number of the policy questions are addressed elsewhere in this book, the focus here will be on legal and institutional issues. We discuss various national laws but make particular reference to the recently enacted oil revenue management law of Sao Tome and Principe, as set out in abridged form in Appendix 1. This law was drafted by a special oil commission made up of representatives of various branches of the government with assistance from The Earth Institute at Columbia University,¹ the World Bank, the International Monetary Fund and others. Although specific to Sao Tome and Principe and not a model in every respect, the Saotomean law illustrates the issues which any law must address and provides one set of solutions. The Saotomean law addresses oil, but similar considerations would also apply for other exhaustible natural resources.

In principle, oil or mineral revenues could be handled like any tax or other receipt, placed in Treasury accounts, and allocated in accordance with normal budgetary process. However, in a resource-dependent economy, the magnitude of the receipts and the difficulties of control suggest the need for special legislation directed to the particular problems posed by such revenues. Although the issues we discuss are common to any resource-dependent economy, the discussion is particularly addressed to developing countries with still maturing institutions.

As an initial matter, any oil revenue management law -- like other laws -- must be adapted to the needs, institutions, and legal framework of the country. Drafting must take place within the parameters of the local legal system and must take account of existing laws and practices. Many

subjects that might be included in a revenue management law may be already addressed in other legislation and regulations. Laws or regulations governing public procurement, public information, disclosure, conflicts of interest, and judicial review, for instance, may all come into play. Any law must also be integrated with existing expenditure rules, limitations, and laws that govern budget processes. One size does not fit all, and the failure or success of any oil law is likely to depend in large measure on the way it is integrated with -- or in some cases separated from -- existing institutions and practices. It is also essential to understand how statutory law actually works in the country. Many times, formal codes are merely “show” laws often adopted from developed world models but in practice not enforced. This may be the result of lack of resources, lack of experience, overriding political and economic considerations, or simply the lack of a culture of compliance.² Details count, but drafters must be cautious to avoid excessive complexity.³ Particularly in weak states, it is important to work through the responsibilities of each entity, its capacity to carry out its intended functions, and the possibility of using bright-line rules --that do not require or permit discretionary judgment. Moreover, one must not assume that “new” institutions will somehow master government and administrative skills that existing institutions lack.⁴ Nor can one assume that the norms and mentality will necessarily change because wine has been put in new bottles.

In this context, oversight and transparency play a key role in law enforcement. The participation of a broad base of constituencies in the oversight of the oil revenue management strengthens its implementation and enforcement. Finally, a critical aspect of any law is transparency regarding the sources, amounts, and use of oil funds and with respect to the contracting processes. Without this, government officials, oversight committees, and the public will simply not have the basic information necessary to assure responsible use of the nation’s resources. On the other hand, transparency can help make up for the deficits of even weak institutions, as civil society, the press, and responsible elements of government can use such information to demand accountability and to press for reform. Transparency cannot assure the responsible use of resource revenues, but without transparency, abuse is almost certain.

Against this backdrop, we first present an analysis of issues relating to the structuring and management of oil funds. We then address revenue management oversight and control mechanisms, the role of transparency and public governance and integrity in the process. We then discuss the particular aspects of integration of oil revenue management systems with the oil-rich

government's existing international obligations, and conclude with a discussion of ideas on how to keep the oil revenue management law in place. Our conclusions and recommendations are reflected throughout the chapter in the analysis of specific issues.

I. Structuring an Account for Oil Revenues

I.1 Establishment of the Account

There are often important reasons for establishing a special account for managing oil revenues (see Chapter 8 for a discussion of a number of the motivations). It is possible for oil funds to be held and managed in an account held by the central bank or treasury, as is the case with Norway, or in a trust fund, as is the case with Alaska. Given the central importance of oil revenues, however, the management, transparency, and protection of oil funds may be enhanced by the establishment of a separate, segregated account -- an "oil fund". While most of the discussion in this chapter is oriented towards such an account, many of the considerations we discuss remain relevant, even if a special account or fund is not established.

In practice, there are a number of basic decisions that must be made in determining how best to establish an oil account.

- Whether the account should be a trust fund, a special account, another sub-account of the reserves held by the Central Bank, or simply a segregated account or accounts held by the Treasury
- Whether the account should be held in an off-shore depository or in domestic institutions
- What the qualifications of the custodian should be and how the custodian should be selected

Prior to actual oil production when the only receipts are signature bonuses or if the amounts otherwise are relatively limited, one could use an official institution where the Central Bank already holds an account. In that case, the oil fund will need to be segregated into a separate account or sub-account.⁵ For larger amounts and a fuller range of services and capabilities, one must turn to the major international institutions. In fact, the universe of eligible institutions is quite small given the need for strong technical capacity and the highest credit rating.

If an oil fund is to be held outside of the normal government accounts, it is necessary to select a “custodian” institution. It is preferable that the funds be held in an institution outside the oil producing country and that the holdings be denominated in international currencies. Holding the account in domestic institutions or in domestic currency would increase the vulnerability of the country to “Dutch disease”, which would result in further distortions of the economy. Also, most domestic banking systems do not have the controls and capacity necessary to assure the integrity and safety of an oil account, particularly given its potential magnitude. Furthermore, the selection of a domestic institution to be custodian is likely to be a highly politicized process.

The role of the custodial bank is to hold the assets of the fund as securely as possible so that the only risk is the market risk inherent in the investments of the account. In addition, the custodial institution must be able to provide a range of services to allow the efficient management of the account. This is particularly important if domestic capacity is weak, as maybe the case especially during the start up period. For instance, it can provide to the public direct web access to information about the fund and its activities, as well as summary financial reports on the performance of the fund managers. The custodial institution may or may not be an investment advisor, as the two functions are distinct.

A number of different persons in the government could be charged with establishing the account depending upon the local political structure. Ordinarily, the Central Bank would be the logical candidate to take the lead as it would have the relevant experience. Given the importance of the custodian, however, it may be desirable to include a larger number of officials in the process, as was the case in Sao Tome and Principe. Selection between private custodians should be made on the basis of a competitive open tender.

I.2 Deposits and Withdrawals

The petroleum sector may generate a large number of different cash streams that move to the government, e.g., bonuses, taxes, royalties, receipts from the sale of government oil. There is a question then about which of these should be covered by the law. In general, one would expect the definition of revenue to be as comprehensive as possible.⁶ A good example is Sao Tome and Principe's Oil Revenue Law, which defines oil revenues for the purposes of the law in a very inclusive manner.⁷ In the case of a national oil company, there are a number of specialized issues for the determination of payments owed to the government by the company, which should be set forth in the instructions to the custodial bank.⁸

Deposits. To enhance transparency and to avoid possible diversion or delay, payments should be made by electronic transfer directly into the oil account by the entity bearing the payment obligation. The obligation to the government should not be considered discharged until the payment is received into the account.⁹ This enhances controls (such as auditability) and dovetails with transparency obligations.

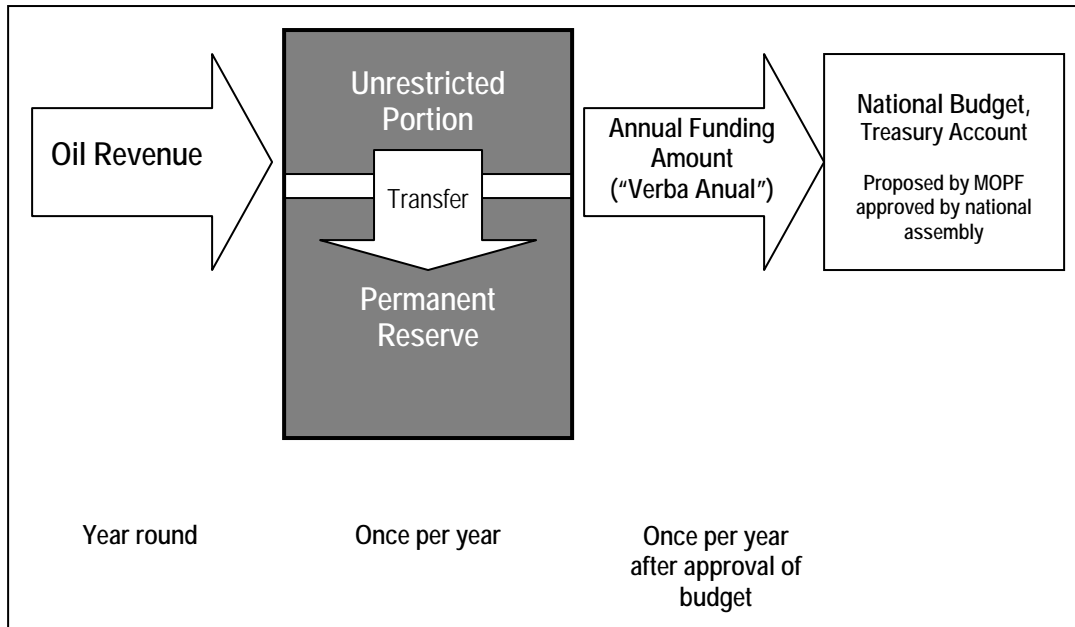
Withdrawals. While ordinary accounts may be subject to electronic transfer orders simply from the Central Bank, an oil account requires a more formal structure to provide protection where institutions are not strongly and deeply established. For instance, in the case of Sao Tome and Principe, the signatures of four officials from different parts of the government are required on withdrawal orders.¹⁰ Another possible protection mechanism is the requirement of a delay of several days between the presentation of transfer documents and the actual withdrawal of funds. This would allow for informal or formal intervention prior to the movement of funds when irregularity is suspected. Provision also needs to be made for payment of the expenses of the fund itself, such as custodial charges, payments to investment advisors, transactional charges, and possible refunds in the case of mistaken payment or overpayment.

A further control, which might or might not be included in the instructions to the custodial institution, is to limit by law the transfer of funds to the budget to a single annual withdrawal, as was mandated by the Saotomean oil revenue law. The amount of the withdrawal each year, the "*Verba Annual*", is determined in the budget process and then there is only a single transfer from the oil

account to the Treasury (see Box 11.1). This enhances regularity in the process and reduces the temptation to meet each short-term financial need by recourse to the oil fund.

Box 11.1

Revenue Flows in Sao Tome and Principe



Source: The Earth Institute at Columbia University.

I.3 Spending Limits, Stabilization and Endowment Funds

An oil account can serve a number of purposes.¹¹ It could be a mechanism for monitoring oil financial flows, a stabilization fund to take account of fluctuating oil prices, or a savings device to establish a permanent fund to service the state or its citizens. The policy arguments for a permanent fund are canvassed elsewhere, but if a permanent fund is to be created, there are a number of issues which must be addressed in the law: namely, what is the desired size of the permanent fund and what should be the path to achieve the desired size, that is, how is the division of income between current expenditures and savings to be determined during the period of production.

Building a permanent fund requires the restriction of current expenditures to a level below oil revenues, at least during the initial period of oil production. A key policy and drafting issue is the determination of whether to cap expenditures by law and if so, what the cap should be and how

“hard” it should be. In Norway, for example, there is no cap as such. Withdrawals from the oil fund are set equal to the deficit in the budget, and the buildup of a permanent fund depends solely upon annual discretionary decisions regarding the budget. In Sao Tome and Principe, on the other hand, the law itself specifies hard limits on the amount of annual expenditures. The Timor-Leste Petroleum Fund Law takes a somewhat similar approach in requiring an annual calculation of the maximum estimated sustainable income taking account of the country’s oil wealth. However, the Law allows the parliament, on an annual basis, to exceed the ceiling under certain specified conditions.¹²

Setting the size of the permanent fund involves intangible choices of intergenerational equity, assumptions about the efficiency of current expenditures and public investment, and estimates about the size and value of a country’s petroleum resources. One rough rule of equity, adopted by the Saotomean oil revenue law, is to try to maintain an even revenue flow to the government or its citizens, throughout both the period of production and afterwards. The Timorese petroleum fund law uses a similar approach through its calculation of the “maximum sustainable annual expenditures.” This can be done in principle by finding the present value of the oil resource and making available for current consumption the expected return on the estimated value plus the return on the balance in the oil account.¹³ To do this, however, requires estimates of a number of variables and any process will only provide a rough leveling of revenues. The estimated value of the resource in particular changes over time when and if new commercial discoveries are made, and as prices change.

As part of setting a ceiling, whether mandatory or indicative, it is usually necessary to place a well defined value on the petroleum resources of the country.¹⁴ This estimation requires a number of assumptions – the size of the petroleum reserves and extraction rates, future prices, and the discount rate to determine the present value of the reserves. Price assumptions particularly can result in widely differing values of reserves and hence widely different levels of permissible spending. The wide range of prices over the last seven or eight years -- from \$10 to over \$70 per barrel -- could allow for great deal of discretion and thus could create the temptation to predict an increase in future prices in order to justify higher current expenditures.

To avoid this, we recommend that the law tie the numbers to some objective determination. In the case of Sao Tome and Principe, the projected price is based upon the historical price over the prior 10 years.¹⁵ This has two advantages. First, it is based upon known numbers, and second, it will change only slowly year to year, as a new year is added to the calculation to replace the oldest figure in the prior calculation. Second, the production figures used are those in the plans which producers have to file with the government. These will usually be conservative providing a conservative bias to the estimate of oil wealth. Over time, new discoveries may increase the estimated oil wealth, and the use of a formula such as that in Sao Tome and Principe will again adjust (although if very substantial new commercial discoveries, occur the level of reserves can result in a significant increase in the amount of permitted annual spending). But since it is unlikely that such estimates must be adjusted downward, these changes, unlike projections of future prices, should not lead to the situation in which governments must decrease the level of spending year to year.¹⁶

The Saotomean oil revenue law provides for a second set of spending limits unrelated to the buildup of a permanent fund. Prior to actual oil production, a country may receive limited oil revenues in the form of signature bonuses and possibly other payments. These amounts are relatively small but should nevertheless move through the oil fund. In the case of Sao Tome and Principe, formulas try to spread these funds over five years, the estimated period prior to commercial oil production. Of course, there may ultimately be no production, as exploration may not turn up commercially producible reserves.

Even if no permanent reserve is envisioned, there is still often a need for a stabilization reserve.¹⁷ One of the most serious problems incurred by resource rich countries is the fluctuation in spending. When prices are high, spending increases. When prices then fall, however, the spending cannot be sustained. This may result in a stop-go pattern of development with increased pressures to borrow--the net effect being that resource rich governments are also among the most heavily indebted. The permanent fund with annual spending limits, as in Sao Tome and Principe, helps avoid this problem since the formulas act to smooth expenditures even during periods of significant price fluctuations.¹⁸ If there is to be no permanent fund, one can create a stabilization reserve within the oil account (or as a separate account) to address price fluctuations. In determining whether monies should be transferred in or out of the stabilization fund, one could use formulas for

projecting prices and future production that would be similar to those used in determining how much to transfer to a permanent reserve. To avoid political estimates, estimates should be tied to market data, to the extent possible.¹⁹ Because of the unpredictable nature of future oil prices, prudence would suggest building a significant reserve in connection with the stabilization fund--that is, the initial spending levels should be less than the amounts expected to be available even after stabilization, until a reasonable reserve is accumulated.²⁰

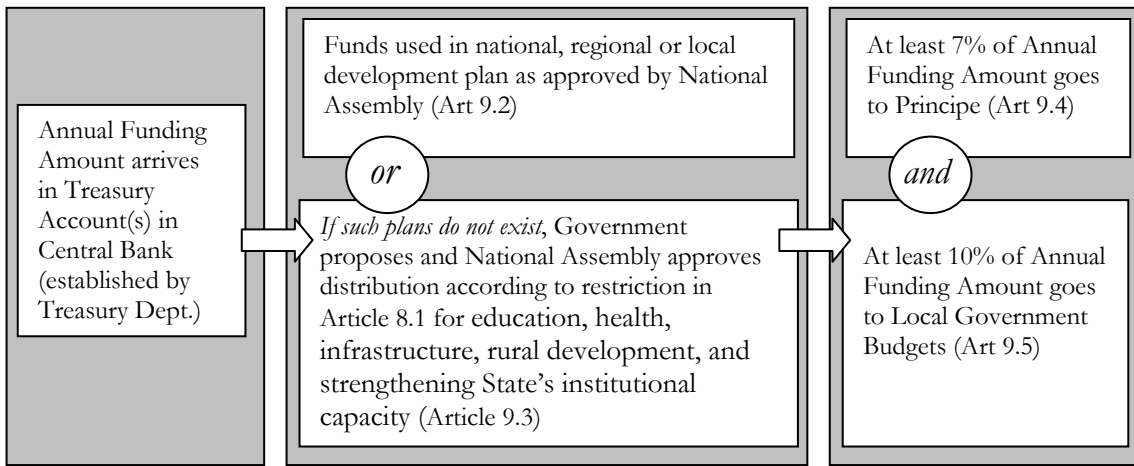
I.4 Uses of Revenues

An oil revenue management law could reasonably be restricted to the receipt, management and control of oil revenues without addressing expenditures apart from whatever overall spending limits are imposed. Nevertheless, a number of laws establishing funds have specified some restrictions as to areas of use. For instance, the use of funds may be restricted to certain priority sectors or there may be set allocations to regional or local governments. In the case of Sao Tome and Principe, regional allocations -- often a highly contentious issue -- were specified²¹ but sectoral allocations were only broadly predetermined (See Box 11.2). The statute contains only a general requirement that the revenues be used in connection with a national development plan and poverty reduction strategy or, in the absence of such plan or strategy for priority, in “education, health, infrastructure, and rural development.” The drafters felt that more detailed limitations on the activities of future governments were inconsistent with democratic notions, holding that parties and candidates in the future should be free to determine the details of their own expenditure choices within the ceilings.

Another important idea has been direct distribution of a portion of the annually available funds to citizens of the country.²² Apart from the Alaskan fund, however, no fund has provided for direct distribution.²³ The idea was broached in Sao Tome and Principe, but was immediately rejected. For a discussion of some of the arguments in favor or against this option, see Chapter 9.

Box 11.2

The Flow of Revenues Into and Within Sao Tome and Principe



Source:

The Earth Institute at Columbia University.

II. Oil Fund Management

Central to any revenue management law is the set of rules and basic principles governing the management of the oil fund. Good governance, professional management and broad oversight can go a long way in protecting the value of oil fund assets.

II.1 Oil Fund Management Functions

The law must provide a clear governance structure covering the main oil fund asset management functions: setting investment policy, selection and oversight of investment managers, and selection and oversight of the custodial institution.²⁴ The oil revenue law should establish clear mandates, compensation policy and governance rules for the investment committee, for the portfolio managers and for the custodial bank.

1. Investment Policymaking and Oversight

The overall responsibility for the management and investment of oil fund assets should be assigned to an investment committee charged by law with creating and periodically reviewing the

investment policy, and overseeing the oil fund asset management. The investment committee should have a clear mandate, advisably in the body of the law, which spells out its membership and selection process, and its main functions, powers and responsibilities. The oil revenue management law should not charge the investment committee with making investments itself; rather, the investment committee should be charged with establishing general investment policy, and selecting and overseeing qualified professional portfolio managers who will carry out the investment policy. Many developing countries will have to look overseas for their oil fund portfolio managers, as no expertise can be found locally.

The membership of the investment committee should be broad enough to ensure political support from the different branches of government and political constituencies. The committee should be structured to include people who are likely to have financial knowledge and experience. It almost certainly should include representatives of the ministry of finance and the central bank. In the case of Sao Tome and Principe, the committee also includes a member appointed by the President and two members appointed by the National Assembly, one of whom must be from the opposition. Where experience is limited, representatives of international financial institutions could participate in the investment committee as non-voting members. In addition to providing technical assistance, international observers and other non-voting members could act as a further check on conflicts of interest or other inappropriate activity. This idea was, however, rejected in Sao Tome and Principe.

In Timor-Leste, the executive branch has the overall responsibility for investment policymaking, oversight, and management of the Timorese Petroleum Fund portfolio. The minister of finance, in particular, plays a key role in making investment decisions with the operational management delegated to the central bank, pursuant to a management agreement. Similarly, in Sao Tome and Principe, the policymaking, oversight and asset management functions are all assigned to a single committee -- the Management and Investment Committee.²⁵ The Management and Investment Committee has the authority to delegate investment management responsibilities to qualified professionals.²⁶ It is yet to be seen whether the committee will delegate or exercise the investment management function directly once the country's oil fund is set up and begins operations. Kuwait's permanent oil fund, the Future Generations Fund, is also subject to executive branch policymaking and management, which is carried out by the Kuwait Investment Authority

(KIA). Similarly, the Norwegian Petroleum Fund is by law managed by Norway's Minister of Finance, which it does through the country's central bank, Norges Bank, pursuant to a management agreement.²⁷

To promote transparency, an oil revenue management law should require the investment committee to report its activities periodically to the government and to the public, and its activities should also be subject to audits by independent international auditing firms.²⁸ Voting members should be subject to fiduciary duties and, in case of breach, to the appropriate sanctions. Finally, the law should address compensation of non-governmental members.

2. Selection and Oversight of Portfolio Managers

An oil revenue management law should set forth clear rules and procedures that delineate the selection process for portfolio managers. The process should be subject to open and competitive public procurement pursuant to rigorous qualification requirements, which should include proven experience in the management of large portfolios for large investors.

An oil revenue management law should also establish objective criteria for assessing the performance of portfolio managers, who should be subject to periodic performance reviews against pre-agreed benchmarks.²⁹ Either the law should itself establish clear benchmarking procedures with which to evaluate the investment managers' performance in managing and investing oil fund assets, or it should charge the investment committee with the task, following consultation with the portfolio managers³⁰

As the size of the oil fund grows, it may be advantageous from a performance standpoint to break the oil fund into separate investment-specific portfolios that may be more profitably managed by specialized managers. The larger the oil fund, the easier it is to justify the transactional costs and institutional burden involved with selecting, overseeing and evaluating the performance of multiple portfolio managers. The Norwegian Petroleum Fund, for example, selects various external portfolio managers to manage different financial asset-specific portfolios,³¹ and the Alaska Permanent Fund is divided into more than 40 financial asset portfolios that are managed by over 20 managers.³²

Be they members of the investment committee, as in the case of Sao Tome and Principe, trustees as in the case of Alaska, or outside professional asset managers, portfolio managers should be held to appropriate standards of care when carrying out management duties and exercising whatever discretion with which they are vested. In common law jurisdictions, this is often expressed as a fiduciary duty that requires trustees, for instance, to meet a “prudent investor” standard or similar rule³³ (see for example the provisions in the Alaska Oil Fund.)³⁴ Sao Tome and Principe has adopted a similar approach which provides that investment management functions shall be discharged pursuant to the “prudent investor rule,” as defined in the law.³⁵ The Timor-Leste law, on the other hand, has opted for a more open approach³⁶ with no further criteria being provided but for the duty of the portfolio manager to take actions to maximize the return on the investments taking into account the appropriate risk as evidenced by the investments permitted under the applicable law.³⁷

Underlying the formulation of any of these rules is the question of who can elaborate the standard (should it be the courts or the government (through contract, regulation or statute?), who can enforce whatever standard is applicable (should it be citizens or particular governmental entities?), and which institution can decide whether the standard is met (should it be domestic or foreign courts?). Although the reference for trustees or governmental investment committees may typically be domestic law and domestic institutions, it would be possible to give jurisdiction in certain instances to foreign courts that possess more developed expertise and stronger institutional history to enhance the protection of the oil fund’s assets. Indeed, contracts with foreign asset managers are very likely to be governed by foreign law and subject to arbitration or some form of adjudication outside of domestic courts.

II.2 General Investment Policy

The oil revenue management law may give broad discretion to the investment committee for devising an investment policy or it may set out a specific investment policy that gives very little room for committee discretion. The oil revenue law of Sao Tome and Principe, for instance, charges the executive branch to submit for the approval by the National Assembly an investment policy proposed by the Management and Investment Committee. Timor-Leste, on the other hand, opts to give the executive branch greater discretion to design an investment strategy for the oil fund,

subject only to statutory limits and to consultation with an investment advisory board by the minister of finance.

Where separate accounts are set up (for example a main oil fund account, a permanent reserve account, and a stabilization reserve account), the law may provide for a different investment policy (with the appropriate investment horizon and adequate investment requirements) for each account. Such legal flexibility will allow for the re-examination of investment strategies, horizons and restrictions, if needed, as the size of an oil fund increases and the institutional capacity and experience in oil fund portfolio management develop.³⁸

II.3 Specific Limitations on Investments

1. Limitations on types of investments

An oil revenue management law should limit an oil fund's investments to certain secure and non-speculative instruments. Both the Sao Tome and Principe oil revenue law and the Timor-Leste petroleum fund law provide such limitations.³⁹ As a fund becomes larger, it may be appropriate to permit some portion of the assets to be invested in more sophisticated or more risky instruments. Again, this is an area in which rules and institutional capacity must be closely calibrated.

2. No domestic investment; no development fund

Investment advisers of a country's oil account should not be permitted to invest the fund in the country, or in domestic enterprises or enterprises controlled by nationals of the country. This prohibition serves two very important purposes. First, it helps limit political influence in the fund's choice of investments and enhances the likelihood of a fully professional investment regime. Second, it avoids governmental use of the oil account as an extra budgetary fund without full governmental and parliamentary oversight. Authorization of development spending should be the responsibility of the parliament, pursuant to the budget process. As recommended in Chapter 7 such expenditures could draw significantly from oil revenues,⁴⁰ but development should not be done through the back door of the oil fund. The oil fund itself is supposed to be a permanent endowment for the country's future and should be invested solely from the perspective of

protecting and growing that endowment. Requiring the fund to be invested in offshore assets also keeps the oil fund itself from contributing to inflationary pressures in the domestic economy, the “Dutch disease.”

The Sao Tome and Principe oil revenue law expressly prohibits the investment of oil revenues deposited in the oil fund “in investments domiciled in Sao Tome and Principe, or in any investments controlled directly or indirectly, totally or partially, by any national [or entity of Sao Tome and Principe], whether or not resident of Sao Tome and Principe, or who falls within [conflict of interest] circumstances.” The Timor Leste petroleum fund law also contains provisions to that effect.

3. No Borrowing

A critical issue in any oil revenue law is whether borrowing against oil resources or the assets held in the fund should be permitted. One can sketch scenarios, particularly in the early life of oil production or before oil production commences, when borrowing to enhance current human or capital investment would be sensible; actual experience, however, is negative.⁴¹ The Saotomean, Norwegian, Alaskan and Timorese oil revenue laws all prohibit borrowing. In Sao Tome and Principe, for instance, borrowing against the assets of the fund, and borrowing against the country’s oil resources are both prohibited.

“Any and all acts are prohibited by the State or its Officials if such acts directly or indirectly create, permit, assume, or promise the existence of public loans, public bonds, security interests or any other liens or encumbrances relating to the Oil Accounts or any other Oil Resources, whether existing or future, or related thereto.” Sao Tome and Principe Oil Revenue Law, Article 4.1.

In addition, an oil revenue management law should prohibit the pledge or other such use of oil resources or oil fund assets as security for loans. Such a prohibition prevents the government from borrowing against future production, which would result in the same consequences that arise from borrowing directly against natural resources.⁴² Prohibiting the creation of security interests in oil fund assets does not mean that the government cannot borrow, but it does prevent the government from securing that borrowing with oil revenue or oil resources. Lenders thus must instead rely on the general credit of the country. This provides important discipline for both the country and the lenders, and gives the lenders a greater stake in stability and good government.

Such discipline can be particularly important during the interval between the discovery of commercial oil and the commencement of oil production -- a period in which there will be strong popular pressure to increase spending.

Narrow technical exceptions to this rule may be carved out in the law to permit the borrowing of securities in connection with prudent portfolio management,⁴³ subject to strict conditions, and the payment of pre-established financial charges in connection with the maintenance and the management of the account, as permitted, for example, by the Saotomean oil revenue law. The Timorese petroleum fund law, by contrast, contains a flat prohibition on any liens or encumbrances whatsoever on the Petroleum Fund.

III. Oversight and Controls

III.1 Oversight Groups

1. Parliamentary and Governmental Oversight

The collection, management and use of all oil-derived revenues should be subject to wide and detailed oversight. In strong and well established governments, this oversight may be carried out by parliamentary commissions or other governmental bodies that already have oversight functions.⁴⁴ Traditional legislative oversight can be enhanced by requiring the publication of periodic and public reports by the various parts of government charged with carrying out the revenue law. For instance, in Sao Tome and Principe, the National Assembly is required under the Oil Revenue Law to conduct yearly public plenary sessions to discuss general oil and gas policy. Ministers, investment committee members, the Auditor General, and the oversight board are required to be present to answer questions from parliamentarians, and to discuss the activities of the fund including the required annual oil fund audits.

2. Oversight Board

Given the significance of oil revenues and the limitations on existing institutions, it may also be desirable to consider the establishment of additional oversight groups, especially groups which

may bring in civil society and elements not necessarily represented in the government. The case of Chad provides an early example. There, the management of resource revenue generated in connection with the Chad-Cameroon Petroleum Pipeline Project was supervised by an oversight board, the Committee for the Control and Supervision of Oil Resources or “*Collège de Contrôle*”,⁴⁵ which included civil society representatives among its members and was monitored by the World Bank and the International Monetary Fund.⁴⁶ This oversight board was charged with verifying that the oil fund complied with applicable law, and with authorizing and controlling the disbursement of funds held in the oil fund. Chad, unfortunately, also provides an example of what can happen when oil institutions are divorced from the real power institutions of the country. In a widely criticized action, the Chadian government recently amended the revenue management law to reduce the authority of the *Collège* and to undo the basic revenue management framework. In December 2005, the Chadian parliament amended Law No. 001, providing for the deactivation of the country’s oil fund, an increase in oil revenue expenditures, and a reassignment of a portion of the mandated expenditures for bureaucratic and security purposes.

In Sao Tome and Principe, the Oil Revenue Law created a new independent oversight body, the Petroleum Oversight Commission, composed of governmental and civil society members. The commission is charged with monitoring the management of oil revenues and assuring the implementation of the revenue management law and has been given significant investigative powers. In Timor-Leste, the Petroleum Fund Law created a Petroleum Fund Consultative Council, made up of former officials, but its function is limited to providing opinions on major issues and acting as a medium of communication with the public.⁴⁷

The nature, composition, and powers of any new oversight institution must be considered carefully. Such institutions have the advantage of creating a sharp focus on the resource sector and of bringing into the oversight function groups which might otherwise be excluded. Moreover, the experience built up in such groups may be very important in providing continuity in oil policy and in explaining activities to the public. Further, oversight institutions may enhance public trust and understanding, which may be critical to the long-term existence and management of the fund.

Box 11.3

Oil Revenue Management Oversight Around the World – Selected Examples

<i>Country</i>	<i>Oversight Body</i>	<i>Membership</i>	<i>Mandate</i>
Azerbaijan	Supervisory Board	9 members, all appointed by the President, but should represent both government and civil society	Review and comment on draft annual budget, annual report and financials, audits
Chad	Committee for the Control and Supervision of the Oil Resources (CCSPR) or <i>Collège de Contrôle</i>	9 members, multiple constituencies. Includes 4 members from civil society.	Ensure fund's compliance with finance law; authorize and control withdrawals, and oversee use of funds
Kuwait	Board of Directors of Kuwait Investment Authority (KIA)	8 members. Includes 5 members from private sector.	Oversee and direct the activities of state oil Company
Sao Tome and Principe	Petroleum Oversight Commission	11 members, multiple constituencies. Includes 3 members from civil society.	Permanent oversight of all payment, management and use of oil revenues and oil resources
Timor-Leste	Petroleum Fund Consultative Council	Multiple members, exact number may vary in time. Includes former government officials, government appointees and civil society.	Advise on matters relating to the performance and operation of the Petroleum Fund

Source: Authors

At the same time, such institutions could become a second “government” and thus create further civil conflict. In some instances, this conflict may be necessary given the character of the government, and the oversight commission then becomes a brake on arbitrary governmental action. There are limits to this, however, as demonstrated by the experience of the Chadian *Collège* in its

attempt to deal with its own autocratic and unsupportive government. Second, unless clearly defined, such bodies may take on an amorphous legal character. The Petroleum Oversight Commission in Sao Tome and Principe, for instance, mixes investigative and administrative powers, as well as limited judicatory powers,⁴⁸ and in a number of respects overlaps existing institutional responsibilities.

Whatever the approach, the oil revenue management law should set forth a clear mandate for the oversight board. The Saotomean Petroleum Oversight Commission, for example, has broad responsibilities to monitor and ensure compliance by the government with the oil revenue law, and it has independent administrative powers to investigate allegations of misconduct.⁴⁹ Depending on its scope, an oversight board should be accorded the power to investigate, to require and compel the production of documents and information, and to initiate and conduct investigations on its own motion or upon complaints. The powers of an oversight board may also include the power to enjoin the actions of any governmental institutions or governmental officials in violation of the law, and the power to take judicial action to ensure the enforcement the law.⁵⁰ See Box 11.3 for a summary of different provisions that have been used in a sample of countries around the world.

To promote independence, membership of an oversight board should reflect the multiplicity of stakeholders in the management of a country's oil revenues. To enhance legitimacy, seats could be assigned not only to the various branches of the government at all levels (national, regional or local) but also to the opposition and to civil society.⁵¹ Participation of the international community in the oversight board may also be desirable, through a non-voting observer represented by an international public institution present in the country. Note that this idea was rejected in Sao Tome and Principe.⁵² Numerous organizational issues such as term length, composition, independence from selecting bodies, staff and compensation also need to be addressed.

III.2 Audits and Reporting

An important mechanism of accountability is the periodic auditing of the oil fund. An oil revenue management law should specify the accounting method or methods the oil fund should follow, and require all activity of the oil account to be audited annually by an independent internationally recognized accounting firm that utilizes internationally accepted accounting methods

selected by open and public procurement. The law should also require that audits, any back-up papers and special reports be presented to governmental agencies and be made public.⁵³ Moreover, any governmental agencies that the annual audits may be allowed to comment on them and pose any pertinent questions as such agencies see fit.

To the extent that a body of the local government has the power and responsibility to audit state accounts, such institution should also be required by the law to conduct an audit of the oil account activity.⁵⁴ In Sao Tome and Principe, for example, the national oil account is subject to a dual audit requirement, with mandatory annual audits by the country's Auditor General and by the international accounting firm audit. In Chad, this internal audit is a responsibility of the General Accounting Office of the Supreme Court.⁵⁵ In Canada, the Alberta Heritage Savings Trust fund is audited by the Auditor General.⁵⁶ Similarly, Norway's oil fund is also audited by the country's office of the Auditor General.⁵⁷

Reporting requirements should also be established. The country's oversight board and each governmental agency involved in the production, compilation, processing or receipt of data or other information relating to oil revenue should be required to report periodically to the government and to the public. In varying levels, all revenue management laws contain reporting (and reporting disclosure) requirements.

III.3 Private Rights of Action/Judicial Controls

Any law must be clear as to who has standing to seek judicial enforcement of activity under the law, enforcement that should include the right to injunctive or mandamus relief. In order to further strengthen public oversight, some consideration should be given to private or citizens' rights of action to enforce compliance with the requirements of the oil revenue management law. The use of private litigation to enforce public rights is just beginning to emerge in developing countries, but it is a significant potential source of control over unlawful government action.⁵⁸

III.4 Penalties

Legal sanctions such as those against bribery, abuse of office, and dereliction of duty may be directly applicable to actions under the petroleum law, but if not, the petroleum law will have to address these issues.

The Saotomean oil revenue law prescribes a range of penalties applicable to violations of the law, including fines, imprisonment, the disgorgement of any monies and reversion or any improper advantages obtained, and, in some cases, the nullification of contractual agreements and documents.⁵⁹ In addition, the Saotomean oil revenue law provides enhanced penalties for both misdemeanors and criminal acts.

IV. Transparency

IV.1 Scope of public information

The requirement of transparency and the establishment of mechanisms that ensure such transparency are critical in any oil revenue management law. As a general rule, all oil revenue-related information should be made public. Any law should provide a non-exhaustive list of items subject to transparency, and the parties responsible for making each piece of information public.⁶⁰

Among many international efforts to foster and strengthen transparency in natural resource management are the “Publish What You Pay”⁶¹ and the “Extractive Industries Transparency Initiative” (EITI) campaigns,⁶² both of which support transparency of resource revenues through the disclosure of information on natural resource related payments made by private companies to resource exporting governments, among others.⁶³ Also of particular note and value is the newly published IMF Guide on Resource Revenue Transparency.⁶⁴

A special issue with respect to the publication of payment data is whether such information should be available on an individual company basis or should be aggregated.⁶⁵ In countries with mature institutions, individual company data may be available, but in many developing countries there is no such disclosure.⁶⁶ While aggregate data may be the best information available in some

countries, civil society or parliamentarians cannot use such data to directly compare payment data reported by the government with payments reported by the companies.

The Sao Tome and Principe Oil Revenue Law takes the preferred approach and mandates public access to individual payment data rather than to summaries or aggregations of information. Furthermore, in the joint development zone controlled by Nigeria and Sao Tome and Principe, Presidents Obasanjo and de Menezes have signed a declaration of principles, the Abuja Joint Declaration, which requires public disclosure of individual company data and of contracts by the governing authority and the companies.⁶⁷ One of the advantages of having direct public web access to the records of the custodial account (described in more detail below) is that payment information is available on a disaggregated basis and, without any intervention or discretionary action by the government, that all of the information can be made available to other branches of the government, civil society, and interested international groups.

A separate issue is the publication of all oil-related contracts. Although governmental oil contracts have traditionally been kept confidential in the developing world, that is not the practice in advanced democracies.⁶⁸ Moreover, the most recent practice even in developing countries is moving towards disclosure.⁶⁹ For instance, the Saotomean oil revenue law requires disclosure and public access to “all contracts relating to the participation of the State or any enterprise or entity owned or controlled in whole or in part by the State, the scope of which directly or indirectly concerns activities related to Oil Resources or Oil Revenues.”⁷⁰ Making contracts public ensures the integrity of bidding and negotiations, which in turn ensures that awards are made competitively and are consistent with whatever rules have been laid down. Without the transparency of contractual agreements, it is impossible for civil society or interested members of parliament to ensure that contracts are enforced and payments made accordingly. Making contracts public at the time at which they are entered makes possible full public oversight of those agreements that will be central to the political economy of the country in the future, and is the only way to give such contracting full political legitimacy. This legitimacy is important not only for the citizenry, but also for the companies because it provides protection against political second guessing when exploration prospects turn out favorably. Secrecy may protect the negotiators (government and private), but no one has identified a governmental interest in keeping agreements private. The contracts themselves are shared among industry partners; it is only the public that is excluded if they are kept confidential.

Sometimes in order not to make contracts or payments public, companies rely on confidentiality clauses and assert that it is the government that prevents them from making such information public. However, the government can and should, in the exercise of its own sovereign power, determine that such information shall be publicly disclosed. Certainly, a self-imposed confidentiality argument has no weight in the debate on a forward looking law.

Any exceptions to the disclosure requirements should be very narrowly drawn. The Saotomean oil revenue law specifically allows the withholding of information only if it is classified as confidential by law or treaty, and it puts the burden of claiming confidentiality on the proponent. The Saotomean law protects proprietary information from disclosure, but specifically prohibits making any payment information confidential. The Timorese petroleum fund law, on the other hand, has a general exception for confidential information without defining it. It also permits the government to use a number of other justifications for preventing the release of data.⁷¹ Although certain of the exceptions might make sense in principle, they are drawn so generally that a determined government could use them to prevent almost any meaningful disclosure. What as a general matter should be considered confidential has been widely discussed in the literature, particularly in connection with environmental information.⁷²

IV.2. Public information office

A requirement that information be made public necessitates supporting infrastructure that may not already be in place. For instance, there needs to be some form of a central, adequately financed depository, as well as a public information office where such information is readily available. In many cases, one could use existing institutions.⁷³ Alternatively, one could set up a new office particularly for oil related information. In Sao Tome and Principe, an office was created under the auspices of the National Assembly to serve as depository for oil related information. One of the shortcomings of the Timor-Leste law is the failure to provide for a public information office or web facility where documents which are to be made public will be available; the subject may or may not be treated in other legislation.

It is important to have access to complete, readable and comprehensible physical copies in local language. This access should not only include reports in summarized and understandable form but should also include access to the underlying data so that independent checks can be made.

IV.3 Direct access to information through the Internet

Electronic technology can greatly facilitate public access to information. All information, regardless of whether it is also available in print, should be scanned to digital format, uploaded, and maintained on the Internet. Any document received by the public information office should also be scanned and posted with its control number. This would allow for universal access to all public information both locally and internationally.

Internet access can also offer a dramatic increase in oversight of the oil account itself. In Sao Tome and Principe, the Earth Institute oil team proposed that the public be granted web access to the financial data of the national oil account— e.g. deposits, withdrawals, and holdings. Such access would be similar to the access an individual account holder has to his or her private account. If extended to the oil account, such access would provide greater transparency. In the case of Chad, there was a monthly posting of the account's activity as well as of quarterly reports. Timor-Leste has implemented a quarterly reporting system regarding holdings and aggregate receipts for its fund.⁷⁴ The proposal in Sao Tome and Principe would, by providing real time access to the oil account's financial data, go well beyond that.

IV.4 Responsibility for disclosing information

An oil revenue management law could reinforce a transparency regime by requiring private parties to publicly disclose governmental contracts and oil-related payments. This would provide an independent check on government reports and would help ensure that such information is available even if the government fails to carry out its obligations to make such information public. The Saotomean oil revenue law requires disclosure by both the government and the payer. The oil law further enforces such mandatory disclosure by requiring that the obligation to disclose agreements be included in all oil resource contracts either explicitly or by operation of law.⁷⁵

V. Public Governance and Integrity

Matters such as public governance and integrity may be already addressed by existing legislation; if not, they should be addressed in the oil revenue law or in ancillary regulation. At a minimum, the basic principles of public governance and integrity, as applicable to the management of oil revenues, should be included in the revenue management law unless clearly addressed elsewhere.

V.1 Conflicts of Interest

If not already defined by law, an oil revenue management law should set forth the elements of impermissible conflicts of interest and the basis rules for handling situations of unacceptable conflicts of interest. Laws and regulations governing ethics in public service often include mechanisms such as mandatory disclosure, temporary and permanent limitations, anti-nepotism rules, blind trusts and mandated divestiture or liquidation of a public official's interest.⁷⁶ Again, one should be cautious about establishing rules that require or permit discretionary judgments; for example, the term "abuse of office." It may be better to provide bright line rules, for example, "no employment of a relative" (with "relative" carefully defined).

In Sao Tome and Principe, the oil revenue law sets out strict conflict-of-interest standards that prohibit government officials from holding interests in oil revenues or representing any entity in which the oil revenues deposited into the oil fund are held or invested,⁷⁷ and also provides for the Petroleum Oversight Commission to establish its own conflict of interest regulations. Ethics rules aimed at avoiding unacceptable conflicts of interest also exist in Alaska, Azerbaijan, and elsewhere. Having the rules and enforcing them, however, are two different things.

V.2 Bribery and Corruption

The Saotomean oil revenue law also requires all oil-related agreements and contracts to include no-bribery and procurement compliance representations, public disclosure obligations, and prevailing language (Portuguese) provisions, as well as a provision conditioning the effectiveness of

the agreement or contract on full compliance with applicable government contract law. Under the law, agreements and contracts are to be construed to include these provisions, even if such provisions are not expressly written therein. Where the standards are included in the contract, any violation will constitute a breach of contract, allowing for an additional cause of action in case of bribery or corruption. The law can go even further (which the Saotomean law does) and can make any contract voidable with respect to the violator. As this is a severe sanction and could itself be abused by the government, further elaboration may be necessary in order to limit voidability to situations of gross abuse or bribery related to the contracting process itself.

In any event, it is recommended that an oil revenue law itself contain an express prohibition of bribery and any illegal or undue advantages in the oil sector.⁷⁸ Note that most Western companies will already be subject to penal sanctions for bribery in their home country so that one effect of anti-bribery provisions is to equalize, at least in principle, the standard for all companies.⁷⁹

V.3 Public Procurement

Public procurement is one of the areas in public governance most prone to corruption. With a view to reducing the opportunities for corruption and undue favoritism and patronage in public procurement, an oil revenue management law should stipulate that all significant contracts and agreements relating to oil revenues or to oil resources must be subject to open competitive public procurement. Under the Saotomean oil revenue law, oil contracts – which are defined very broadly – are void unless entered into pursuant to the competitive provisions required by the Act.⁸⁰ The law requires that oil contracts be awarded pursuant to competitive public tenders in accordance with general legislation. In the absence of such legislation – and to the authors' knowledge currently no such general legislation exists – contracts are supposed to be approved by the Petroleum Oversight Commission. This presents somewhat of a conundrum since the Petroleum Oversight Commission itself cannot be established until further implementing legislation is adopted.

VI. Integration with Other International Obligations

Frequently, oil resources may be shared with adjacent countries, and in such cases any oil management law must take account of the regime that governs such resources. If care is not taken

the joint zone can become a separate pocket of off budget activity with limited control. In the case of Sao Tome and Principe which shares oil resources with Nigeria, a preexisting treaty prevented Sao Tome and Principe from prescribing rules for the zone shared by the two countries, but the Saotomean oil revenue law was able to regulate and reinforce the commitment of the two countries with respect to the joint development zone.

Domestic law, while it cannot always directly control a joint development zone, can control the activities of domestic officials acting on behalf of the government with respect to the joint zone.⁸¹ In particular, no official is authorized to approve any contribution to the budget for the administration of the joint zone without such contribution being approved by the National Assembly. Officials are also subject to the conflict of interest and other legal provisions that apply to all government officials and representatives. As per the Sao Tome and Principe Oil Revenue Law, for instance, no Saotomean official could agree to or authorize any document encumbering the oil resources of the joint zone that are allocable to Sao Tome and Principe. Moreover, Saotomean officials are directed by the law to work with the Nigerian representatives to implement the provisions of the Abuja Declaration agreed to by the two Presidents.⁸² Since such provisions are generally consistent with the Saotomean law, this provides some coherence between the two regimes.

While a problem area in the case of Sao Tome and Principe, joint resources could, with some imagination, be an opportunity for enhanced and more secure oil management. For instance, it would be much easier to set up a truly independent international trust account with fixed rules that neither country could arbitrarily void even if its government changed or was subject to instability. The rules could be changed by agreement of all participating parties, but the account would not be subject to change simply because of instability of one of the parties.

VII. Keeping the Law in Place

A central issue for an oil management law is how to create practical and legal barriers that will inhibit subsequent governments from abandoning or evading the law while at the same time maintaining flexibility to meet changing conditions. Sovereignty means that any law passed by the

current government is in principle subject to amendment or repeal by any future government. The action in Chad is a case in point. Still, measures can be taken even legislatively which may make it harder to change the law. For instance, in certain countries, it is possible to create special supermajority legislative approval and referenda requirements for changes in the law.⁸³

Another way to reinforce the oil law is to adopt a constitutional amendment addressing certain key elements. A constitutional amendment would significantly strengthen the controls over the collection and use of oil revenues, and would inhibit -- but not prevent -- the ability of any party or subdivision of the state to arbitrarily or unilaterally change the rules governing the oil account. In the unlikely event that an unconstitutional government attempts to seize power, such an amendment might also help protect the country from the seizure of funds, especially if the funds are held in an international institution outside of the country.

An amendment could reaffirm key principles, as discussed below, of the oil revenue management law. For instance, the amendment might state that all petroleum resources and the revenues derived from them are the property of the state and cannot be pledged or encumbered,⁸⁴ that all revenues from such resources must be deposited in the oil account, that all transfers from the oil account to the general funds of the Treasury must be approved by the appropriately designated institution or institutions, that the activities of the oil account, including all deposits and withdrawals, shall be public, that monies from the oil account can only be made available for particular specified uses and, possibly, that pledges or other encumbrances on the petroleum resources of the state. The constitutional amendment could be passed separately or in conjunction with the oil law.⁸⁵

The state constitution of Alaska for example provides in Article IX, Section 15, that “[a]t least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.”⁸⁶

The Alaskan fund is interesting in another respect and that is its use of a trust. Trusts, at least at common law, are frequently used to put assets beyond the control of either the party establishing the trust or the beneficiary of the trust. The trustee or manager of the trust is then required to act in accordance with the instructions setting up the trust, and the beneficiaries of the trust can sue the trustee if it fails to act as required.⁸⁷ In the oil fund context the difficulty is the sovereign binding future sovereigns.⁸⁸ More generally, it is hard to imagine any government being willing to commit large sums to a foreign trust and then to throw away the key.

Even though the government maintains full control of a fund, the stability of a fund could also be enhanced by the involvement of regional or international institutions such as NEPAD⁸⁹ or the World Bank. Chad provides a good example of the power of such involvement and the limitations on that power.⁹⁰ Even where such institutions have simply observer status or non-voting membership, they can provide an additional degree of professionalism, transparency, and accountability. Apart from enhancing management, their presence could be especially helpful in resisting domestic pressures driven by short-run political advantage.

Whatever form the fund takes, however, legislators and those assisting them must recognize that the law without strong supporting institutions may become just paper. In the end popular support rather than good drafting is the most important sustaining mechanism, but a well constructed law may help increase and build that support. There is a possibility of a virtuous circle in which a workable and effective law creates stronger popular constituencies who in turn will act to support and maintain the law.

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¹ The “oil” team of the Earth Institute was made up of the authors and Macartan Humphreys, Martin Sandbu, and Peter Rosenblum, all of Columbia University. This chapter relies heavily upon the work of the team.

² See Greenspan Bell (2000).

³ The Saotomean oil law is telling in this respect. Not only does the new law impose a number of requirements that current institutions may not be equipped to carry out, but, contrary to recommendations, the law itself calls for additional laws to establish a public information office and an oversight board. The need for these additional laws has significantly delayed the startup of both these institutions.

⁴ Indeed, there is some research suggesting that in the face of limited resources, focusing on new rules for existing institutions may be more fruitful than focusing on the establishment of new institutions. See for example Posner (1998), and sources cited therein.

⁵ Sao Tome and Principe is using the New York Federal Reserve to hold its account.

⁶ Chad’s petroleum revenue management law, for example, was severely criticized because in its original form it only covered a portion of the oil stream although partial coverage may have been the most that was politically feasible. See Catholic Relief Services (2005).

⁷ Art. 1(ii).

⁸ Pursuant to the Timor-Leste Petroleum Fund Law, any state-owned oil company receipts shall be included as Petroleum Fund gross receipts (Art. 6.2). Selected provisions of the Timorese Petroleum Fund Law are transcribed in Appendix 2.

⁹ Such electronic transfers should be free of any transfer or exchange taxes.

¹⁰ In the draft discussed among the Saotomean lawmakers the officials were also required to certify as part of the withdrawal order that it was in accordance with the provisions of the oil law.

¹¹ See Chapter 8 for a discussion of natural resource funds.

¹² Pursuant to Article 9 of the Timor-Leste Petroleum Fund Law: “No transfer shall be made from the Petroleum Fund in a fiscal year in excess of the Estimated Sustainable Income for the Fiscal Year unless the Government has first provided the Parliament with” certain reports and explanations. However, “[i]f required under the law of Timor-Leste, transfers from the Petroleum Fund are exceptionally permitted for the purposes of refund of tax, in the event of overpayment of tax [...] This amount represents a reduction of the Petroleum Fund receipts, and shall not be considered as part of the appropriation [the amount approved by the Parliament for the relevant fiscal year].” Article 10.

¹³ For example, the Saotomean oil revenue law limits expenditures based on a formula that is essentially equal to five percent (i.e., the expected earnings on the fund) multiplied by the amount in the permanent fund plus five percent of the remaining estimated oil wealth. There is a further limit to make sure that the amount calculated as five percent of the remaining oil wealth does not exceed the unrestricted portion of the account in the prior year. The latter restriction is intended to avoid any invasion of the principal amount of the permanent fund.

¹⁴ If all revenues are put into a fund and then only earnings from the fund are used to support current expenditures, such estimates would not be necessary, but this would result in a very low level of initial spending. While in some cases this

may be consistent with absorptive capacity, it is very unlikely to be consistent with political pressures for rapid development and spending that arise, once commercial petroleum is found.

¹⁵ For new oil streams, it is necessary to look at comparables to obtain the historical figures, but this can be done by using some sort of basis adjustment which, while not entirely free of subjective elements, will cause only modest variations in the calculated average price.

¹⁶ For examples of the calculations under various assumptions, see The Earth Institute website at http://www.earthinstitute.columbia.edu/cgsd/STP/index_oillaw.htm.

¹⁷ See, for example, Davis et al (2001b). For estimates of the required size of a stabilization fund for Nigeria, see IMF (2005).

¹⁸ If in the first year or two of commercial oil production prices are very low compared to historical prices, initial revenues may not be able to support expenditures at the level calculated at historical prices. The Saotomean oil revenue law addresses in part by incorporating an initial one year lag after the commencement of commercial oil production into the determination of the limit on expenditures, and by limiting the amount to be spent to actual prior year revenues plus expected earnings on the permanent fund balance. Article 8.3(b). The effect of various buildup patterns is illustrated at The Earth Institute website, available at http://www.earthinstitute.columbia.edu/cgsd/STP/index_oillaw.htm.

¹⁹ It would also be possible to incorporate forward markets into a hedging strategy to provide more stability of income flows (see Dodd 2004).

²⁰ If only a stabilization fund is used, the estimate of future prices becomes more critical. A permanent fund, except in its earliest years, provides a much larger fund balance or “reservoir” from which current expenditures can be financed. Hence, the inevitable difference between forecasted or current prices and the prices used to calculate the limits is much less likely to result in a liquidity or funding problem.

²¹ Regional allocations are highly political and have been the central focus of much conflict regarding the use of oil revenues. This is true for example in Nigeria, where greater disclosure is needed for the special oil revenue allocations made to oil-producing state and local governments. On this topic, see Brosio (2000, 24-25). In Sao Tome and Principe there is a mandated allocation of 7 percent of the Verba Anual to Principe, an autonomous region, and 10 percent to local autarchic governments. Although Principe and local regions are allocated funds, their budgeting and appropriation procedures are subject to national supervision.

²² See Chapter 9 for a discussion of distributive aspects of resource revenues.

²³ Although frequently pointed to as a model, the constitutionally required allocation of revenues to the fund and direct distribution has been criticized for diverting revenues from the general fund and depressing expenditures for education, infrastructure and other social needs. For a more general discussion of the topic, see Davis et al 2001a. A variant of direct distribution has apparently been successful in Mexico where payments are made to families whose children are enrolled in school. See Gertler and Boyce (2001), Davis (2003) and Rawlings (2004).

²⁴ The custodial function encompasses solely the custody of the oil fund assets, and is carried out by the account custodian.

²⁵ Articles 11 and 13 of the Sao Tome and Principe Oil Revenue Law.

²⁶ Article 13.4 of the Sao Tome and Principe Oil Revenue Law.

²⁷ See Act No. 36 of June 22, 1990, relating the Norway's Government Petroleum Fund available at the Norges Bank website at http://www.norges-bank.no/english/petroleum_fund/management/actno36.html, and Management Agreement between the Minister of Finance and Norges Bank dated as of February 12, 2001, as most recently amended on December 1, 2004, at http://www.norges-bank.no/english/petroleum_fund/management/agreement-2004.html.

²⁸The Timor Lest Petroleum Fund provides for quarterly reports on the fund performance. The initial report is available at <http://www.transparency.gov.tl/PR/PFQR.htm>.

²⁹ Specific benchmarks can facilitate the oversight of government spending and thus help protect against political manipulation and diversion of funds. A clear benchmark also provides a specific guide to the ministry of finance for developing the budget.

³⁰ Pursuant to Timor-Leste's Petroleum Fund Law, the Investment Law, the Investment Advisory Board is responsible for developing performance benchmarks of desired returns on, and appropriate risks of, the investments of the Petroleum Fund. Article 10.1(a). In addition, the annual report for the Petroleum Fund shall contain a comparison of the income derived from the investment of Petroleum Fund assets with benchmark performance indices provided to the Minister of Finance by the Investment Advisory Board for the relevant fiscal year. Article 14.2(f).

³¹ Pursuant to the Norwegian Central Bank, this strategy was devised with "the objective of achieving the highest possible return within the guidelines and framework set by the Ministry of Finance." See Norges Bank website at http://www.norges-bank.no/english/petroleum_fund/mandates/.

³² A list of managers and specific mandates, portfolios managed and respective benchmarks is available at the Alaska Permanent Fund Corporation website, at <http://www.apfc.org/investments/MANAGERS.cfm>.

³³ In the United States, virtually all states have adopted their respective versions of the Uniform Prudent Investor Act, which sets out the required standard of care for the fiduciary investment in trust of another's assets. See Trillos (2005).

³⁴ In Alaska, the "prudent investor rule" means that in making investments, the portfolio manager should exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion and intelligence exercises in the management of large investments entrusted to it not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income.

³⁵ Pursuant to Article 1(II) of the Sao Tome and Principe Oil Revenue Law, the "prudent investor rule" shall mean that an agent shall ensure high quality and efficiency standards in the performance of any investment transactions or services, and shall discharge his duty to protect the legitimate interests of the state with the diligence of a discerning and orderly manager, pursuant to the risk sharing principle and the safety of the investments, in accordance with the investment rules approved by the Management and Investment Committee.

³⁶ Article 11.4 of the Timor Leste Petroleum Fund Law.

³⁷ Article 12.5 of the Timor Leste Petroleum Fund Law.

³⁸ See Article 14.3 of the Petroleum Fund Law of Timor-Leste, which provides for the range of specified permitted investments to be reviewed by the government and approved by the Parliament at the end of five years taking into account the size of the oil fund and the level of institutional capacity.

³⁹ See Article 15.1 of the Petroleum Fund Law of Timor-Leste (Appendix 2).

⁴⁰ Chad's oil revenue escrow account was used as a development fund. In Timor-Leste, certain constituencies claim that the oil fund should be used as a development fund.

⁴¹ Angola's recent history, for example, illustrates how oil-backed financing can exacerbate oil price fluctuations and further weaken already poor accountability and public governance in oil exporting countries. Angola has mortgaged much of its future oil production by using it to secure international short-term, high-interest, financing, the proceeds of which were not used in development or poverty alleviation programs, but rather often wasted or lost to corruption. Global Witness (1999, 2002).

⁴² Some commentators have expressed concern about whether such an account might be subject to attachment by private creditors, but under existing international and U.S. law and longstanding doctrines of sovereign immunity, a governmental account is immune from attachment.

⁴³ Investments held by the oil account can in certain instances be used to collateralize other securities held in the account where such securities are of short duration.

⁴⁴ Pursuant to the Saotomean oil revenue law, the country's Auditor General also performs certain oversight functions, being responsible for auditing the oil account on an annual basis and for reviewing oil contracts *ex ante* and *ex post*. It is not clear, however, that the Auditor General has been able to fully carry out these functions.

⁴⁵ Website: <http://www.ccsrp.td/>. The Chad Revenue Management Plan is available under "Revenue Management Plan" on the Chad-Cameroon Development Project website, at http://www.esso.com/Chad-English/PA/Files/20_ch16.pdf

⁴⁶ Despite the active monitoring of international financial institutions, the effectiveness of the Collège de Contrôle has proven weak at best, in view of lack of enforcement of the law, insufficient human capacity and political pressures and influences. See, e.g., Catholic Relief Services (2005).

⁴⁷ In a number of sections of the Timorese law, parties are required to "advise" or to provide an opinion to others.

⁴⁸ The language of Article 24.2(d) of the Saotomean Oil Revenue Law provides the Petroleum Oversight Commission with the power to "carry out searches, inspections, and seizure of any documents or personal property that are the object, tool, product of any infraction, or that are necessary to the opening of the respective process." In drafting the Petroleum Oversight Commission's implementing legislation, however, the Saotomean lawmaker has expressed its concern that the Petroleum Oversight Commission not usurp judicial functions from the judiciary branch, and that the implementing laws should clearly provide that any such search and seizures be subject to the appropriate judicial proceedings. As of August 31, 2005, the implementing laws had not yet been enacted.

⁴⁹ Art. 24.

⁵⁰ In Sao Tome and Principe, the drafting committee considered, but then rejected, giving the oversight board the power to suspend any transfers out of the oil account in exceptional circumstances of "grave" violation, subject to the review of the country's highest court or to action by a supermajority of the National Assembly.

⁵¹ The oil revenue management law should leave the procedure of non-governmental member selection to the discretion of the selecting constituency.

⁵² The Petroleum Oversight Commission includes 11 members appointed or elected, as the case may be, by the President of the Republic, the National Assembly (including one member selected by the opposition), the Superior

Judiciary Council, the Autonomous Region of Principe (the island of Principe), local governments, business associations, trade unions, and non-governmental organizations.

⁵³ The Sao Tome and Principe Oil Revenue law provides that all audit backup documents and reports shall be made public. Similarly, the Timorese law provides in Article 24.2 that the sources of information required by the law to be disclosed and made public shall be annexed to the Petroleum Fund's Annual Report, whatever its form, and including all reports and statements, in unedited form.

⁵⁴ A list of existing supreme audit institutions is available at the International Organization of Supreme Audit Institutions (INTOSAI) website, at http://www.intosai.org/Level2/2_DIRECT.html.

⁵⁵ Catholic Relief Services (2005).

⁵⁶ See Alberta Heritage Savings Trust Fund Act, Queen's Printer website, at <http://www.qp.gov.ab.ca/Documents/acts/A23.CFM>.

⁵⁷ See Norges Bank Petroleum Fund website, at http://www.norges-bank.no/english/petroleum_fund/reports/1998/1.html.

⁵⁸ An example is the evolving use of citizen suits to enforce environmental laws in developing countries. See Baydo et al (2004) for an overview of the recent experience in the Philippines. See also Roberts et al (1992).

⁵⁹ Penalties could also include reprimands and warnings, removal from office in the case of public officials, temporary or permanent loss of contractual rights, termination of contract, non-imprisonment sentences, etc. Penalties can include nullification of agreements and documents entered into, in violation of the law, the disgorgement of any monies and reversion of any advantages improperly obtained. Penalties may also include fines, expatriation or expulsion of foreign residents, deemed aggravation of relevant crime or misdemeanor, and imprisonment in appropriate cases.

⁶⁰ The Timor-Leste Petroleum Fund Law, however, follows the inverse approach, establishing a general principle of transparency and listing all exceptions to the principle.

⁶¹ Publish What You Pay, <http://www.publishwhatyoupay.org>.

⁶² Extractive Industries Transparency Initiative, <http://www.eitransparency.org>.

⁶³ Other international transparency initiatives include the OECD Guidelines for Multinational Enterprises; the OECD Project on Revenue Transparency in the Democratic Republic of Congo; the World Bank Extractive Industries Review; the International Monetary Fund Code of Good Practices and Fiscal Transparency; etc.

⁶⁴ International Monetary Fund (2005a).

⁶⁵ While EITI reporting guidelines provide for the disclosure of oil revenues on an aggregate basis by oil-rich governments, the level of aggregation is contentious in that many argue that only with the disclosure of payment information on an individual company basis would accountability be possible and transparency effective.

⁶⁶ For a discussion of host government-mandated disclosure of oil company payments to governments see Save the Children (2005), which notes that Canada is the only country with any mandatory requirements on disclosure on a country-by-country basis. See also Save the Children (2005b).

⁶⁷ A copy of the Abuja Joint Declaration is available at the Nigeria-Sao Tome and Principe Joint Development Zone website, at <http://www.nigeriasaotomejda.com>.

⁶⁸ For a discussion of the recent progress in the oil industry transparency see Olsen (2005).

⁶⁹ The government of Congo-Brazzaville, for example, has recently published on its website all of its Production Sharing Agreements, recent production figures and audits of the state owned oil company. See Catholic Relief Services (2005). Information on and excerpts of such production sharing agreements are available (in French) at the Congo-Brazzaville government's website at <http://www.congo-site.net/v4x/MEFB/home.php>.

⁷⁰ Art. 17.2(k).

⁷¹ Timor-Leste Petroleum Fund Law, Article 32.

⁷² See, e.g., the Aarhus Convention, <http://www.unece.org/env/pp/welcome.html>.

⁷³ In Sao Tome and Principe, the Columbia University Oil Advisory Group proposed the establishment of a public information office as a subdivision of an already existing governmental body, in the physical form of an office where documents would be filed, indexed, kept, and made readily available to the public. The head of the public information office would be appointed and dismissed as provided for in the oil revenue management law, and have the legal obligation to appear before the government (the National Assembly, in the case of Sao Tome and Principe) on an annual basis to testify about the compliance of the country's authorities with the information disclosure provisions of the oil revenue management law.

⁷⁴ See <http://www.transparency.gov.tl/PR/PFOR.htm>.

⁷⁵ Art. 21.

⁷⁶ OECD/IDB Forum on "Implementing Conflict of interest Policies in the Public Service", Rio de Janeiro, 5-6 May 2004. Background papers and presentations are available at the OECD website, http://www.oecd.org/document/11/0,2340,en_2649_33735_31419595_1_1_1_1,00.html.

⁷⁷ Art. 30.

⁷⁸ Sample language outlawing bribery can be found in the United Nations Convention Against Corruption (UNCAC), the Organization of American States Inter-American Convention Against Corruption, the OECD Convention on Combating Bribery of Foreign Public Officials, the Council of Europe's Criminal Law Convention on Corruption and Civil Law Convention on Corruption, the Convention of the European Union on the Fight Against Corruption involving officials of the European Communities or officials of member states, the African Union Convention on Preventing and Combating Corruption the United Nations Convention Against Transnational Organized Crime, and the United Nations Convention Against Corruption.

⁷⁹ See in the United States the Anti-Bribery and Books & Records Provision of the Foreign Corrupt Practices Act (15 USC 78) and in the United Kingdom the Anti-Terrorism, Crime and Security Act of 2001 (ACTSA). See also the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (1997), the Council of Europe Criminal and Civil Conventions on Corruption (1999), the Inter-American Convention Against Corruption (OAS Convention) (1996), and the United Nations International Convention Against Corruption (2003).

⁸⁰ Art. 22.

⁸¹ The Treaty governing the joint-zone requires the parties in the first instance to try to make decisions by consensus, but this requirement, which is not absolute, does not relieve the Saotomean officials of their obligations under Saotomean law.

⁸² The full text of the Abuja Declaration is available at the Joint Development Authority website, at <http://www.nigeriasaotomejda.com/Pages/Publicity.html>. The Declaration was not self implementing and in spite of the commitment of the two Presidents, the administrators of the zone have failed to enforce all of its provisions. Among other items, the recently negotiated joint production agreement with Chevron and Exxon has not been made public although the authors understand that payments and certain provisions of the contract will be made public. Even this limited compliance has not yet occurred as of February 2006.

⁸³ Recent experience in Bolivia shows that referenda may be abused. Referenda are two edged swords and may be used to compromise legislative prudence and weaken effectiveness of the existing revenue management framework.

⁸⁴ Such amendment need to be carefully drafted so as not to be construed as creating a monopoly on drilling and production by the state. Such restrictions in Mexico and elsewhere have resulted in significant distortions.

⁸⁵ It is worth noting that certain countries allow for the creation of unchangeable constitutional provisions, which may not be amended. The German Constitution, for example, contains immutable clauses. Similarly, Article 89 of the French Constitution, which sets forth the process of constitutional amendment, provides that the republican form of government may not be subject to amendment (“La forme républicaine du gouvernement ne peut faire l'objet d'une révision”), and earlier French Constitutions purported to be entirely immutable. Along the same lines, Article 60 of the Brazilian Constitution provides that no proposal of amendment shall be considered which is aimed at abolishing the federative form of state; direct, secret, universal and periodic suffrage; the separation of the three branches of government; and individual rights and guarantees. Article 60 also provides that the Constitution shall not be amended during a federal intervention, the state of defense, or the state of siege.

⁸⁶ Alaska Constitution, Article IX, Section 15.

⁸⁷ Although trusts are typically a common law institution, a somewhat similar arrangement can be established in civilian systems through the use of a “foundation” controlled by a self-perpetuating board of directors. The arrangements are more subject to the oversight of the state and the board of directors would usually have much more power to control the disposition of funds than the typical trustee.

⁸⁸ The case is different where there are third-party rights. In those instances the trust is likely to be set up under foreign law and the third-parties have the right to enforce the terms of the trust. Such a trust has been used in the case of the Chad-Cameroon pipeline the payments are initially made to a trust in which the lenders including the international institutions have an interest. The trust is not subject to the control or the laws of Chad and cannot be unilaterally changed by Chad. Chad’s amendment of Law No. 001 and the ensuing default under its financing agreements led to the suspension of World Bank loans and distributions from the accounts to Chad. The oil fund balances themselves remain beyond the reach of unilateral action by the Chadian government. See “CHAD: Government and World Bank struggle to save face in oil row,” Reuters (Source: IRIN), February 6, 2006.

⁸⁹ NEPAD, The New Partnership for Africa’s Development, <http://www.nepad.org/>.

⁹⁰ See World Bank press releases on Chad on the World Bank website, at <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/CHADEXTN/0,,menuPK:349881~pagePK:141159~piPK:141110~theSitePK:349862,00.html>. See also public statements by the International Monetary Fund and the European Investment Bank on their websites, respectively.