



ELEVENTH PLENARY MEETING OF THE POLICY DIALOGUE ON NATURAL RESOURCE BASED DEVELOPMENT (12 December – 13 December 2018, OECD Conference Centre, Paris)

KEY OUTCOMES

Under the co-chairmanship of **Chile, Guinea, Nigeria, Norway**, and the **United Kingdom**, 23 government delegations from Africa, Asia, Europe, Latin America and the Caribbean, as well as representatives from 8 partner international organisations and institutions, and 34 major firms, industry associations, civil society organisations, academia, law firms and think tanks, convened at the OECD on 12-13 December 2018 for the Eleventh Plenary Meeting of the Policy Dialogue on Natural Resource-based Development. International organisations and institutions represented included the Commonwealth Secretariat, the European Commission, the Extractive Industries Transparency Initiative (EITI), the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF), the International Monetary Fund (IMF), the United Nations Environment Programme (UNEP) and the World Bank. Mr. Seong-ho Lee, Ambassador and Permanent Representative, Permanent Representation of the Republic of Korea to the OECD and Vice-Chair of the Governing Board of the Development Centre and Mr. Federico Bonaglia, Deputy Director of the OECD Development Centre delivered opening remarks.

Work Stream 1 – Shared Value Creation and Local Development

Recognising the importance of localising production and procurement of goods and services in order to create in-country value, data from the OECD TIVA database show that services account for 23% of the value added in mining and 15% in oil and gas. In addition, the share of domestically procured services embodied in the exports of goods is between 16% and 19% in the mining sector, whereas in the oil and gas sector is 12%. The percentage of the value of actual exports that are domestically procured services is substantial and has increased in the last 10 years across countries regardless of their level of income. Collecting data on industry's spending procurement strategies and categories of expenditures is essential to identify sizeable opportunities for localisation and value creation along the value chain, if the required local capability exists. The analysis of spending expenditures of the oil and gas industry in Kazakhstan successfully informed the development of the Technology Roadmap and led to the establishment of a geochemical laboratory for finger printing technology, a cost-efficient solution for drilling wells. The laboratory is providing services to the oil and gas industry in Kazakhstan as well as to the wider region. South Africa has also undertaken a similar mapping exercise to reduce inefficiencies and develop innovative, competitive solutions in the mining sector. Chile aims to become the global hub for clean mining technology and export value added technological services worldwide to diversify its economy and establish a virtuous circle between investments, innovation and human capital. Innovative technologies for waterless and fossil-free iron ore processing show the transformational potential of upgrading sustainable solutions in extractive value chains. However, to achieve impact at scale, alignment between climate, mining and local value creation objectives and policies should be coupled with unprecedented coordination between public and private investments in technology shifts that are necessary to support the development of climate smart solutions and jobs. Development trajectories targeting different sub-segments in the value chain will differ across countries according to context variables and skill availability and require supporting regulation and financing instruments.

Work Stream 2 – Revenue Management and Spending

Participants welcomed the OECD Development Centre's consolidated report on how to translate finite natural resources into long-lasting development gains and encouraged the widest dissemination of the results of the analysis and the associated practical policy recommendations. Participants emphasised the importance of establishing a disciplined fiscal policy framework and associated stabilisation fund before production commences or as soon as possible thereafter. When addressing the trade-off between savings and spending in countries with low capital stock, participants observed that there is limited economic rationale in accumulating long-term savings if the risk-adjusted returns of a savings funds are less than the country's borrowing costs. Moving forward the Policy Dialogue will focus on mechanisms to catalyse extractive revenues to support the low-carbon transition.

Work Stream 3 – Getting Better Deals

Participants welcomed the steps taken toward the finalisation of the *Guiding Principles for Durable Extractive Contracts*, following a Workshop that took place in conjunction with the Eleventh Plenary Meeting of the Policy Dialogue on Natural Resource-based Development. In terms of the consequences of non-fiscal changes of laws, participants agreed that the costs attributable to

compliance with such changes in law and regulations, and wholly, necessarily and exclusively related to project specific operations, should be treated as any other project costs for purposes of tax deductibility, and cost recovery in production sharing contracts. If such changes in law and/or applicable regulations result in the investor's inability to perform its material obligations under the contract or if they lead to a material adverse change that undermines the economic viability of the project, durable extractive contracts require the parties to engage in good faith discussions which might eventually lead the parties to agree to renegotiate the terms of the contract. Participants also agreed that a predictable fiscal regime that includes responsive terms defined in legislation and/or the contract to adjust the allocation of the overall financial benefits between host governments and investors to variables that affect project profitability (such as variance in commodity prices, costs, production volume, or resource quality) contributes to the long-term sustainability of extractive contracts and reduces the incentives for either party to seek re-negotiation of terms. Participants further recognised the need for host governments to generate financial benefits from the extraction of their resources. Durable extractive contracts avoid sustained periods of commercial production with little or no revenue flows to the government.

Work Stream 4 – Domestic Resource Mobilisation (tackling corruption in commodity trading and BEPS in mining)

Participants welcomed the practical progress made by the *Thematic Dialogue on Commodity Trading Transparency* in building blocks towards driving change. Participants acknowledged that the OECD development Centre's preliminary *Stock-take of the Selection Procedures used by State-owned Enterprises to Select Buyers of Oil, Gas and Minerals* provides a useful knowledge base that helps to demystify issues at stake, while also contributing to improving accountability. Participants reached common ground on the key types of information that are critical for accountability and therefore need to be included in the global reporting template for payment disclosure by companies involved in commodity trading. Besides data on physical transactions and financial flows, including the use of intermediaries, beneficial ownership information and one-year time lag, participants recommended the inclusion of contextual information, such as commodity trading-related loans or guarantees given by the buyer to the government to better understand price information. Participants acknowledged the importance of knowing the identity of the parties to the transaction. It was noted that a database of state-owned enterprises managed by the OECD could help to address the challenge that many buyers face in determining which entities are state-owned. Participants emphasised the importance of taking a holistic approach, linking commodity trading transparency with the broader international agenda on illicit financial flows, leveraging advanced information technology to collect and analyse data, and looking at potential interventions in both producing countries and trading hubs.

The IGF and the OECD Centre for Tax Policy and Administration presented three practice notes on how to address specific risks of tax base erosion and profit shifting in the mining sector: [valuing mineral exports](#), [excessive interest deductions](#), and [tax incentives](#). Understanding the value of mineral production is critical for both revenue collection and contract negotiation purposes. Host governments should assess the level of risk of undervaluation in order to determine the appropriate policy response. Available options range from monitoring companies' own internal export valuation processes, requiring that these comply with international sampling and testing standards and that companies report accordingly, through requiring the use of accredited third parties, to establishing a government mineral laboratory or a combination of the above elements. Using existing facilities in neighbouring countries or setting up a shared laboratory at the regional level reduce costs associated with establishing sampling and testing systems. Participants recognised that debt is a necessary part of the funding mix of capital-intensive mining projects. However, excessive interest deductions are one of the tax planning strategies that can result in tax avoidance. Profits can be shifted away from host countries to reduce taxable profits through the allocation of a disproportionately large amount of debt to the host country or the application of non-arm's length high interest rates for intra-group loans. BEPS Action 4 established a common approach to limit interest deductibility between 10% to 30% of EBIDTA with the option to combine this fixed ratio rule with a group ratio where groups are highly leveraged with third-party debt for non-tax reasons. This allows the deduction of an amount equivalent to their net third-party interest expenses, while also limiting the extent to which groups might be able to increase their intra-group interest deductions to exceed their actual net third-party interest expenses. Tax incentives also reduce the tax base. When governments consider offering tax incentives, they should not only appreciate whether they are necessary to attract investment, but they should also weigh their costs and benefits. A financial model is now available (<https://protect2.fireeye.com/url?k=9f05496f-c31e00e7-9f0562ac-002590f45c88-a86d8b1415c597f0&u=https://www.igfmining.org/wp-content/uploads/2018/12/IGF-Tax-Incentives-Model-beta-version-1.xlsx>) to policy makers and negotiators to help states better understand the impact of tax incentives, including investors' behavioural responses that can magnify the amplitude of the revenue loss. Experience shows that the more general and broad based is the tax incentive, the less likely it is to produce development benefits. Further work is underway to understand how smart tax incentives can be linked to key performance indicators, such as job creation or local procurement, in order for governments to encourage desired investors' behaviours.