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Editor-in-Chief
Thomas W. Wälde
twwalde@aol.com
Professor & Jean-Monnet Chair
CEPMLP/Dundee and Principal
Thomas Wälde & Associates

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Oil, Gas & Energy Law Intelligence

Petroleum Production, Trade and Corruption in Sub-Saharan Africa by M.J. Schloss

About OGEL

OGEL (Oil, Gas & Energy Law Intelligence): Focussing on recent developments in the area of oil-gas-energy law, regulation, treaties, judicial and arbitral cases, voluntary guidelines, tax and contracting, including the oil-gas-energy geopolitics.

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Our aim is for OGEL to become the hub of a global professional and academic network. Therefore we invite all those with an interest in oil-gas-energy law and regulation to contribute. We are looking mainly for short comments on recent developments of broad interest. We would like where possible for such comments to be backed-up by provision of in-depth notes and articles (which we will be published in our 'knowledge bank') and primary legal and regulatory materials.

Please contact **Editor-in-Chief** Thomas Wälde at twwalde@aol.com if you would like to participate in this global network: we are ready to publish relevant and quality contributions with name, photo, and brief biographical description - but we will also accept anonymous ones where there is a good reason. We do not expect contributors to produce long academic articles (though we publish a select number of academic studies either as an advance version or an OGEL-focused republication), but rather concise comments from the author's professional 'workshop'.

PETROLEUM PRODUCTION, TRADE AND CORRUPTION IN SUB SAHARAN AFRICA*

Miguel Schloss; Managing Partner DamConsult Ltd. and former Executive Director of Transparency International

A major portion of Sub-Saharan Africa's foreign exchange earnings are devoted to the procurement of petroleum. This situation could be ameliorated: a revamping of policies and practices in hydrocarbons procurement and distribution could reduce corruption and yield savings in the region of an amount significantly greater than yearly net disbursements of World Bank loans and credits to all continent combined.

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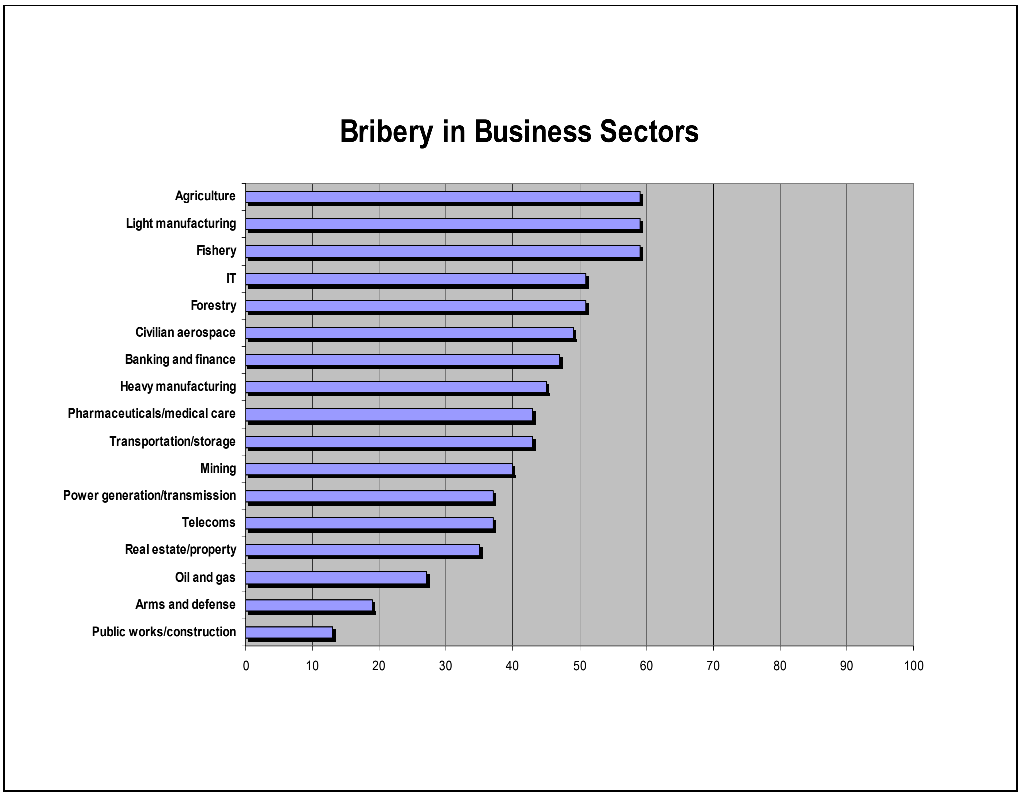
* This article is based on tow papers from the same author: "*Combating Corruption for Development* ***- - Moving from Words to Deeds"*** ; International Law Institute, June 24, 2003 and ***"Does Petroleum Procurement and Trade Matter?: The Case of sub-Saharan Africa",*** Finance & Development, March 1993.

Transparency International issues every two years the **Bribe Payers Index (BPI)** that ranks the leading exporting countries in terms of the degree to which their companies are perceived to be paying bribes abroad. The BPI indicates that corruption is widely seen as playing a significant role in international commerce. The data provides a disturbing picture of the degree to which leading exporting countries are perceived to be using corrupt practices.

Particularly disturbing is the high corruption associated with resource-based industries.



Particularly disturbing is the high corruption associated with resource-based industries – the economic bedrock for many developing countries[1]. Take the case, for instance of petroleum, where countries like Nigeria, Indonesia, Algeria, Mexico export anywhere between US $2 to 35 billion, depending on oil output volumes and prices - - and yet their performance in terms of GDP growth is significantly lower than countries in the same income per capita levels. Where has that money gone that there is so little to show for?

It thus is not surprising that petroleum producing countries tend to fall in the lower percentile categories of governance ratings, where corruption figures high:

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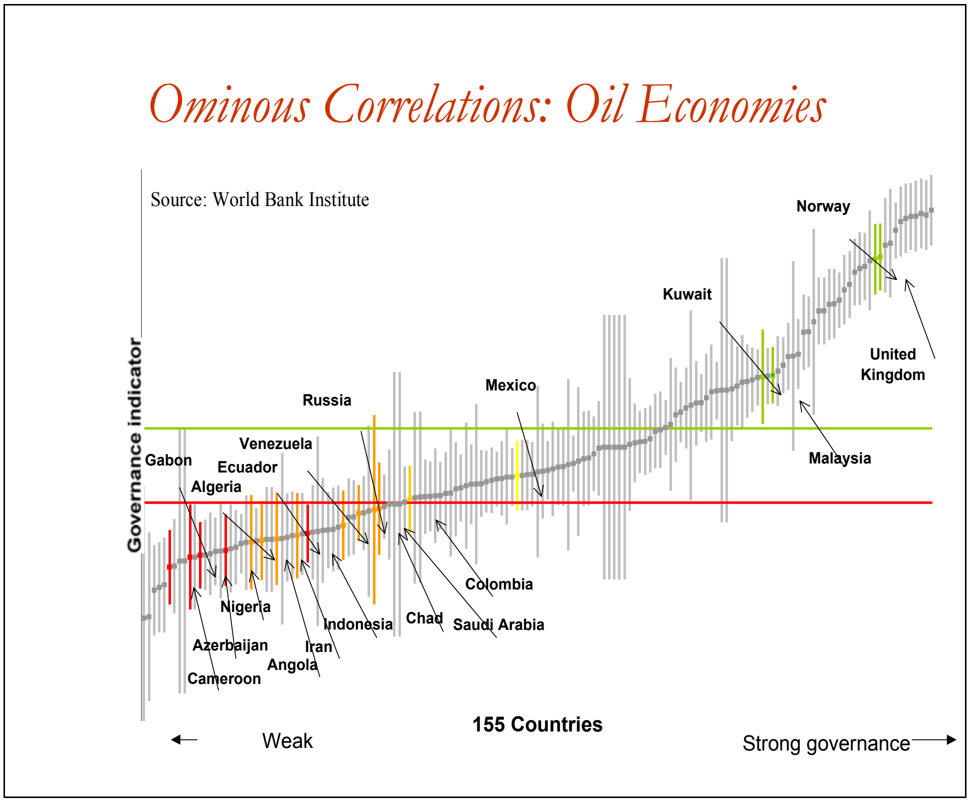


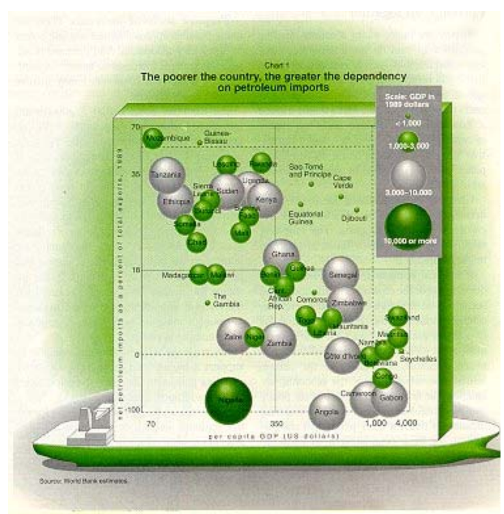
But the secondary effects, downstream, are equally devastating though much more widespread. Petroleum products play a pivotal role in Sub-Saharan Africa's economic development. Their purchase absorbs 20-35 percent of export ratings for the bulk of the countries in the region, and generates approximately 40 percent of tax revenues – thus constituting the single largest item in the balance of payments and fiscal revenues for most countries in this region. Although the primary energy balance is currently dominated by household consumption of fuel wood, petroleum products are the most important source of commercial energy, supplying approximately 70 percent of commercial requirements; and they are likely to be the fastest growing portion of the region's energy balance as the continent's modernization unfolds.

As the region becomes more developed, the demand for energy will also grow, thus setting up a vicious circle: Economic growth will be needed to pay for the expanding oil bill, and more imported fuel will be needed to generate economic growth. These countries must make fundamental policy choices with respect to the petroleum industry if they are to escape this self-defeating cycle.

Except for Angola, Cameroon, Congo, Gabon, and Nigeria, all countries of sub-Saharan Africa are net importers of crude oil or petroleum products. Data comparing per capita GDP to oil imports show that the lower the per capita GDP, the higher the percentage of net imports represented by petroleum. Greater efficiency in procuring and distributing petroleum products would reduce the amount of funds these countries devote to paying their oil bills, thus freeing those resources for the other uses and potentially reducing the poverty level do these countries.

Greater efficiency in procuring and distributing petroleum products would free resources for other uses and allow reducing poverty levels in low income countries.

Petroleum Import Dependency



And yet massive resources “disappear” from the way the business is conducted. If corrected, savings of about US$ 1.4 billion a year at 1989-90 prices. This amount is greater than total World Bank annual disbursements of adjustment policy loans, and close to 50 per cent higher that the net disbursement to the entire region combined. These savings represent the difference between the actual cost of supplying petroleum products to consumers and benchmark cost corresponding to procuring these products from world markets under competitive conditions.

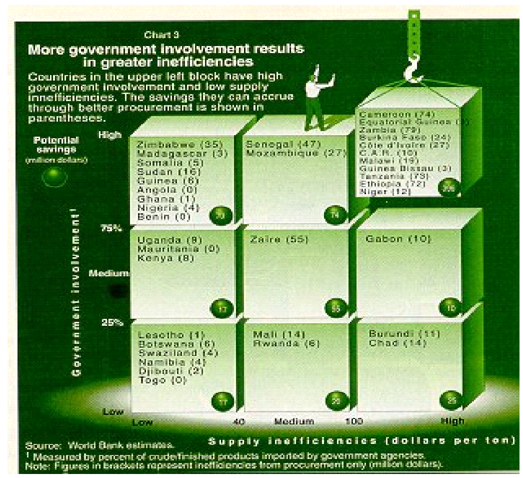
As one reviews transaction throughout the supply chain, fully half of resources cost could be recuperated at the point of procurement, some 40 % at the refining stage, and the remainder through inland distribution.

Massive resources “disappear” from the way the natural resource-based business is conducted.

Potential Savings

Moreover, the greater losses are associated with discretionary power and monopoly arrangements.

Government Involvement and Levels of Inefficiency



New global standards of behavior are emerging, and need to be furthered beyond their current development through more institutionally binding standards.

The inescapable conclusion is that hydrocarbons procurement and distribution must be opened to the discipline of greater competition. Indeed, the experience recorded in other regions (Western Europe, southeast Asia, and Latin America) that have allowed numerous available suppliers to compete in their markets suggests that a policy change in Africa along these lines would provide significant benefits to the continent, in the form of more efficient and corruption free petroleum procurement and trade.

Going beyond the production and distribution of natural resources industries by multinational companies, corruption is of growing concern to donors, nongovernmental organizations, governments, businesses more generally, and citizens, in developing and industrial countries alike. Fortunately, the opportunities to address corruption are also greater than they have ever been. New global standards of behavior are emerging, driven partly by changing attitudes toward transnational bribery in industrial countries and partly by heightened awareness in developing countries of the costs of corruption. But much more work is needed to develop institutionally binding industry standards. These could be furthered through more effective inter and industry standards, and proper coalition building with relevant civil society organizations.

The purpose of the OECD Convention is to end corruption generated by their citizens and companies abroad

In this regard, in late 1997, thirty-four countries signed the OECD Convention on Bribery of Foreign Public Officials in International Business Transactions. The purpose of the convention is to criminalize corruption of foreign officials and to end the tax deductibility of bribes, thereby removing the associated fiscal incentives. This is a historic first step forward, and one that provides a sound, though limited, framework for an international anti-bribery system.

Multilateral development banks have similarly begun to play their role in their respective areas of expertise and responsibility. The IMF has started to restrict its operations in countries where the level of corruption is deemed to negatively affect in a material way their economic performance. The World Bank has initiated a more comprehensive program.

These measures can only have an effect if they are mutually supported by on-the-ground policies in the countries concerned. Specifically, in the petroleum sector, most Sub-Saharan African countries will need to: (i) free-up **institutional arrangements** that remove excessive (and self-serving) government control through public enterprises, joint ventures or government monopolistic procurement arrangements that commercial and commercial side of the business; (ii) revamp **pricing policies** that tend to produce unwarranted rents and resource misallocation, particularly when they bear no connection with production and distribution costs, or the nearest international markets; and (iii) establish **investment policies** aimed at increasing the private sector role to introduce efficiency into operations, attract risk capital, and enhance creditworthiness of energy companies so that they can finance required projects.

Only in this way can the continent expect to lower prices to consumers (industrial and others); shake off habits, attitudes, and unsustainable techniques, all of which are wasteful; and increase accountability, the lack of which has kept inefficient and often-times corrupt operators in business at the expense of the development potential of the countries.