

The **AFRICA** JOURNAL

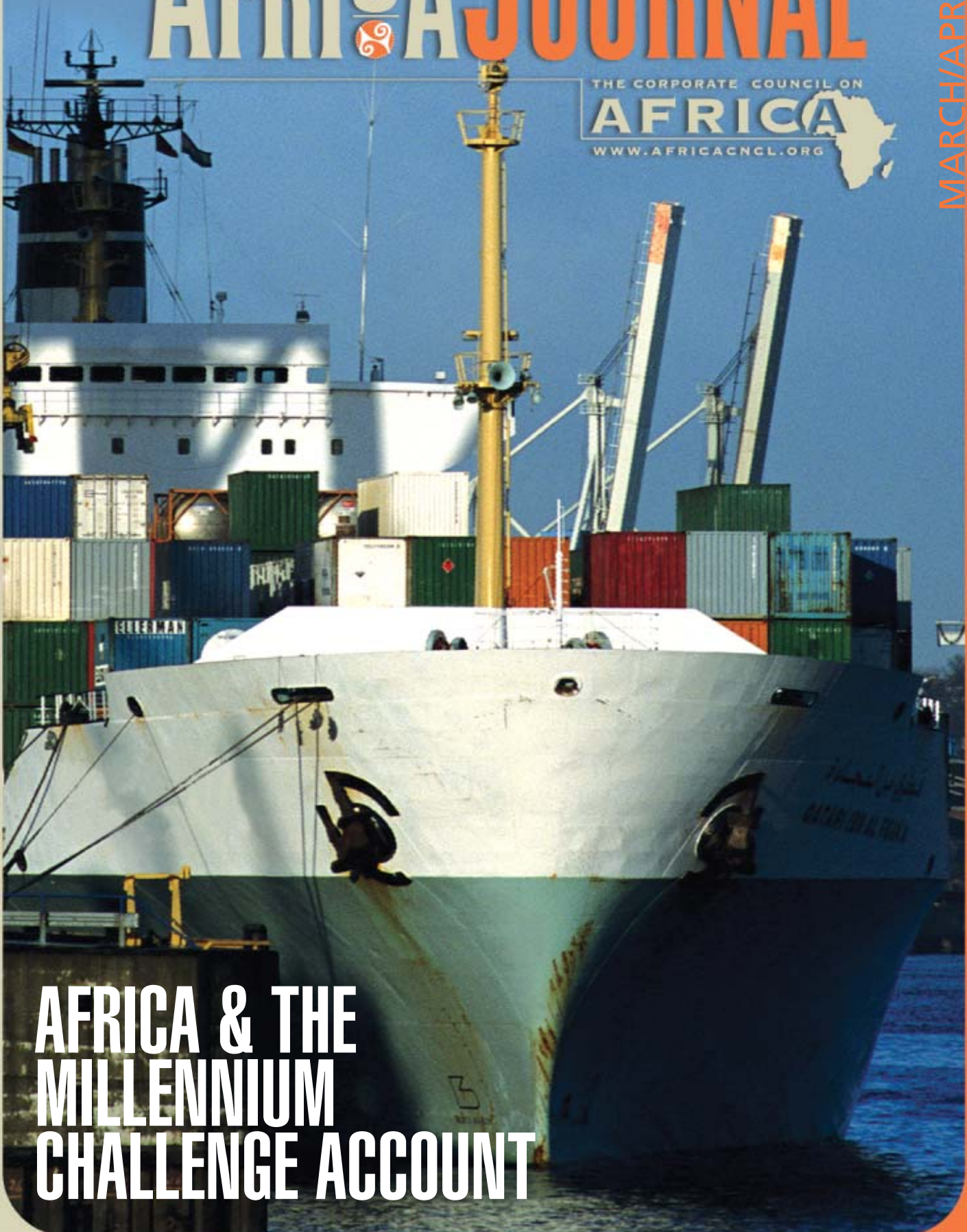
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MARCH/APRIL 05



**AFRICA & THE
MILLENNIUM
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Sao Tome and Principe: Threshold Country < By Joseph Bell and Teresa Faria >

Sao Tome and Principe, one of seven threshold countries designated by the Millennium Challenge Corporation, is leading the way to greater transparency in the natural resource industry. Through its recently enacted petroleum revenue management law and the Abuja Joint Declaration signed by President Fradique de Menezes jointly with President Olusegun Obasanjo of Nigeria, Sao Tome and Principe has established new standards for openness and transparency in the receipt and management of oil funds.

Sao Tome and Principe has no current oil production, but it shares with Nigeria a deep-water zone thought to have significant oil resources. ChevronTexaco and other block partners have just signed the first production sharing contract in the zone paying the two countries a signature bonus of \$123 million. In addition to the remaining blocks in the zone, Sao Tome and Principe has also the prospect of oil in waters it solely controls.

Oil elsewhere in the developing world has frequently been the source of great waste and often corruption, and in many places has resulted in weak and ineffective governmental institutions. Indeed, although there are exceptions, most developing countries with significant natural resources have developed slower than those not so well endowed. Keenly aware of these problems the President, government, and the National Assembly have worked together through a national oil committee to draft and adopt a law intended to help ward off the "curse" of oil and to try to ensure that the country's potential new oil wealth will be used for social and economic development to the benefit of all its citizenry.

The law establishes a national oil fund to be held by an international custodial bank. All oil payments, very broadly defined, must be made electronically directly into the account. Withdrawals from the account are limited to a single annual transfer to the budget as approved by the National Assembly. The annual transfer to the budget must be signed by the President, the Prime Minister, and representatives of the Treasury and Central Bank. Expenditures are to be used for national development, poverty reduction, and the strengthening of good governance, and may be made only in accordance with a development plan and a national poverty reduction strategy. The country is not permitted to borrow against the account. The government may engage in borrowing funded by general revenue or revenues from particular development projects, but it cannot encumber future oil production or the funds in the national oil account.

A very important feature of the law is the establishment of limits on the amount of the annual transfer to the budget. The amounts not expended are accumulated in a sub-account, the permanent reserve. The spending limit is set so as to accumulate in the permanent reserve sufficient funds during the period of production to create a national "endowment" that will continue to support government spending indefinitely at roughly the same level even after the resource is exhausted.

The spending limits also accomplish an important fiscal task of limiting expenditures and increasing savings during periods of high oil prices and providing for the maintenance of spending during period of low oil prices. One of the major problems of



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A team of experts from the Earth Institute and Hogan & Hartson LLP, working pro bono, assisted São Tomé and Príncipe in its year-long effort to develop and enact a new international standard for transparency and control of oil revenues. "Nothing will be hidden, nothing will be wasted," said São Tomé and Príncipe President Fradique de Menezes. Above: The main street and cathedral in São Tomé.

many oil-producing countries is the increase in spending that occurs when prices are high which then cannot be maintained when prices drop, resulting either in the country taking on debt which it may not be able to service or finding itself in an inefficient start-stop mode of development.

Investments by the national oil fund will be managed by professionals pursuant to policies established by the Management and Investment Committee composed of representatives of the government, the National Assembly and the President. The law provides for a very conservative investment policy. A further, and very important restriction prohibits any investment in Sao Tome and Principe or in entities controlled directly or indirectly by nationals of Sao Tome and Principe. This is intended to reduce political pressures on the fund's investment policy. It also makes clear that the fund itself is not a "development" fund but an endowment. Rather development funding is to be determined by the government and the National

Assembly as part of the annual budget process.

The activities of the fund are to be fully transparent. In this it joins the growing movement in Africa and elsewhere to make natural resource income public. This movement has been spearheaded by church and civil organizations and formalized and promoted by the UK government particularly in its Extractive Industries Transparency Initiative (EITI). The Saotomean law goes well beyond the minimum requirements of the EITI by mandating public access to information on all payments into the fund on an individual payment basis. Fund withdrawals and fund holdings as well as all related oil contracts, except for proprietary information, are also to be made public. Information will be available through a new public information office which will provide information locally in hard copy and will also post such information on a government web site. It is also envisioned that eventually direct web access to view the fund's activities and its holdings will be provided by the custodian institution without any intervention or intermediation of the government.

In addition to the provisions establishing and governing the fund, the law also addresses certain other important areas. In particular it requires competitive tenders for oil contracts. It also mandates anticorruption and transparency provisions in all oil related contracts, constructively applying such provisions if they are not explicitly set out in the contract. The anticorruption provision essentially mirrors the OECD anti-bribery convention.

The law sets out strict conflict-of-interest standards and enhanced penalties for both misdemeanors or criminal acts. In addition, the law requires disgorgement of any unlawful

benefit. Injured parties may appeal administrative decisions and such appeals, except in certain extraordinary cases, stay the effectiveness of any action. Any act in violation of the law is void except for the rights of bona fide third-parties.

To further protect the integrity of the fund and to ensure full disclosure, the law creates a new Petroleum Oversight Commission made up of representatives of government, members of the National Assembly including the opposition, and civil society. The Commission is not intended to supplant any existing institution, but by monitoring the government's compliance with the law the Commission is expected to strengthen the oil regime. To carry out its functions the Commission is given significant investigatory and administrative powers.

Another important feature of the law is the incorporation of the transparency principles adopted by President de Menezes and President Obasanjo of Nigeria in the Abuja Joint Declaration, issued in July 2004. The Abuja Joint Declaration, applicable to the zone shared by Sao Tome and Principe and Nigeria, requires all oil contracts and all oil payments on an individual company basis to be made public. The requirement to make payments public is imposed on both the administering authority and the private contracting party. It is expected that the first production sharing contract in the zone will reflect these requirements.

The law itself represents a very serious effort on the part of Sao Tome and Principe to put in place before the hoped for flood of revenues, provisions that are consistent with the good government and economic development goals of the Millennium Challenge Corporation. Indeed, the process of developing the law itself

was a good example of open democratic processes. The ad hoc national oil committee which developed the law was composed of representatives of all political elements: the President, the government, and the National Assembly including the opposition. Equally important there was a National Forum process which held 55 local meetings throughout the country to explain what oil might mean for the country and to seek input into how oil resources might be used. Thus the drafting process itself increased democratic participation in the country and enhanced public support for an open and transparent regime.

Even if commercial quantities of oil are discovered, Sao Tome and Principe will not receive significant revenues for five or more years. Yet existing needs must be met, and new problems caused by the prospect of oil are already developing. There are pressures on local prices; unwanted and potentially destabilizing immigration is increasing; all sorts of companies are seeking to negotiate non-competitive arrangements; the budget continues in serious deficit. The next few years are a critical period for Saotomean society as it stretches to strengthen its existing institutions and build new ones to manage its potential good fortune. Building on its threshold status, becoming eligible for the Millennium Challenge Account, and negotiating a Millennium Challenge Account pact is an important step in this development process. Time is of the essence. ©

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