

Tanzania's 2015 Extractive Sector Legislation: Recommendations for Effective Implementation

INTRODUCTION

In recent years, deposits of natural gas—currently estimated at 57.27 trillion cubic feet—have been discovered in Tanzania's territorial waters.¹ If Tanzania's natural gas is managed well, it has the potential to substantially contribute to the long-term sustainable growth of the economy and its diversification into higher value-adding activities, which will ultimately improve living standards in Tanzania.

If the investments necessary to exploit the largest deposits go ahead,² Tanzania will have the better part of a decade before significant oil and gas revenues begin flowing. Many challenges must be addressed in that time in order to maximise the opportunities that gas production will bring. These challenges can be very difficult to overcome, as can be seen by the numerous examples of countries where natural resources have failed to lead to sustained development gains and the increasing focus on the resource curse in the economic literature. However, the resource curse is not inevitable. Experience shows that if natural resources are managed well, they can significantly contribute to poverty reduction and economic development. Good governance is critical to this. There are some well-known examples of resource-rich countries, such as Norway and Botswana, whose success in natural resource management has been frequently associated with their strong institutions and good governance. In addition, the Resource Governance Index, which measures the quality of governance in oil, gas and mining sectors, shows a significant correlation between strong governance and income per capita. Furthermore, Daniel Kaufmann, president of the Natural Resource Governance Institute (NRGI), estimates that a 300 percent 'development dividend' (translated as increased GDP per capita) can result from good governance more generally.³

The government of Tanzania has taken the challenges posed by the extractive sector seriously and has begun to develop its response. In July 2015, it passed three pieces of legislation which lay the foundations for strong governance of the sector: The Petroleum Act, the Oil and Gas Revenues Management Act and the Tanzania Extractive Industries (Transparency and Accountability) Act.⁴ NRGI commends the government of Tanzania for this important step, constructing a legislative environment specifically for the oil and gas sector is in line with recommendations in Precept 1 of the Natural Resource Charter. (See discussion in the annex.)

1 It is not guaranteed that all of these deposits will be commercially viable, however, but they still represent a substantial development resource.
2 At the time of writing there is no guarantee that the necessary investments will be made, as discussed further on page 2 of this analysis.
3 Daniel Kaufmann, *Corruption in Transition: Reflections and Implications from Governance Empirics*, Presentation at the Economic Research Forum Annual Conference, Cairo, Egypt, March 25, 2012.
4 For brevity's sake, these will be henceforth referred to as the Petroleum Act, the Revenue Management Act and TEITA.

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The Petroleum Act, which is the central pillar of the legislation governing the sector, establishes the legal and institutional infrastructure. It is comprehensive in scope, applying to the sector's up-, mid- and downstream, and it addresses many of the key issues of petroleum sector governance, such as the institutional framework, competitive licence allocation, the fiscal regime, local content, environmental management and the decommissioning of project sites.

The Revenue Management Act establishes the rules for the spending and saving of extractive revenues to ensure that both current and future generations will benefit. It builds on many of the lessons learned from other resource-rich countries and addresses some key challenges of non-renewable resource revenue management: revenue volatility, exhaustibility of revenue and the risk of waste through misuse and corruption.

The TEITA act establishes transparency and disclosure requirements to enable stakeholders to monitor the sector, thereby helping ensure that it operates in the best interests of all Tanzanians. The act includes provisions regarding revenue disclosure, contract transparency, local content/social investment disclosure, environmental reporting and establishes the institutional infrastructure to facilitate enhanced transparency. By entrenching transparency and accountability best practices, making company and government participation mandatory and overcoming legal obstacles to EITI implementation, the TEITA act is a positive step towards the realisation of Tanzania's broader natural resource governance goals.

The passing of these acts is a positive step, but there is still much to be done. The analysis in this document is intended to identify potential challenges that various entities of the Tanzanian government may need to address in the process of developing regulations. It is hoped that it will prove a valuable resource in future policy discussions.

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The regulatory challenges within each piece of legislation are dealt with in detail below, but consideration is first given to some of the broader issues related to a successful implementation of these acts.

First, it is necessary to be aware of the often competing needs of the various stakeholders whom the legislation affects, and to manage these tensions fairly so that the laws enjoy strong public buy-in. As an essential part of this, it is important to be aware that the private sector has not yet firmly committed to all of the myriad investments that will be necessary to see the gas projects to fruition. It is also possible that investments may not be made in the immediate future, as firms wait to see how the global market develops, the outcomes of Tanzania's constitutional reform and the contents of the regulations associated with these acts.

Second, the government should also seek to overcome the "silo effect" of agencies or jurisdictions to which the different laws pertain (e.g., Tanzania's national oil company, oil and gas fund managers) effectively operating outside of other extractive sector policies and processes. Coordination and communication between key agencies will be critical to successful implementation.

Third, regulations should seek to clarify any vaguely worded provisions and resolve apparent contradictions between separate provisions. Some examples are identified in this analysis.

As a final point, this assessment reveals that despite the solid principles established by the Revenue Management Act on the management of revenues from the oil and gas sector, some improvements are needed that go beyond what can be achieved through regulations. The gaps in the act are such that officials should consider a

consultative review. It is hoped that this analysis conveys the justification for this recommendation.⁵

The document provides a detailed analysis of the individual acts. This analysis offers recommendations for consideration in the drafting of the regulations to enable effective implementation of the acts. The analysis starts with a summary of the key goals and notable provisions of each act, followed by a summary of the key recommendations, and finally the full analysis and recommendations.

To outline all of the provisions of each act is beyond the scope of this analysis, but their notable aspects are outlined and assessed.

Finally, this analysis is based on the publicly released legislation as of November 2015 and all related amendments. Its final format may change subsequent to this, so the findings and recommendations must be read with this caveat in mind.⁶

I. PETROLEUM ACT, 2015

Key goals and provisions of the act

The Petroleum Act's stated aim is "to provide for regulation of upstream, midstream and downstream Petroleum Activities, establishment of the Petroleum Upstream Regulatory Authority, to provide for the National Oil Company, to secure the accountability of petroleum entities and to provide for other related matters." It is thus quite a broad-ranging act, and constitutes the bulk of the legal architecture for how the petroleum sector will function.

Some of the key goals and provisions of the act include:

The establishment of the Oil and Gas Advisory Bureau

This is to be a non-executive body which advises the cabinet on matters pertaining to the sector. This provision reflects the recommendation in the Natural Resource Charter that there be an "authorising environment" that can coordinate the actions of separate government entities in advancing the strategy for the extractive sector. The cross-cutting, big-picture view of the bureau—combined with the high level at which it advises—can be a means of reducing the silo effect mentioned above.

Increased cabinet involvement

The cabinet will be more involved in the management of the sector than previously, and the minister responsible for petroleum affairs in mainland Tanzania or Tanzania Zanzibar, as applicable, must seek cabinet approval for more decisions. Cabinet will also be advised directly by the Oil and Gas Advisory Bureau.

Fiscal regime

The fiscal regime includes royalty rates (12.5 percent for onshore, 7.5 percent for offshore), standard oil contract items (production share, cost gas profit gas, etc.), annual fees paid to the TPDC (acreage rental, training and research fees), signature and production bonuses (also paid to TPDC), and ring-fencing requirements.

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5 Rates for the fiscal rules cannot now be amended until 2020, according to §16(5). But revenues will not start to flow until after that date, and any amendments can be signalled in advance to provide certainty to stakeholders.

6 Update: Since the drafting of this analysis, the Petroleum (Natural Gas Pricing) Regulations have been published. This analysis does not include a review of these regulations.

Local content rules

This act contains several provisions for promoting local content in the sector, and it is possible that the local content strategy for the sector will be subsumed under this act, rather than in a separate local content act. The act makes some clear requirements that licence holders, contractors and subcontractors give preference to goods produced or available in Tanzania and services provided by Tanzania citizens or local companies. The act also provides for training and recruitment of Tanzanian citizens to ensure that the sector contributes to employment and skills development.

Corporate social responsibility (CSR)

The act requires that license holders prepare a credible CSR plan agreed jointly with local authorities. The act also places requirements on local authorities to help promote such plans and increase public awareness of them.

Inclusion of domestic supply obligation provisions

The act places an obligation on licence holders to satisfy the domestic market out of their share of profit oil or natural gas.

New role for the Tanzania Petroleum Development Corporation (TPDC)

TPDC has up until now undertaken a regulatory role in the sector on top of its formally mandated commercial functions.⁷ This situation has the potential to create conflicts of interest. This act formally assigns all regulatory functions to the Petroleum Upstream Regulatory Authority (PURA), and makes TPDC a state-owned commercial entity. This is in line with best practice principles and the government should be congratulated on this.

In representing the state as a commercial entity, TPDC has certain legal rights:

- It is the sole license holder in the upstream part of the sector, and may contract with other firms to undertake exploration and development projects.
- It will have a minimum 25 percent holding in all projects, though it has the discretion to alter this amount.

Establishment of the Petroleum Upstream Regulatory Authority (PURA) as the new regulator

PURA becomes an overarching regulatory body for the upstream, with broad-ranging powers to regulate the sector, advise the minister, acquire data on reserves, issue licenses, enforce safety standards and promote local content.

Establishment of Energy and Water Utilities Regulatory Authority (EWURA) as the mid- and downstream regulator

EWURA has a similar regulatory function in the mid- and downstream parts of the sector, though its functions and powers are not quite as broad as PURA's. EWURA is required to approve petroleum infrastructure construction permits within 30 days of receiving them (c.126), indicating the government's desire for rapid development of the sector.

The Petroleum Act assigns all regulatory functions to a new body, the Petroleum Upstream Regulatory Authority, and makes TPDC a state-owned commercial entity.

7 See government Notice No.140 of 30 May 1969.

Establishment of an aggregator

The act establishes an aggregator, which is to be a subsidiary of TPDC. The aggregator will have the right of first refusal on all natural gas sales (except liquefied natural gas [LNG] preserved for export). This allows the government to regulate domestic gas supply through a public monopoly.

Establishment of the National Petroleum and Gas Information System (NPGIS)

NPGIS is a centralised information system covering all midstream and downstream gas activities. It is a mechanism for informing the public periodically on the gas industry as well as a strategic planning tool for the government and other interested parties.

NPGIS is to be maintained by EWURA and, with the exception of proprietary and other confidential information, its contents will be publicly available.

New safety and environmental principles

The act includes several provisions designed to protect worker safety and the environment. In doing so, it supports other pieces of legislation such as the Environmental Management Act and the Occupational Health and Safety Act. Provisions include requiring investors to: have emergency preparedness plans, decommissioning plans, contribute to a decommissioning fund and establish safety zones. The minister may also prepare a petroleum emergency plan which requires his office to intervene in the petroleum supply chain in order to protect safety. These provisions are in line with several of the best practice principles that NRGi recommends in Precept 5 of the Natural Resource Charter. (See discussion in the annex.)

Summary of key recommendations

Transparency requirements

- The regulations should provide clarity and detail on transparency requirements for the sector by explicitly requiring publication of bidding documents, full text contracts, environmental impact statements and plans, and local content plans in accordance with the requirements of the TEITA Act and its regulations.
- Regulations should provide specificity on what constitutes “confidential information” in the NPGIS to ensure that EWURA’s discretion to withhold such information from the public is used appropriately

License allocation and selection of contractors

- The regulations should provide clarity on the following:
 - The process for selecting contractor companies.
 - The pre-qualification requirements with standard procedures for assessing company capacity, technical knowledge and financial capability.

State participation through TPDC

- If the act is reviewed, it should specify on what basis TPDC may determine a different level of state equity participation from the minimum 25 percent currently provided for, and state whether this equity will be free or not, to provide clarity to investors. Otherwise this clarity should be provided in regulations. Regulations should also specify the form that state equity that is

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not free will take (whether paid or carried) and should specify that the state's share will be non-dilutable.

TPDC's mid- and downstream rights

- The regulations should clarify TPDC's midstream and downstream exclusive rights to undertake a range of activities.

Roles and responsibilities

- If the act is reviewed, the law should clarify responsibility for appointing the Commissioner for Petroleum Affairs. Otherwise, this clarity should be provided in regulations. Regulations should also specify the role and responsibilities of the Commissioner.

Domestic market obligation (DMO)

- **Size of DMO:** Regulations should provide certainty on the growth trend of domestic supply obligations, taking into account the need to incentivise investment in an LNG plant.
- **Domestic pricing:** Regulations should set forth the pricing structure of the domestic market.

Regulations should provide certainty on the growth trend of domestic supply obligations, taking into account the need to incentivise investment in an LNG plant.

Fiscal regime

- **Negotiable items:** The regulations should state whether cost oil/gas recovery limits are to be negotiable. If cost oil/gas limits are not negotiable, regulations should include a cap. If cost recovery limits are negotiable, then regulations should specify a permissible range.
- **Transfer price:** The transfer of costs between the upstream and downstream should be monitored carefully to limit opportunities for reducing tax liability. The regulations should outline such monitoring mechanisms. Open negotiations will be important to make any regulations commercially viable.
- **Definitions:** The following terms should be defined in the regulations: "production sharing contract," "profit oil" and "cost oil."

Local content

- **Definitions:** The definition of "local companies" should be reviewed so that it refers to companies with majority Tanzanian ownership, management and employees.
- **Locally produced:** In order to achieve the desired impact, preferences should be required for goods "produced in" Tanzania, rather than the less limiting "available in" Tanzania.
- **Coverage:** Regulations should provide a full overview of all local content requirements, which are currently scattered throughout the act, including listing everything that must be included in the local content plan, as well as the timeframe in which this plan must be submitted.
- **Restrictions:** The government should ensure that local content rules are aligned with any restrictions it has signed up to, such as those of the World Trade Organisation (WTO).

Analysis

Transparency requirements

Transparency is necessary, though alone not sufficient, for effective governance of extractive industries. Transparency provides all stakeholders with the information they need to hold government and companies accountable. As the TEITA Act is intended to address transparency issues in the sector, the Petroleum Act provides limited explicit transparency requirements. But through a progressive interpretation of these clauses in regulation, these requirements can still have a powerful impact on transparency in Tanzania. For example, “The Minister shall supervise the petroleum industry and shall . . . ensure and sustain transparency in the petroleum subsector” (section 5(1)f); “PURA shall exercise and perform its functions and powers in a manner that ensures transparency in relation to activities of the petroleum sector” (section 14(1)d); “EWURA shall . . . ensure...transparency in relation to the activities of the petroleum sub-sector” (31(2)m-iii).

It is recommended that regulations include a statement requiring disclosure of bidding documentation, contracts, beneficial ownership, environmental impact statements and environmental reporting, and local content plans and reports, in accordance with the requirements of the TEITA Act and its regulations.

In addition, section 124(5) states that the NPGIS shall be available for inspection by the public, excepting information that would undermine national security, proprietary market data or any other confidential information as EWURA may determine. In order to ensure that the NPGIS is truly transparent and EWURA’s discretion is used appropriately, regulations should provide details as to what may constitute “confidential information” and the basis upon which EWURA may make a confidentiality determination. Regulations should also specify that data will be available in an open data format.

License allocation procedures and selection of contractors

The Petroleum Act provides that TPDC “shall have exclusive right over all petroleum rights granted” for upstream operations and the license granted to TPDC “shall not be transferable to any other person.” The act further provides that TPDC may enter into partnerships with Tanzanian or foreign companies, subject to the consent of the minister and the advice of PURA. At the same time, section 48(1) states that “[p]etroleum agreements shall not be entered unless a transparent and competitive public tendering process is completed.” The process by which TPDC’s partners may be selected is therefore unclear.

The process by which TPDC’s partners in upstream operations may be selected is unclear.

The intent may be an arrangement whereby TPDC is the exclusive license holder who may then contract with a private company or group of private companies to carry out operations as “contractors.” Such a system could allow TPDC to develop capacity in the commercial side of the business and chart its own partnership strategies. On the other hand, if TPDC has sole discretion over partner choice, partners may be selected to suit TPDC’s commercial interests above the strategic interests of the sector or country. The act may also envisage selection of TPDC partners via competitive tender. A competitive process has the potential to ensure that Tanzania gets the best possible deal for its petroleum.

Regulations should therefore specify the process by which TPDC partners will be selected and who is responsible for this selection.

The law also provides relatively weak procedures for pre-qualification. Regulations should therefore establish criteria and standard procedures for assessing operator-company “capacity, technical knowledge and financial capability.” Precept 3 of the Natural Resource Charter discusses rights allocation and the importance of pre-qualifying contracting companies. (See discussion in the annex.)

State participation through TPDC

The act states that there will be a minimum 25 percent state participation (through TPDC) in joint ventures in the sector, with section 45(5) granting TPDC the discretion to determine a different level. Section 219 also covers a maximum government participation to be specified by the minister, on a case by case basis, when announcing areas for granting of petroleum exploration and development licences. Together, these provisions leave unclear whether or not there is an actual minimum state participation requirement and under what circumstances TPDC may exercise its discretion to determine a different state equity participation level. If the act were to be reviewed, it should include a statement setting out the circumstances under which TPDC is able to exercise this discretion. In the absence of a review, this clarity should be provided in regulations.

It should be noted that while a minimum 25 percent state equity requirement is not markedly out of step with international practice, it may be high when taking into consideration the practice with existing offshore gas projects and other investor financial obligations, including the royalty and the profit oil/gas split. TPDC discretion in determining a different level of state equity could be a useful way for the regulations to build in some desirable flexibility around the question of state participation, which has both pros and cons.

Ownership of shares of projects can provide the state with a useful regulatory tool through participation in decision-making at the board level and direct access to board level discussions and information. However, shareholder agreements would need to be carefully crafted to ensure that the state’s rights as a minority holder are protected; for example, by providing a minimum list of key decisions that require TPDC consent.

As a fiscal tool, state participation should be viewed in light of other fiscal obligations such as royalties, production share or CSR and local content obligations and the balance that must be struck between maximization of revenues to the state and competitiveness as an investment destination. If the required state equity participation is perceived as high, investors may seek to reduce fiscal obligations in other areas. In this regard, mandating a minimum level of state participation does not necessarily increase the overall revenues accruing to the state, but has the effect of shifting their structure from, for example, production share to dividends.

Emphasis on dividends as a revenue stream poses certain risks. Dividends are usually paid later in the production cycle than royalties or revenues from production share. As the government has considerable short-term development financing needs, it should consider such timing implications in its decisions. Further, dividends are a less certain source of income than other revenue streams. Depending on the strength of minority shareholder protections, majority holders may make the decision to reinvest funds rather than distributing dividends.

Greater clarity should be provided on whether minimum state equity participation requirements are in the form of paid, carried or free equity. A decision as to which form of equity will require government consideration of several factors. Paid equity

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requires large upfront payments by the state-owned company before it knows whether the project will be successful. Given the opportunity cost of public funds in terms of current development needs, and increasing public indebtedness, the implications of this option should be seriously considered. The other options for acquiring the 25 percent equity are either for free or via carried interest, whereby the state exercises its right to the equity if exploration is successful, and then pays for this equity plus interest from its share of the revenue stream on an agreed schedule. Free equity poses a financial burden on companies who must cover the state's share of cost and forgo additional equity financing they would have received if they sold the shares to a paying investor. Companies may seek concessions in other areas of the fiscal regime or some investment might be deterred. Carried equity still involves consideration of the opportunity cost of the use of the forgone revenues used to pay back the investor for the cost of the shares plus interest.

The impact of whether minimum state equity is free or not on the investment and financing decisions of companies means that any review of the act should specify the government's intention in this area. In the absence of a review, this clarity should be provided in regulations. Whether equity is paid or carried has a lesser impact on investor decision-making and therefore the government may benefit from maintaining some flexibility with this decision. However, regulations should still state that any equity that is not free could be either paid or carried.

Finally, regulations should specify that minimum state equity will be non-dilutable, to prevent the state's ownership share being reduced by subsequent sale of equity.

The ministry should consider these factors when determining the optimum level of state participation to ensure that the structure and timing of petroleum revenue flows to the government are closely aligned with national priorities.

TPDC's mid- and downstream rights

The regulations should provide more clarity regarding TPDC's participation and rights in the mid- and downstream. The activities reserved exclusively for TPDC or its subsidiaries in other parts of the value chain also need to be more clearly defined. The act gives TPDC "exclusive rights over natural gas midstream and downstream value chain" to undertake a range of activities including carrying out specialised operations, promoting investment, planning and proposing midstream and downstream ventures and implementing the gas master plan. But it also requires non-state companies to apply directly to EWURA for licenses for mid- and downstream activities and provides that the exclusive rights of a TPDC subsidiary to purchase, collect and sell natural gas from producers shall not extend to natural gas preserved for export in the form of liquefied natural gas. Furthermore, the act provides no guidance or procedures for most of the powers given exclusively to TPDC in the mid- and downstream sector. Many of these functions are of critical importance, and have the potential to be costly if mismanaged, so it is important to outline how TPDC is expected to execute them and the oversight of its decisions in so doing.

The regulations should provide more clarity regarding TPDC's participation and rights in the mid- and downstream.

Roles and responsibilities

Regulations should clarify roles, responsibilities and oversight mechanisms. For instance, the role of the Commissioner for Petroleum Affairs is not clear, and more detail on that person's appointment process, responsibilities, and/or place in the institutional hierarchy would help avoid confusion. However, if the act were to be reviewed, consideration should be given to clarifying responsibility for appointing

the Commissioner in the act itself. This would align it with the treatment of appointments to other roles of similar seniority in government.

Domestic market obligation (DMO)

The level and nature of domestic supply obligations may influence the likelihood of IOCs investing. Section 97 effectively states that the entire domestic market must be served from the profit share of a license holder and contractor, up to their entire profit gas. Although current domestic needs are small relative to proven reserves and optimum production output, they may increase in the future – especially if urbanisation continues to grow rapidly and Tanzania's economy diversifies to include more manufacturing activities, as is currently planned in the Five Year Development Plan II. It is possible that a large share of an IOC's production could be consumed by the domestic market, impacting on the economic viability of building a liquefied natural gas (LNG) plant. Given extraction of offshore reserves is only likely to be viable if LNG exports are possible, the level of domestic supply obligations could therefore influence whether these reserves are actually developed in the first place. Regulations can address this by reference to section 5(4), which states that the minister shall ensure a balance between petroleum domestic supply and export. The regulations should provide certainty on the growth trend of domestic supply obligations and ensure that the remaining production share takes into account the supply requirements of the LNG plant.

The regulations should state with some certainty how prices will be determined for the portion of production share that is destined for the domestic market.⁸ This should be done on the basis of consultation and negotiations with IOCs, as well as taking into account what prices are affordable for citizens and the level of public subsidies necessary to support such prices. Section 165 supports the need to incentivise investment and adhere to international best practice, while still making gas affordable to strategic industries and households. But Section 98 states that “[t]he domestic natural gas price shall be determined based on the strategic nature of the project to be undertaken by the government.” As detailed strategic natures of potential future projects cannot currently be known, this introduces risk for investors. Regulations should more clearly specify limits on how this price might vary with planned investments, as well as outline compensating mechanisms in these cases.

Fiscal regime

The act does not set a cost oil/gas recovery limit or provide any ground for its determination. This could therefore become a main negotiable item of production sharing agreements. This is not unreasonable, but it would limit the amount of profit oil available to split between the government and the contractor. It is therefore necessary to clearly state whether the cost recovery limit is negotiable. If it is negotiable then regulations should state the aspects that can be included, such as headquarters overheads (operational expenditures) and investment expenditures. Guidelines on the range within which cost recovery limits can vary in agreements should also be provided in the regulations.

Given that the Petroleum Act does not set a cost oil/gas recovery limit or provide any ground for its determination, regulations should clearly state whether this limit is negotiable.

⁸ Procedures for price determination should be stated in advance. Clearly the future price itself, or even a range of future prices, cannot be specified without great risk to one or both parties, but a pre-agreed means of determining this based on prevailing trends, such as through a specified formula, can be devised.

The fiscal regime that will apply to the downstream is not described in the same detail as it is for the upstream provisions. Assuming that it will therefore be subject to general tax law, this means that the upstream will be taxed more heavily than the downstream. This is consistent with current expert thinking: the downstream petroleum sector should be regulated as a utility and most revenues should come from the upstream. However, it does imply that the price at which gas from the upstream is sold to the downstream (either for LNG processing or for domestic market users) needs to be monitored to avoid transfer pricing at below the market rate. Combined with the aforementioned domestic market obligation, the importance of having the right pricing regulations in place becomes paramount, so cooperation and open negotiations will be key to setting a viable price.

The terms “production sharing contract,” “profit oil” and “cost oil” should be defined in regulations.

Precept 4 of the Natural Resource Charter discusses some best practice principles for fiscal regimes in extractive sectors. (See discussion in the annex.)

Local content

The rest of the analysis of this act makes recommendations for the effective implementation of the act. However, in the area of local content, there are sufficient differences with the local content policy that the ministry should consider undertaking a review of these parts of the act in order to harmonise the approaches.

First, the definition of local companies is at odds with that of the Local Content Policy.⁹ The Local Content Policy defines local business as an entity “which is incorporated under the applicable laws of Tanzania and is wholly owned by Tanzanians or with at least 51 percent of shares owned by Tanzanian Nationals and is registered to offer goods or services in the oil and gas industry” (page iii). However, the Petroleum Act defines a local company as a company or subsidiary company incorporated under the Companies Act, which is 100 percent owned by a Tanzanian citizen, or a company that is in a joint venture partnership with a Tanzanian citizen or citizens whose participating share is not less than 15 percent.¹⁰ Aside from conflicting with the Local Content Policy, this definition limits the extent to which Tanzanians will benefit from local content provisions as it means an 85 percent foreign controlled joint venture could qualify as a local company, and receive preference for providing services to operators in the extractive sector.

Second, the act requires that preference be given to goods “produced in” or “available in” Tanzania (section 219(1)). Taking a literal interpretation, goods imported into Tanzania by a foreign-owned company are “available in” Tanzania yet they would provide no value-addition in country, supply chain participation or similar benefits to Tanzanians. The draft Local Content Policy, in contrast, states that operators shall “as far as practicable use goods and services produced by or provided in Tanzania by Tanzanian-owned businesses for their operations in preference to foreign goods and services provided in Tanzania by foreign registered businesses in Tanzania or foreign businesses not registered in Tanzania” (page 20). The Local Content Policy better captures the goal of the petroleum sector stimulating local supply chain development.

There are sufficient differences between the local content provisions in the Petroleum Act and the Local Content Policy that the ministry should consider undertaking a review of these parts of the act.

9 The Local Content Policy of Tanzania for oil and gas industry-2014, available here: <https://mem.go.tz/wp-content/uploads/2014/05/07.05.2014local-content-policy-of-tanzania-for-oil-gas-industry.pdf>

10 See section 219(9) of the Petroleum Act.

Furthermore, the act requires that goods and services not available in Tanzania be provided by a company that has entered into a joint venture with a local company that owns at least 25 percent of the share of the venture (section 219(2-3)). However, as noted above, the law's definition of a local company includes companies which are themselves joint ventures, and in which Tanzanian citizens may own a participating share of as little as 15 percent. So for goods and services not already available in Tanzania, the Tanzanian participation in the joint venture providing these may be as little as 15 percent of 25 percent, which is a mere 3.75 percent.

In order to promote greater local participation and bring the definition in line with, and surpass, that of the Local Content Policy, a "local company" should be defined as one with majority Tanzanian ownership, management and/or employees.

Aside from these areas for review, there are some challenges the regulations should address.

Local content requirements are currently referred to in different parts of the act, so regulations or some other central reference document should state them clearly and comprehensively under the same heading for ease of reference, including listing everything that must be covered by the local content plan, such as recruitment and training of Tanzanians, a succession plan for the progressive replacement of foreign employees with Tanzanian employees, a supplier development programme, and a procurement plan for use of goods and services produced or provided by local companies (with the timeframe in which licence holder, contractor and subcontractor are required to submit this procurement plan).

The draft Local Content Policy envisages an exercise, in collaboration with industry, to develop baseline information on current capacity and capabilities for Tanzanian-owned companies to become suppliers. Therefore regulations might require procurement plans to be aligned with these identified areas, or might directly set forth these identified areas.

Finally, local content regulations must naturally not infringe on trade agreements and WTO restrictions. A good flow of information between the Ministries of Trade and of Energy and Minerals is therefore necessary so that restrictions in the purview of the former inform the regulations drafted by the latter.

The Petroleum Act's definition of a local company includes companies which are joint ventures, and in which Tanzanian citizens may own a participating share of as little as 15 percent.

II. OIL AND GAS REVENUES MANAGEMENT ACT, 2015

Key goals and provisions of the act

The act's stated aim is to "provide for the establishment and management of the Oil and Gas Fund, to provide for the framework for fiscal rules and management of oil and gas revenues and to provide for other related matters."

The Revenue Management Act is slim compared with the Petroleum Act, containing just 23 provisions. Nevertheless, it contains a significant number of provisions relating to how the proceeds from the oil and gas sector are to be managed, including the establishment of savings rules and an oil and gas fund. The key objectives and provisions are outlined below.

The framework

Oil and gas revenues will be deposited in an Oil and Gas Fund, which contains two accounts: a revenue holding account and a revenue savings account. The Revenue Holding Account is used for collecting and distributing most oil and gas revenues.¹¹ The Revenue Savings Account collects savings which are used for three purposes: to provide budget financing when there are shortfalls in oil and gas revenues, finance TPDC's strategic investments and acquire long-term savings.

The revenues arrive first in the holding account. From there, a fiscal rule determines their treatment: the government may run a deficit of up to 3 percent of GDP (excluding oil and gas revenues) and oil and gas revenues up to this amount are transferred from the holding account to the budget to finance this deficit. Oil and gas revenues in excess of this amount are transferred to the savings account. The government then effectively runs a balanced budget and savings from oil and gas revenues are the residual after financing the deficit.

If oil and gas revenues fall below 3 percent of GDP, then withdrawals can be made from the savings account to finance the budget deficit, so that expenditure stability is maintained even when prices fall (and also when they rise, which would result in more transfers to the savings account). This is the stability function of the savings account. If the savings account's deposits are insufficient to cover the fiscal deficit, then the government may borrow to finance the deficit.

There are earmarking rules in the framework too. Of the oil and gas revenues that are transferred to the budget, at least 60 percent must be directed towards strategic development expenditure. In this, a preference should be given for human capital development, particularly in science and technology. There are further rules to guide overall government spending and, unlike the fiscal deficit rules which only bind the government once revenues reach 3 percent of GDP, these rules come into force immediately. Total recurrent expenditure growth (goods and services, wages and salaries) is limited to growth in nominal GDP. This implies that Tanzania wishes to at least maintain the government's investment spending over time and avoid an expansion in recurrent spending as seen in other resource-rich countries. Total government expenditure is also capped at 40 percent of GDP.

The Revenue Management Act contains a significant number of provisions relating to how the proceeds from the oil and gas sector are to be managed, including the establishment of savings rules and an oil and gas fund.

¹¹ Royalties, government profit share, dividends from state participation in operations, corporate income tax on exploration, production and development of oil and gas resources. Capital gains tax of IOCs do not enter the fund. Neither do signature and production bonuses, which TPDC collects.

A rather unusual feature of Tanzania's fund is that the equivalent of 0.1 percent of GDP of the savings account's deposits will be earmarked annually for the national oil company, TPDC, to finance strategic investments (potentially increasing to one percent based on parliamentary approval). The disbursement of these earmarked funds to TPDC is done through the normal budgetary process. If there are insufficient resources in the savings account for this transfer to TPDC, budgetary transfers to the fund will occur.

The act also requires that local government authorities hosting oil and gas projects receive a service levy.

Another noteworthy provision in this act is that the fiscal rules may only be revised every five years, counting from 1 July 2015, at which point a two thirds majority in parliament is required to revise the act. In the event of war, or the need of a major investment by the government, the fiscal rules may be suspended if approved by a two thirds parliamentary majority.

The framework is presented schematically in Figure 1.

Summary of rules

Balanced budget rule

- When oil and gas revenues reach 3 percent of GDP, the non-oil and gas fiscal deficit should not exceed 3 percent of GDP. This is the equivalent to financing the deficit with oil and gas revenues (through the sale of an asset, as opposed to borrowing).
- Oil and gas revenues in excess of 3 percent of GDP are transferred to the savings account.

Stabilisation mechanism

- If oil and gas revenues are less than 3 percent of GDP once the rules on the fiscal deficit come into force, the fiscal deficit may be financed from the savings account. If this is insufficient, the government may borrow.

TPDC financing

- Funds equalling 0.1 percent of GDP in the Revenue Savings Account will be earmarked for the national oil company. This can rise to a maximum of 1 percent, subject to parliamentary approval.

Expenditure rules

- 60 percent of oil and gas revenues entering the budget should be spent on "strategic development expenditures."
- Recurrent expenditure growth (goods and services, wages and salaries) from one year to the next cannot exceed the growth in nominal GDP.
- Total expenditure is capped at 40 percent of GDP.

When oil and gas revenues reach 3 percent of GDP, the non-oil and gas fiscal deficit should not exceed 3 percent of GDP, and oil and gas revenues in excess of 3 percent of GDP are transferred to the savings account.

Objectives

The objectives of the Oil and Gas Fund are described in §8(3). They are to ensure that:

- 1 Fiscal and macroeconomic stability is maintained
- 2 The financing of investment in oil and gas is guaranteed
- 3 Social and economic development is enhanced
- 4 Resources for future generations are safeguarded

The objectives of the fiscal rules are described in §16(2). They are:

- 1 Financing of the government budget
- 2 Financing of the national oil company investment
- 3 Fiscal stabilization
- 4 Saving for future generations

The principles behind the fiscal rules are stated in §16(3). They are:

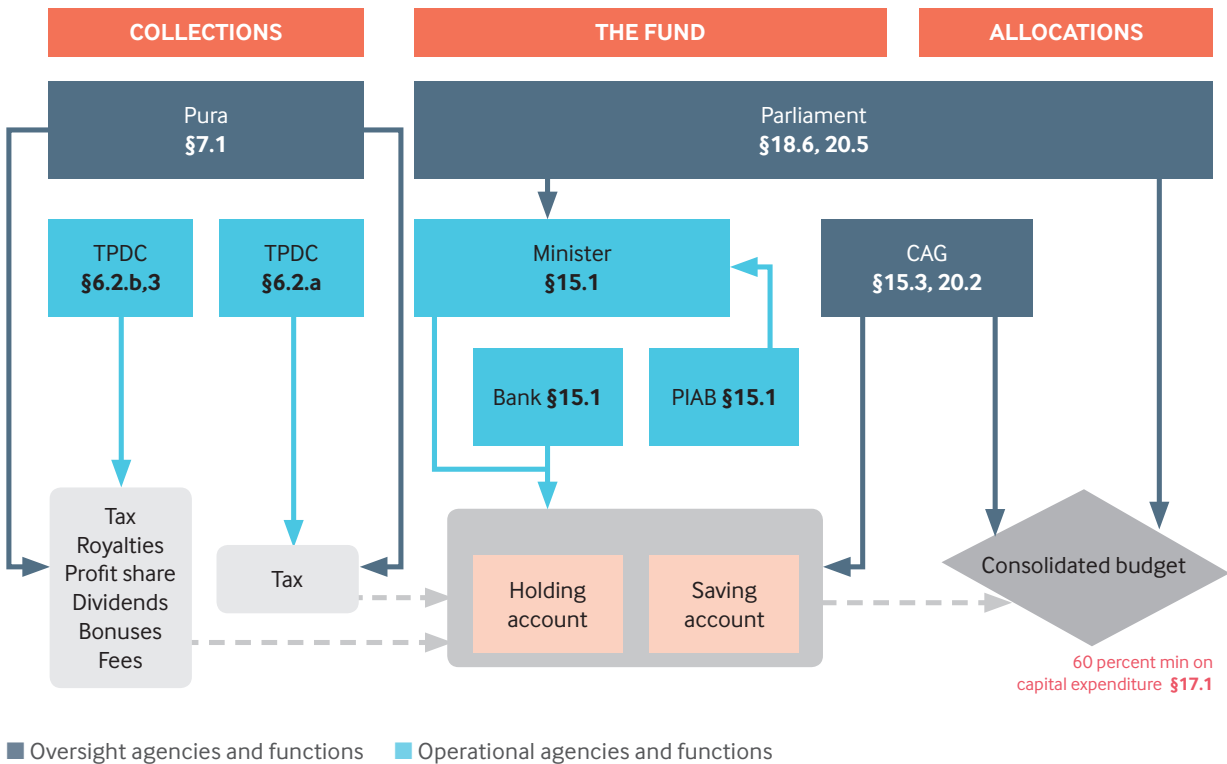
- 1 Safeguard of the economy against inherent volatility of the oil and gas revenue
- 2 Presence of uncertainty of the timing and size of the revenue flow
- 3 Adherence to fiscal convergence criterion for the East Africa Monetary Union
- 4 Maintenance of expenditure growth that is consistent with the absorption capacity of the economy
- 5 Avoidance of borrowing where government holds financial savings
- 6 Diversification and unlocking of the economy for sustainable development
- 7 Ensuring collection efforts of revenue from non-oil and gas sources are not neglected
- 8 Safeguard interests of future generation through expenditure on alternative investments, including human capital development and financial savings

Governance

The minister of finance manages oil and gas revenues, formulates and supervises all policy matters relating to the fund (in that sense he is the ultimate authority on it), and formulates and monitors broad investment strategies and operation guidelines for the Revenue Savings Account of the fund. The minister is advised by the portfolio investment advisory board, who also reports to the minister on the performance of the savings account. The central bank is responsible for the daily operations of the oil and gas fund and implements the strategy laid out by the minister.

The auditor general will annually audit the accounts of the fund. The minister is required to publish oil and gas revenues and expenditure of whatever form in the gazette (§18(4)). The record of oil and gas revenue and expenditure shall also be the subject of parliamentary oversight (§18(6)). The institutional architecture of the fund is represented schematically in Figure 1.

Figure 1. Institutional structure of the Oil and Gas Fund



Summary of key recommendations

In contrast to the sections on the Petroleum Act and the Tanzania Extractive Industries (Transparency and Accountability) Act, in which the focus is on rules and regulations that the government could develop to implement the new legislation, this section also includes several proposals for possible changes to the legislation. This approach is taken here for two reasons. First, given that significant time remains before large revenues start flowing, Tanzania has an opportunity to make adjustments without affecting government planning or harming the credibility of the framework. Second, there are some important shortcomings in parts of the legislation, which create the risk that it will not achieve its stated goals. NRGi is conducting additional economic analysis that should help inform further discussions about revenue management in Tanzania. For now, the following initial recommendations on the legislation are offered.

There are some important shortcomings in parts of the Revenue Management Act, which create the risk that it will not achieve its stated goals.

Oil and Gas Fund

- **TPDC financing:** An alternative mechanism for financing TPDC should be considered. If such a change is not taken up, rules should be created that clarify the use of earmarked funds in the savings account.
- **Investment rules:** The government should include categories of eligible instruments in the regulations, including requirements that savings be invested abroad (to prevent the creation of a parallel unaccountable budget), a list of prohibited risky investments, ethical investment standards and investment guidelines. For

portfolio rebalancing purposes, the government could also clarify the percentage of the fund to serve stabilization and savings objectives, respectively.

Fiscal deficit, expenditure and earmarking rules

- **Pro-cyclical fiscal rules:** The government should consider using another fiscal measure rather than total GDP as an anchor to minimise the risk of volatile pro-cyclical spending. The use of nominal GDP as an anchor for recurrent expenditure growth should also be reconsidered. Options include a set figure (e.g., 4 percent annual recurrent expenditure growth), a multi-year GDP growth average, real trend non-resource GDP growth or structural GDP.
- **Savings threshold:** The appropriateness of the fiscal rules should be reassessed based on rigorous, detailed forecasts of potential revenues and the economy's absorptive capacity.
- **Overall fiscal sustainability:** The government should base the overall spending limits on realistic binding constraints that align with the fiscal deficit rule, and make these flexible enough to adapt to a changing economy.
- **Fiscal deficit reduction:** If the fiscal deficit proposed is to be achieved once it is triggered (and the East African Community (EAC) convergence criteria is to be met by 2023), growth in spending would need to be limited even whilst GDP and revenues are increasing.
- **Strategic development expenditure:** The regulations could define "strategic development expenditure" with greater clarity.

The government should consider using another fiscal measure rather than total GDP as an anchor for its fiscal rules to minimise the risk of volatile pro-cyclical spending.

Governance of the fiscal framework and the fund

- **Transparency:** The regulations should specify where, when and which information will be published.
- **Fund flows:** The exact process through which oil and gas revenues arrive in the fund should be clarified – whether TPDC and the Tanzanian Regulatory Authority (TRA) deposit these directly into the holding account, or whether revenues are first submitted to the treasury which then deposits the revenues in the holding account.
- **Responsibility for implementation:** That the Minister of Finance is responsible for implementation of this act should be explicitly set out in the law.

National oil company financing

- **TPDC financing mechanism:** The government should consider using an alternative mechanism to GDP as a determinant of earmarked funds, and reconsider whether the savings account of the fund should be used for this financing. A fixed formula for transfers from the holding account or a multi-year budgeting arrangement are possible alternative mechanisms. If TPDC is to be financed from earmarked funds in the savings account, there should be greater clarity on how these funds are to be used, such as which investments qualify and what happens to unused funds.
- **Bonuses:** Signature and production bonuses, acreage fees and training and rental fees should be treated in the same way as other oil and gas revenue streams instead of being retained by TPDC. Alternatively, full and transparent oversight of the use of these funds should be established to ensure they are used

in line with national development priorities: they should be tracked separately in TPDC's budget and be subject to regulatory restrictions on their use to achieve the aim of development of the subsector.

- **Reporting:** The reporting requirements of TPDC should be strengthened, as recommended in the analysis of the TEITA Act, to ensure that TPDC's share of revenues are effectively used to develop the sector.

Analysis

Fiscal rules

Fiscal rules—permanent numerical constraints on public finances—can help achieve several different objectives:

- 1 **Managing revenue volatility:** Fiscal rules can help governments smooth fiscal expenditures, even if fiscal revenues are volatile (e.g., expenditure rule limiting expenditure growth to x percent annually)
- 2 **Promoting fiscal sustainability:** Fiscal rules can prevent overspending or overborrowing by governments that can lead to debt crises (e.g., balanced budget rules)
- 3 **Intergenerational transfers:** Fiscal rules can require governments to limit public debt or save some fiscal revenues in a fund in order to reduce the burden of debt on future generations (e.g., debt limits)

Fiscal rules must be designed with the national context in mind. For example, a history of pro-cyclical fiscal policy—where government spending exacerbates natural boom-bust cycles in the economy—can be addressed by enacting a fiscal rule that smooths fiscal expenditures.

Resource-rich and emerging economies generally suffer from overspending and excessively volatile revenues. As such, Tanzanian rules ought to address these issues. However the rules included in the legislation suffer from two serious weaknesses:

- They are pro-cyclical and would exacerbate boom-bust cycles
- The savings-spending split required by the legislation may not take into account the revenue potential of the natural gas sector or the economy's actual absorptive capacity.

The challenges associated with making the fiscal adjustment to a balanced budget and clarifying the timing of withdrawals are also discussed.

Pro-cyclicality of fiscal rules. The use of GDP as an anchor for the various fiscal rules, namely limits to the fiscal deficit, recurrent expenditure growth and total expenditure, should be carefully reconsidered. GDP can be volatile, particularly in resource rich countries, and using it as an anchor may inadvertently exacerbate volatility in budgeting. Tanzania has traditionally experienced volatile GDP growth and volatile fiscal revenues. The addition of natural gas revenues is only expected to intensify this volatility.

Under the current rule, when GDP is higher, expenditure can be higher, so government spending can increase. Expansionary spending during high-growth periods, which must then be cut back during low-growth periods, will tend to exacerbate and reinforce directional trends of growth and therefore contribute to boom-bust cycles. The practical implications of boom-bust cycles are a tendency to

spend on large ostentatious and unproductive infrastructure during boom periods and then resort to harmful spending cuts or overborrowing during recessions. Such spending volatility has been shown in many studies to make planning and forecasting more difficult for both private and public sector entities and reduce long-term economic growth.

Additionally, the choice of *nominal* GDP growth as an anchor for expenditure growth should be revisited as it undermines the stated objective of “maintenance of expenditure growth that is consistent with the absorptive capacity of the economy.” As noted on page 21, expenditure beyond the absorptive capacity of the economy can cause inflation. Nominal GDP is just real GDP plus inflation, so an increase in inflation increases nominal GDP (but not real GDP). However, under this fiscal rule, an increase in nominal GDP due to inflation would be a signal to further increase expenditure, which the economy cannot absorb, and would therefore cause further inflation. A vicious cycle of inflationary expenditure growth could then result.

Instead, the government could change the rules to address volatility—reducing fiscal space during boom periods and expanding it during slumps. Options include using an expenditure rule (e.g., 4 percent annual recurrent expenditure growth) or anchoring spending to a multi-year GDP growth average, real trend non-resource GDP growth or structural GDP.

Each of these options has strengths and weaknesses. For instance, while Chile and Norway have successfully utilised a structural GDP anchor, the calculations required to adhere to the rule are fairly open to manipulation. Thus, their rules require an independent fiscal authority and strong institutions. NREGI is working now to model the implications of different fiscal rules for Tanzania.

There are also practical challenges to the use of GDP as an anchor, irrespective of the specific measure of GDP that is used. In particular, limits imposed on the formation of the budget will be based on the government’s own forecasts of GDP growth. But given the importance of these forecasts to the operability of the fiscal rules, such forecasts should be free from conflicts of interest, otherwise there will be a significant risk that over-optimistic forecasts could be produced as a means of creating more fiscal space. This would divert more oil and gas revenues to current spending than envisioned by the rules.

Using forecasts from independent sources, such as a specially constituted forecasting body or international organisations, could attenuate this risk. The source(s) used and the method for using them should be set out in regulations.

Savings-spending split. The spending-savings decision determines how much of the revenues from the oil and gas sector to spend or invest now, versus how much to save for future generations. A government might decide to backload spending by banking all revenues and only spending the interest (a ‘bird in the hand’ approach), it might decide to consume all revenues as they arrive, it might decide on a middle way, by banking some and consuming some to ensure expenditure is constant (a ‘permanent income hypothesis’ approach, or PIH), or it might decide to mix elements of all these approaches depending on current spending needs, absorptive capacity and considerations of intergenerational equity.

The government could change the rules to address volatility—reducing fiscal space during boom periods and expanding it during slumps.

The objectives of the fund and fiscal rules (see page 15) include saving for future generations as well as supporting current spending. In the fiscal framework laid out in the act, the fiscal deficit rule determines when oil and gas revenues funds begin to be saved: when they exceed 3 percent of GDP. Below this level, they are used to finance the budget deficit. If the non-oil and gas fiscal deficit is equal to or greater than 3 percent of GDP and revenues from oil and gas do not exceed 3 percent of GDP in a given year, then no savings occur. When oil and gas revenues are below 3 percent of GDP, funds can be withdrawn from the savings account and paid into the consolidated budget to meet the shortfall (the stabilisation mechanism).

The rule ensures oil and gas revenues are put aside once they reach a certain threshold. However, there are questions around whether this threshold is set at a level which takes into account the revenue potential of the natural gas sector or the economy's absorptive capacity.

Even if the investments necessary to develop Tanzania's largest gas deposits go ahead, there is a significant possibility that revenues will take a number of years to reach the threshold of 3 percent of GDP, or that they may not reach that level at all before all reserves are depleted. An IMF forecast from 2014 suggests that meeting the threshold might be optimistic,¹² and the gas price has fallen since then, so revenues are likely overstated. As noted below, this threshold may actually be overly restrictive for Tanzania. Nevertheless, an understanding of the current revenue potential of the sector is crucial for the management of expectations and to inform the government's wider strategy for the economy. NREGI is working now to develop realistic forecasts of potential revenues from natural gas production.

The savings-spending threshold of 3 percent of GDP may not take into account the economy's absorptive capacity—the ability to transform money into productive investments. The efficiency of government spending needs to be considered, with project appraisal appearing to be a particular weakness in Tanzania's public investment management.¹³ However, over the past 20 years, increases in government spending have rarely led to a rise in inflation, suggesting the economy is operating within its absorptive capacity. Tanzania also currently has relatively low public debt levels. According to the IMF, it is at low risk of debt distress; the debt-to-GDP ratio is currently hovering around 40 percent. Therefore it may be reasonable for Tanzania to spend a greater proportion of revenues to finance high-return investments which will also benefit future generations, for instance in infrastructure and clean water. The government should therefore consider reviewing the savings-spending trade-off, and NREGI is currently undertaking analysis in this area to inform such a review.

Even if the investments necessary to develop Tanzania's largest gas deposits go ahead, there is a significant possibility that revenues will take a number of years to reach the savings threshold, or that they may not reach it at all before all reserves are depleted.

12 <https://www.imf.org/external/pubs/ft/scr/2014/cr14121.pdf>

13 Era Dabla-Norris et al. *Investing to Public Investment: An Index of Public Investment Efficiency*. IMF Working Paper 11/37, <http://www.imf.org/external/pubs/ft/wp/2011/wp1137.pdf>.

'Absorptive capacity' is the ability of the economy to respond to large investment injections with a supply response. For example, if firms can expand operations easily by accessing credit and skilled workers, can rely on physical and energy infrastructure, and can obtain intermediate goods through effective ports infrastructure, then they can respond to increased orders through increased production. Otherwise, they are more likely to simply raise prices in response to increased demand, leading to inflation. Furthermore, if the presence of supporting factors (e.g., skilled workers, appropriate infrastructure) means firms are able to increase production, then a large public investment is more likely to lead to a multiplier effect: firms ordering more from second tier suppliers, who then order from their own suppliers and so on. The total profits and employment gains from the investment become equivalent to several multiples of the original investment size. Without the ability to rely on domestic supply chains, increased demands such as public investment is more likely to have to rely on imports, with consequent deterioration of the trade balance. The combination of all of the factors that dictate the potential supply response is called absorptive capacity as it describes the ability of the economy to 'absorb' new investments, rather than to respond negatively with inflation and a worsening trade balance.

Preparing for the fiscal deficit limit. The proposal to reduce the size of the fiscal deficit is something for which the government must prepare effectively. At the current fiscal deficit (approximately four percent of GDP), a shift to a balanced budget (a fiscal deficit financed by oil and gas revenues) will require several years of limited spending growth even whilst the economy is growing and revenues are increasing. A great deal of political will would be needed to overcome the inherent political difficulties of implementing this fiscal restraint. Indeed, it is unclear whether the proposed shift to a balanced budget is necessary given Tanzania's relatively low public debt levels and adequate absorptive capacity.

It is unclear whether the proposed shift to a balanced budget is necessary given Tanzania's relatively low public debt levels and adequate absorptive capacity.

The fiscal deficit limit set out in the EAC convergence criteria is less restrictive, allowing for a deficit of 3 percent of GDP. However this criteria has to be met by 2023. Therefore, gradual scaling back of spending growth should begin as soon as possible regardless of whether the limit specific to Tanzania is applied in later years.

That said, maintaining overall fiscal sustainability is vital in itself, including in the years before production when high expectations can lead to unsustainable spending patterns. The non-oil and gas deficit rule will not contribute to the management of such risks until oil and gas revenues reach the threshold of 3 percent of GDP and international experience indicates that regional targets can often be weak on political buy-in and accountability. The cap on expenditure at 40 percent of GDP and the limit on recurrent expenditure growth at nominal GDP growth offer a mechanism to manage these risks. Yet with expenditure currently at around 20 percent of GDP, it is unlikely that the cap on spending will be a binding constraint for the government in the years before either fiscal deficit target is enacted. Moreover, linking recurrent expenditure to nominal GDP growth is no guarantee that the budget share of capital expenditure will be maintained or increased. (Recurrent expenditure can still grow faster than capital expenditure.)

The government should consider overall recurrent expenditure growth limits that represent an effective binding constraint, and ones that realistically bring spending in line with the EAC convergence criteria and then the balanced budget target (if this target is to be maintained). These should be flexible enough to adapt to changing economic structures and demands but also be informed by the absorptive capacity of the economy.

Timing of withdrawals. The withdrawal mechanism states that savings can be withdrawn from the Revenue Savings Account if revenues fall below a budgeted

three percent of GDP in a given fiscal year. However the act does not specify at what point in the year the withdrawal should be made. The government will not know if revenues will eventually fall short of three percent until the end of the year. Thus the timing (e.g. annually, quarterly) of withdrawals should be clarified.

Investment rules

It is notable that there is no reference in the act to the types of investments that may be made by the Oil and Gas Fund, either domestically or internationally. This carries risks for the objectives of the act. The regulations should therefore clarify rules on the types of investments that may be made by the Oil and Gas Fund, both domestically and internationally.

The lack of clarity on asset allocation rules poses several dangers, including: (1) potential for excessive risk-taking and losses due to excessive management fees; and (2) establishment of an unaccountable parallel budget.

Potential for excessive risk-taking and losses from excessive management fees. Excessive risk-taking by investment managers can create challenges. While the executive or ministry of finance is usually responsible for overall management of a sovereign wealth fund (SWF) and sets investment policy, and the central bank or an independent agency acts as day-to-day operational manager, external managers are often hired to make some or all of the actual investments. The use of external managers can reduce conflict of interest challenges, but may also lead to excessive risk-taking. Since much of their compensation comes from management fees and they can charge higher fees for trading more complex, higher-risk financial products, external managers have an incentive to push SWFs to invest in risky assets like derivatives,¹⁴ often with severe consequences. For example, while SWFs with low-risk investment strategies emerged relatively unscathed from the global financial crisis, the Libyan Investment Authority's investment of \$1.2 billion in equity and currency derivatives managed by Goldman Sachs had lost 98.5 percent of its value by June 2010. High-risk/high-return investments may have a place within even a very conservative private institutional investor's overall portfolio, but, as custodians of public funds, SWF managers have a responsibility to safeguard SWF assets and prevent waste or excessive risk-taking.

Constraining fund investment choices is an important means of ensuring that SWFs are managed in the public interest. Clear investment rules, guidelines and targets guard against taking excessive risk, limit the discretionary power of SWF management, and can significantly enhance the transparency and effective monitoring of SWF actions, strategies and performance.

Countries with SWFs employ several different types of detailed constraints on investments:

- **Minimum credit rating:** The investment guidelines or revenue management law may specify minimum credit ratings for debt instruments. The major rating agencies, Fitch, Moody's and Standard & Poor's, all rate the credit quality (risk of default) of borrowers—the countries, companies and agencies who issue bonds and other debt instruments that SWFs invest in. Many SWFs are only allowed to buy bonds issued by borrowers with "investment grade" or "A- or higher" ratings from at least two of the major ratings agencies. This ensures that risk of default by the SWF's debtors is kept very low (although this also reduces

There is no reference in the Revenue Management Act to the types of investments that may be made by the Oil and Gas Fund, which carries risks for the objectives of the act.

¹⁴ Derivatives are financial instruments that derive their value from other assets, indices or interest rates. They include swaps, futures and options, and are generally considered high-risk investments.

returns). The same principles apply to the management of credit or default risk among the SWFs' counterparties—the banks and custodians that trade and hold the SWF's assets. For example, the investment guidelines or SWF law may specify that transactions are only allowed with intermediaries that have a high credit rating, implying low risk of default. The Norwegian Government Pension Fund has mandated that “counterparties for unsecured deposits shall have a long-term credit rating of at least AA-/Aa3/AA- from at least one of the following three agencies: Fitch, Moody's or Standard & Poor's.”¹⁵

- **Restrictions on private market instruments:** Publicly traded instruments—stocks and bonds that are traded on public exchanges—have features that are desirable from a transparency and risk perspective. They can always be priced (their value can be determined at any point in time, because buyers and sellers interact through public exchanges to determine prices), trading volumes are much higher (so that there are always buyers and sellers for marketable securities), and there is no risk that a counterparty or investment partner will default. In practice, SWFs may look to start trading only in public assets and only gradually make allocations to private assets. The Norwegian Government Pension Fund Global, for example, made its first allocation to private assets (real estate) in 2011, almost two decades after the fund's inception. The Ministry of Finance, which oversees the fund, argued that the fund should target a maximum allocation to real estate of 5 percent of the overall.¹⁶
- **Restrictions on other high-risk instruments:** Over-the-counter currency derivatives (futures, options) can help protect a portfolio against unwanted risks for exchange rate movements, if they are well understood and are used appropriately. But they also introduce bilateral counterparty risk because they are traded between two financial institutions rather than on an exchange and are often relatively complex and opaque. The key considerations for authorizing the use of derivatives are whether the fund has the requisite technical knowledge to understand the risks and obligations associated with these contracts and whether the investment guidelines ensure that the derivatives are being used for hedging (insurance) rather than speculative purposes.
- **Currency restrictions:** Some countries restrict investments to assets denominated in convertible currencies or specific currencies. For example, Botswana's Pula Fund makes fixed income investments denominated in only convertible currencies, mainly the U.S. dollar, the Euro, pound sterling and yen. Chile's Economic and Social Stabilization Fund has a currency allocation of 50 percent in US dollars, 40 percent in Euros and 10 percent in yen. The rationale for this type of rule is that assets denominated in convertible and abundantly traded currencies can be traded or turned into cash relatively quickly.

The fund as an unaccountable parallel budget. With very few exceptions (e.g., Azerbaijan, Iran), SWFs are explicitly prohibited from investing in domestic assets. There is the risk that portfolio managers will invest domestically in physical assets such as infrastructure and real estate, or invest in domestic financial assets. This would undermine some of the stated objectives and principles laid out on page 15 of this analysis – specifically, fiscal and macroeconomic stability and maintenance of expenditure growth that is consistent with the absorptive capacity of the economy. (See page 21)

There is the risk that portfolio managers will invest domestically in physical or financial assets, which would undermine some of the stated objectives and principles of the Revenue Management Act.

15 Norges Bank Investment Management, “Investment Mandate,” September 2, 2009. http://www.norges-bank.no/Upload/77273/4_mandate.pdf.

16 Norges Bank Investment Management, *Government Pension Fund Global Annual Report 2012*.

Investment in domestic assets would also run counter to the principles of accountability over public funds, and could create a parallel, extra-budgetary development expenditure process. Public investments are usually required to be made through the budgetary process, which has parliamentary oversight to ensure public funds are used in the interests of the country. If the portfolio manager of the savings fund can invest in such areas without parliamentary oversight, then a parallel and less accountable budgetary process will exist. This could lead to investments not being coordinated with national development priorities or, as a worse case, investments could be privately or politically motivated; a potential channel for patronage and corruption will have been opened. When funds are approved for public investments through the budget, they must pass through public financial management channels, which ideally include project appraisal, procurement and monitoring. However, portfolio investments do not go through these channels, and are not subject to the spending controls of government. While it might be argued that public financial management systems are imperfect and can be wasteful, the response is to invest in improving them, rather than to bypass and undermine them.

Another reason for investment rules is that managing a portfolio of financial assets with the aim of securing the best return for a given risk profile is a very different skill to investing public funds into physical assets with the aim of generating economic development. The portfolio manager of the savings fund should possess the former, while appropriate spending agencies in government should employ officials possessing the latter. Furthermore, if the portfolio manager has one clear mandate, their job will be less complex and prone to miscalculations than if multiple investment mandates have to be met. As such, the rules should ideally require investments to be made exclusively in financial assets.

Earmarking rules

The act states that 60 percent of spending from resource revenues should be on “strategic development expenditure” (§17(1)-c-i-aa). The plan to restrict how resource revenues are spent in order to ensure development is commendable. But in some cases when other countries have attempted this, the result has been increased reporting procedures without tangible changes in spending patterns. This is because oil and gas revenues are fungible – they are amalgamated with all other fiscal revenues when they arrive in the general budget and are not reported separately.

Consider what would happen in a country that was required to spend all resource revenues on public investment. This country collects \$10 billion in taxes from the non-resource sectors and spends \$1 billion on infrastructure. If it also collects an additional \$1 billion in oil and gas revenues, this does not mean that it will spend \$2 billion on infrastructure. Instead, it may simply claim to have spent the oil and gas revenue on infrastructure, maintaining the \$1 billion infrastructure budget, and then shift \$1 billion in non-resource taxes from infrastructure spending to another line item, such as salaries of government employees.

Reporting oil and gas revenues separately within the budget would partially address this, while also increasing transparency of revenue use. However, these benefits could be lost if the rules are not situated in a broader spending strategy that directs resources to priority areas and prevents the withdrawal of non-oil and gas revenues which offsets any additional development expenditure in these areas. The spending strategy of oil and gas revenues should thus be aligned with broader strategy goals (perhaps defined by financing gaps) and tracked through the budget cycle.

The benefits of earmarking resource revenues for development expenditure could be lost if the rules are not situated in a broader spending strategy that directs resources to priority areas and prevents the withdrawal of non-oil and gas revenues from these areas.

Section 17(1)-c-i-aa also requires that the 60 percent investment spending give preference to human capital development, particularly in science and technology. Science and technology are hugely important to development and the continual expansion of the economy's potential, but the initial priority of capital spending should be to build the foundations for more effective future spending and "invest in investing," so that later spending on strategic such areas as science and technology realise larger gains.

The absorptive capacity of the broader economy was discussed on page 21 as a constraint to the effectiveness of public investment. The government can increase the economy's absorptive capacity by measures such as investing in education and infrastructure, broadening credit availability and improving the business environment by increasing the speed with which construction permits and business licenses are issued. These areas also align with several of the priorities that President Magufuli stated in his inauguration speech on 10 November 2015. The importance of developing the economy's absorptive capacity to accommodate resource revenues is discussed in Precept 10 of the Natural Resource Charter (see discussion in the annex).

The revenues that must be spent on capital investments therefore should, through regulations or guidelines, prioritise "investing in investing" and build the absorptive capacity of the government and the broader economy.

Private sector development. The original act proposed that revenues would not be used to provide credit to private sector entities, but amendments debated in parliament have since removed this restriction.¹⁷ This could be beneficial if used in the best interests of the country, that is to say directed towards potential champions that will push forward strategic priorities but that lack affordable access to credit. That would require comprehensive and well-designed guidelines on how recipients are selected and how conditionality of credit is effectively enforced, along with a strong monitoring system. Otherwise it could become a drain on resources at best, or a source of political patronage at worst.

Additionally, the provision in the amendments that 0.5 percent of GDP is to be used to promote private sector entities needs to be clarified. Is the intention for these funds to be used at a macro-level to improve the business environment, or will they be directed at the micro-level to support individual entities? Furthermore, the use of GDP carries the aforementioned volatility risks, combined with inflationary pressures if it is nominal GDP. (It is not stated whether this is 0.5 percent of nominal or real GDP.) The success of many private sector investments relies critically on multi-year financing. But if government support varies with real GDP volatility, or if it increases in inflationary periods only to be offset by higher alternative financing costs (because the central bank raises interest rates in response to higher inflation), uncertainties will be created which will make investment riskier.

The point on private sector credit above also applies here: there is a risk that this 0.5 percent of GDP allocation could be used for political patronage. Safeguards against resources being used in this way, in the form of stringent reporting requirements combined with the beneficial ownership disclosure rules outlined in the analysis of TEITA (on page 31), could help attenuate such risks.

Fund governance and transparency

The act does not make explicit that responsibility for its implementation sits with

Resource revenues that must be spent on capital investments should prioritise "investing in investing" and build the absorptive capacity of the government and the broader economy.

¹⁷ The restrictions on credit provision also extend to the government, public enterprises or any person or entity. These restrictions have so far remained.

the minister of finance. Discussions around the act imply this, but it should be set out clearly in the act. Related to this, a tension exists within the act between responsibility and authority, in that the minister must implement the advice of the Investment Advisory Board¹⁸ or refer the matter to the president for determination. But if the minister is to be held ultimately accountable for the implementation of the act, his or her obligation should be to take on board the advice of the committee but not to be bound by it. Alternatively, accountability should be explicitly transferred to the board on those occasions the board overrides the minister.

The regulations should also make clear the exact route that the oil and gas revenues destined for the fund will take. Those that are collected, but not retained, by TPDC – dividends, profit share/production share, and royalties – and the corporate income tax collected by TRA should have their paths explicitly described. Do these go first to the treasury, which then deposits them in the holding account? Or do TPDC and TRA deposit these directly?

The act includes important commitments to transparency, such as publishing the records of “oil and gas revenues and expenditure in whatever form” (§18(4)). It does not specify what should be published, however, nor when or where it should be published. Inconsistency in the timing of reports and their contents makes it difficult for accountability actors to make effective use of them. This can then undermine any benefits such transparency is intended to provide. The regulations should set out what type of information will be published and when. Table 1 below offers some recommendations in this regard. This list is not comprehensive, however, and is intended as a suggested minimum.

For greater transparency in the management of oil and gas revenues in the budget process, the regulations to this act should require that all government budget documentation include clear forecasts for oil and gas revenues and departmental plans for their use.

The Revenue Management Act includes important commitments to transparency, but does not specify what should be published, nor when or where it should be published.

18 A body formed within the law to advise on the investments strategy of the Revenue Savings Account

| Report | Contains | Timing | Location |
|---|--|---|--|
| Development plans/medium-term expenditure framework | <ul style="list-style-type: none"> Plans for the use of oil and gas revenues | To be determined | Ministry of Finance website |
| Budget | <ul style="list-style-type: none"> Fiscal rules and projected compliance Expected savings Planned spending of oil and gas revenues by ministry and project code Allocation to national oil company (NOC) | Yearly (end of year) | Ministry of Finance website |
| Budget outturn | <ul style="list-style-type: none"> Compliance with fiscal rules and compliance with spending targets Spending of oil and gas revenues | Yearly (first quarter) | Ministry of Finance website |
| Oil and Gas Fund quarterly update (all accounts in the fund) | <ul style="list-style-type: none"> Deposits Withdrawals Closing balances | Four weeks after the end of the quarter | Bank of Tanzania website and Ministry of Finance (including its website) |
| Oil and Gas Fund final report for full year (all accounts in the fund) | <ul style="list-style-type: none"> Deposits Withdrawals Closing balances | First quarter of the year | Bank of Tanzania website and Ministry of Finance (including its website) |

Table 1. Suggested reporting on revenue management execution

TPDC financing

NRGI has begun an in-depth analysis of steps that Tanzania can take to help achieve the goals that have been laid out for TPDC, including how the company is to be financed. A wide discussion of that research with key Tanzanian stakeholders is planned. Based on the initial analysis of the act, the following preliminary considerations on the act itself are offered.

In choosing an appropriate model for financing a national oil company, the government must consider both its need for control over the entity's spending of public funds and the aspirations of the NOC to attain a degree of independence and budget stability to pursue commercial interests. The provisions of this act regarding the financing of TPDC appear to reflect an attempt to strike this balance. Section 17 of the act requires TPDC to seek budget approval for:

- Recurrent expenditure, through the budget process;
- “Strategic investment” up to 0.1 percent of GDP, from the Revenue Saving Account of the fund, through the “normal budgetary process”
- “Special needs for investment,” above 0.1 percent of GDP and up to 1 percent of GDP, from the Revenue Saving Account of the fund, so long as “the request is proposed by the Minister responsible for energy and approved by the Minister for Finance before submission to the National Assembly.”

Provisions regarding the financing of TPDC appear to reflect an attempt to balance the government's need for control over the entity's spending of public funds and the aspirations of TPDC to attain a degree of independence and budget stability to pursue commercial interests.

These requirements for budget approval will help reduce the risk that TPDC becomes a state within a state, with unchecked power over national finances. But as per the discussion of the broader set of fiscal rules above, it is not clear that tying TPDC's funding to GDP will be an effective mechanism for ensuring that it receives revenue shares appropriate to its objectives or spending capacity. On the one hand, there may be a time mismatch by which the moments at which TPDC has higher investment needs do not track with GDP growth. On the other hand, higher GDP growth will increase the revenues of TPDC regardless of whether it has the capacity to spend these additional revenues effectively. The result could be wasteful spending or hoarding of cash that the government could have spent or saved more effectively in line with national priorities.

It is not clear that tying TPDC's funding to GDP will be an effective mechanism for ensuring that it receives revenue shares appropriate to its objectives or spending capacity.

NRGI has studied national oil company financing mechanisms worldwide, and has not encountered other countries that set a GDP-based peg for the company's budget. The most common arrangements can be grouped into five categories¹⁹:

- 1 All revenues to the consolidated fund (or special fund), with annual budgeting for the NOC. This is close to the system established in the act, but most countries have not required GDP-based ring-fencing as in Tanzania.
- 2 All revenues to the consolidated fund (or special fund), with multiyear budgeting for the NOC. This enables the NOC to engage in more long-term economic planning, but retains parliamentary approval of the multi-year budget.
- 3 A formula-based model, usually based on some percentage of total revenue or a particular revenue stream, with a cap and approval by parliament within the cap
- 4 A fixed formula-based model
- 5 Treatment of the NOC as the same as a private company, paying taxes and dividends to the state

In examining the options, the government should closely examine the challenges associated with the current, GDP-delineated formula. The government should also reconsider whether the allocation for TPDC should be held in the savings account, as the demand for financing TPDC investments could put the other objectives of the savings account (savings and expenditure stability) at risk.

Rather than allocating funds from the savings account, a multi-year budget agreement for TPDC could be developed, as discussed above. This would ensure that allocations are held to the same levels of scrutiny as other budget allocations but also give confidence to TPDC in its share of retained earnings for planning and investment. Precept 6 of the Natural Resource Charter discusses financing options for state-owned companies (see discussion in the annex) and NRGI's publication *Reforming Oil Companies: Nine Recommendations*²⁰ offers some guidance that will be useful for assessing TPDC's financing options. The results of the more detailed analysis of TPDC's financing needs and the possible rules that could help meet those needs without putting the state's other goals unduly at risk will build on this guidance.

19 For a more detailed discussion, see Thomas Lassourd, *Financing Options for the Ugandan National Oil Company*, Natural Resource Governance Institute, September 2015, http://www.resourcegovernance.org/sites/default/files/documents/nrgi_financing-options-noc.pdf.

20 See <http://www.resourcegovernance.org/analysis-tools/publications/reforming-national-oil-companies-nine-recommendations>

There are a number of revenue streams that are not subject to budget approval. Signature and production bonuses, acreage rentals and training and research fees can be spent by TPDC outside of the ordinary processes of the national budget, “under normal supervision of the Treasury Registrar.” The signature and production bonuses in particular have the potential to be quite large. The system, in fact, creates incentives for TPDC to push for them to be as large as possible, and TPDC’s commercial interest will not always necessarily align with national interests.

These bonuses should therefore either be aligned with the treatment of other oil and gas revenues, or appropriate oversight mechanisms for the collection and spending of these funds should be established to ensure that TPDC’s use of these bonuses is aligned with national objectives and achieves the stated aim that they shall be used for “enhancing development of the oil and gas subsector” (section 6(3)). These revenue flows should be tracked closely in TPDC’s budget.

Finally, if TPDC is to be financed from earmarked funds in the savings account, the regulations should clarify a number of aspects of this financing mechanism. Clear definitions of “strategic investment” (section 17(e)(iii)), “normal budgetary process” (section 17(e)(iii)) and “special needs for investment” (section 17(e)(iii)(bb)) would help reduce the risks of uncertainty or excess discretion in the distribution of funds. Regulations should also provide clarity on what happens to any unused portion of the 0.1 percent of GDP to be set aside for TPDC each year, i.e., whether it is held for future use.

III. TANZANIA EXTRACTIVE INDUSTRIES (TRANSPARENCY AND ACCOUNTABILITY) ACT, 2015

Key goals and provisions of the act

The stated aim of the act is “to provide for establishment of the Extractive Industries (Transparency and Accountability) Committee for purposes of ensuring transparency and accountability in extractive industries and to provide for other related matters.”

Creation of the EITA Committee

The TEITA Act establishes the EITA Committee as an independent government entity legally mandated to be an oversight body for promoting and enhancing transparency and accountability in the extractive industries, and responsible for ensuring that benefits of extractive industry are verified, duly accounted for and prudently utilised for the benefit of the citizens of Tanzania. The committee serves as the multi-stakeholder group of TEITI and has the same membership structure: a chairman, five government officials and five representatives each from companies and civil society organisations (CSOs). The bulk of the act deals with the structure, membership and nomination procedures of the committee, and its powers to require information to be published. This briefing will not focus on such procedural or membership matters, other than to recommend that there are certain instances where the act lacks clarity around multi-stakeholder group governance and representative selection. For example, clarity is not provided on who constitutes the “umbrella organizations” that will develop the procedure for selecting companies and CSO representatives (section II(5)(4)). It is also silent on the timeline for appointing a new Chairman and committee members after the previous committee’s term has ended. Thus the regulations should ensure alignment with international best practice on multi-stakeholder governance.

The TEITA Act establishes the EITA Committee as an independent government entity legally mandated to be an oversight body for promoting and enhancing transparency and accountability in the extractive industries.

The roles of the committee include, among others, developing a transparency framework that requires government agencies and companies to publicly disclose information regarding extractives operations, including revenues, costs and production volumes. The committee is also tasked with promoting citizen participation in and awareness of the sector, investigating discrepancies between government and company disclosures, and undertaking measures to enhance the capacity of any relevant organ of the Government or local government authority.

The committee is also responsible for ensuring the Minister of Energy and Minerals publishes such items as names of those who hold interests in the extractive sector companies, and implementation of environmental management plans.

The act also requires the minister is also required to report to parliament annually its implementation.

Summary of key recommendations

Scope of disclosure

- To reach the act's stated objectives, and in order to meet requirements like those in the EITI Standard, the regulations should specify a broader range of required public disclosures. The disclosures specified in the regulations should include state-owned enterprise (SOE) disclosures, subnational-level information, bidding documentation, and project-level reporting by all entities.
- The regulations should also provide more specificity and clarity on implementing disclosures already specified in the TEITA Act, such as environmental impact statements and environmental reporting, and local content plans and reports.

To reach the TEITA Act's stated objectives, and in order to meet requirements like those in the EITI Standard, the regulations should specify a broader range of required public disclosures.

Beneficial ownership

- The regulations should interpret the reference in section III(16)(1)(b) of the act regarding individuals "who own interests in the extractive industry companies" to be a reference to beneficial owners – the natural person(s) who, directly or indirectly, own, control or economically benefit from a company.
- In addition to requiring the disclosure of such individuals' names, the regulations should mandate the disclosure of additional information by which they can be clearly identified.
- Regulations should require companies that bid for, operate, or invest in extractive assets to disclose their beneficial ownership information, as well as that of their subcontractors.

Contract disclosure

- The contract transparency provision in section III(16)(1)(a) of the act is commendable. In implementing it, regulations should specify the parameters for disclosure, including required disclosure of full texts, amendments and annexes; allocation of agency roles in assembling documents; and establishing open data criteria to maximise public access.
- Restrictions related to confidentiality that reduce contract transparency should be interpreted narrowly in the regulations, as a broad application of confidentiality provisions would undermine the full impact of the contract disclosure provision.

Open data and timeliness

- The regulations should specify that data should be published in a timely fashion – ideally, as near to real-time disclosure as possible – and in an open data format that promotes the broadest possible access and usability.

Governance impacts and mainstreaming

- The regulations should provide specificity on processes to enable the committee to make recommendations for improving sector governance, as well as on ministerial follow-up.

Analysis

Scope of disclosure should be broadened in line with the EITI Standard.

In general, the TEITA Act provides detailed requirements primarily regarding revenue disclosures at the national level from private companies. However, to reach the act's stated objective of improving transparency and accountability across Tanzania's extractive sector, and in order to meet requirements like those in the EITI Standard, the regulations should specify a much broader range of required public disclosures. The broader disclosures specified in the regulations should include state-owned enterprise (SOE) disclosures, subnational-level information, bidding documentation, and project-level reporting by all entities.

Allowing for these broader level disclosures through regulations could be achieved via interpretation of section II(10)(1) as being related to the committee's responsibility "for ensuring that benefits of extractive industry are verified, duly accounted for and prudently utilised for the benefit of the citizens of Tanzania." The definition of "statutory recipient" should be interpreted in the regulations to include SOEs and local government entities. The definition of "extractive industry company" should be interpreted in the regulations to include companies in the exploration phase. The regulations should require publication of extractive sector bidding documentation, including pre-qualification criteria, a list of pre-qualified companies, bidding criteria, list of bidders, the winning bid and a bid evaluation report justifying the winning bid based on the criteria.

The regulations should require reporting to be at project level, consistent with the "project" definition of a major market mandatory disclosure rule like Rule 13q-1 in Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Article 41(4) of the European Union Accounting Directive, or the Canadian Extractive Sector Transparency Measures Act.

In addition to such disclosures, the regulations should also provide more specificity and clarity on implementing disclosures already specified in the TEITA Act, such as environmental impact statements and environmental reporting, and local content plans and reports.

There is a broader scope of disclosure required under the TEITA Act than required by the Petroleum Act, as discussed on page 7. The regulations to both acts should therefore uphold the transparency principles of the TEITA Act. As noted above, it is recommended that the Petroleum Act regulations include a statement cross-referencing the disclosure requirements outlined in the TEITA Act and its regulations. Likewise, any processes outlined in the Petroleum Act, but not specifically covered by the TEITA Act or its regulations, should still be subject to the same disclosure standards.

Regulations should provide more specificity and clarity on implementing disclosures specified in the TEITA Act.

Beneficial ownership

True beneficial owners are often hidden behind chains of corporate entities, and opacity can obscure conflicts of interest, allowing fraud, corruption, money laundering and tax evasion to occur. The act takes an important step in requiring disclosure of the owners of extractive industry companies, joining a growing number of countries worldwide that are committing to transparency in beneficial ownership. In establishing how this commitment is to be operationalised in regulations, the government should address a number of important details.²¹

The regulations should interpret the reference in section III(16)(1)(b) of the act regarding individuals “who own interests in the extractive industry companies” to be a reference to beneficial owners – the natural person(s) who, directly or indirectly, own, control or economically benefit from a company.

The term ‘beneficial owner’ has already been defined by the Financial Intelligence Unit of Tanzania in its anti-money laundering guidelines for the banking sector.²² Drawing on this existing definition makes sense, though some modifications are necessary to make the definition applicable to the extractive sector rather than the banking sector (e.g., omitting banking-related terms such as ‘customer’ and ‘transaction’). The below definition, which should be considered for the regulations, closely follows this existing definition:

‘Beneficial owner’ means the natural person who – directly or indirectly – makes final decisions regarding an extractive industry company, ultimately controls an extractive industry company, on whose behalf an extractive industry company is being conducted, or who receives substantial economic benefit from a company. This includes the person who exercises ultimate effective control over a body corporate or unincorporated.

Names alone provide little information. In addition to requiring the disclosure of individual’s names, as specified in the act, the regulations should mandate the public disclosure of beneficial owners’:

- Alternative names (if any)
- Name and role of any politically-exposed person who is a beneficial owner, regardless of size of the interest
- Identifying details including date of birth, nationality, and national identity number
- Brief description of the means of ownership or control
- Signed statement of accuracy from the company
- Information on the corporate family (e.g., names of companies that are parents, subsidiaries, related parties, etc.)
- Timely updates when beneficial ownership changes

Regulations should require companies that bid for, operate, or invest in extractive assets in Tanzania to publicly disclose their beneficial ownership information, as well as subcontractors.

The TEITA Act takes an important step in requiring disclosure of the owners of extractive industry companies, but the government should address a number of important details when establishing how this commitment is to be operationalised.

21 See NRG’s publication on disclosing beneficial ownership information: <http://www.resourcegovernance.org/analysis-tools/publications/owning-options-disclosing-identities-beneficial-owners-extractive>

22 Available at <http://www.fiu.go.tz/GuidelinesToCIS.pdf>

Support from organisations like NREGI and others is available to help Tanzania pursue beneficial ownership disclosures.

Contract disclosure

The contract transparency provision in section III(16)(1)(a) of the act is commendable. In implementing this provision, the regulations should specify the processes and parameters by which disclosure will take place, including a broad scope of required disclosure; allocation of appropriate agency roles in assembling and verifying documents; and establishing open data technical criteria and open license details to maximise public access, education, and outreach. The regulations should specify full text disclosure of any state-investor contracts that detail how resource assets will be developed. This should include any addendums, amendments, annexes, or riders that are related to these agreements. Disclosure should include all existing contracts as well as future contracts.

Regulations should specify the processes and parameters by which contract disclosure will take place.

Importantly, restrictions relating to confidentiality under section 27.2 must be further outlined. These should not be defined so broadly as to undermine the intended objectives and provisions of the requirement. They should also make explicit that confidentiality restrictions should only apply to existing contracts, while future contracts should be written in such a way that they do not contain confidential information.

The government may need to conduct a review of existing contracts to determine whether they contain confidentiality clauses that explicitly preclude the publication of the contract/license itself. If confidentiality clauses are present, the government must determine whether: (a) parties are able to share contracts by mutual consent (in such a situation the TEITA Committee may use the EITI process to secure the consent of contracting parties), (b) parties may have to modify some contracts to allow for disclosure by a standard-form amendment, or (c) government can require transparency by law.

Regarding a process for assembling and verifying documents, the government may want to develop a process by which signatories and parties have opportunities to review and validate the authenticity of documents. Given its multi-stakeholder composition, the TEITA committee would be well placed to carry out this role, providing a forum where parties to the contracts can agree that the correct and complete documents have been collected.

The modes of public access should be clearly defined. Best practice is to publish contracts online using a web portal that is free of charge and without a registration requirement or other technological barriers. Importantly, contracts should be published in an open data format rather than 'locked' PDF documents. This enables users to search for terms within contracts and allows the possibility of adding annotations to the versions they themselves download,²³ which make contracts easier to understand and reduces the potential for misinterpretation. ResourceContracts.org is a global contract repository that uses the Open Contracting Data Standard and can be adapted for a national contract repository.²⁴

23 This does not amend the original document that the public accesses, nor does it enable falsification or manipulation of public data. This format allows a user to use the copy of the data they have obtained in a flexible manner without altering the original.

24 NREGI has worked with other countries to provide technical assistance on setting up country contracts databases and would be pleased to work with Tanzania to assist with developing a contracts database.

As with all transparency initiatives, the disclosure of contracts and licenses should not represent the end point of a country's efforts. Public communication is critical if a country is to derive the maximum governance benefits from disclosure. Contracts and licenses are frequently subject to widespread misunderstanding, and the combination of disclosure of the documents and an effective commitment to public education opens up tremendous opportunities for greater trust and stronger oversight. Use of information tools such as contract summaries and annotations (potentially using ResourceContracts.org) can help citizens engage with contracts and their contents, as can training and public outreach on contracts, especially in communities affected by extraction.²⁵

Open data and timeliness

In order to be most useful, information needs to be published in a timely fashion and be in an open data format. Publishing in a timely fashion is important because delays can prevent stakeholders from utilising the information prior to key discussions or debates pertaining to policy matters, thus undermining the ability of stakeholders to meaningfully engage in the dialogue shaping the country's laws and policies.

It is therefore critical that regulations to the TEITA act include a provision requiring all information disclosed pursuant to be done so in timely fashion and in an open data format, such as:

“publicly disclose in hard copy and in open data format as soon as may be practicable and not later than twelve months after the close of the financial year covered in the disclosure, all reports, reconciliations, discrepancies, investigations, accounts, data or other information produced, collected or disclosed by the Committee, by any extractive industry company or by any statutory recipient pursuant to sections 10, 14, 15, 16, 17 or 18;”

A suggested definition of “open data format” is: “open data format” means in a format that is machine-readable, interoperable, non-proprietary, easily accessible, and free of charge.

Since bidding process, contract, beneficial owner and environmental disclosures are not dependent on the end of the financial year, these disclosures should be made as soon as practicable, and on a shorter upper limit than the 12 months stated above. The regulations should also define open data format.

Governance impacts and mainstreaming

The act requires that the minister present a report on the implementation of the activities under this act to the national assembly on an annual basis (19). For this report to have the maximum impact, it should contain an objective and rigorous assessment by the committee of whether implementation of this act is having a real and positive impact on natural resource governance. Otherwise, there is a risk that such a report could become a mere box-ticking exercise. This is why such an assessment is required by the EITI standard. The regulations to this act should similarly specify this level of reporting in order to make this function a meaningful one.

It is critical that regulations to the TEITA Act include a provision requiring all information disclosed pursuant to be done so in timely fashion and in an open data format.

25 See NRG's publication on the steps to disclosing contracts: <http://www.resourcegovernance.org/analysis-tools/publications/five-steps-disclosing-contracts-and-licenses-eiti>

It follows from reporting on real impacts on sector governance that there should be recommendations on how these could be improved. For these recommendations to hold weight, they need ministerial authority. Therefore, the regulations should specify a particular role for the committee to make recommendations for improving sector transparency and governance in its annual report. This easily falls under section 10(1) in that it enables the committee to determine continuous improvements to its ability to meet this responsibility and under section 10(3) in that it allows better governance of extractive industry companies.

The regulations should also specify the procedures by which such recommendations are made and the obligation for the minister to follow up on them: practical protocols and timelines of response.

The regulations should detail the measures by which mandatory disclosures are mainstreamed into government and company systems. That is, the ways that these requirements become an integral and non-discretionary part of the everyday operations of government entities and companies. The particular protocols for how the minister should mandate this mainstreaming should be explained in the regulations.

Regulations should detail the measures by which mandatory disclosures are mainstreamed into government and company systems.

CONCLUSION

This analysis has considered the three pieces of legislation passed by the Tanzanian parliament in July 2015: the Petroleum Act, the Oil and Gas Revenues Management Act, and the Tanzania Extractive Industries (Transparency and Accountability) Act. It has commended the government of Tanzania for this positive step and praised several of the provisions of the acts, such as those that provide transparency to the oil and gas sector and establish strong regulatory principles. This analysis also made recommendations on the best ways that the provisions of these acts could be implemented through drafting appropriate regulations. The analysis pertaining to the Revenue Management Act additionally recommended that certain amendments be considered if the law is to achieve its stated objectives. It also recommended a review of certain parts of the Petroleum Act that relate to local content, in order to achieve consistency with the Local Content Policy.

ANNEX. NATURAL RESOURCE CHARTER DECISION CHAIN

The charter is a framework that breaks down the sets of decisions that countries must make as they seek to convert their natural resources into development outcomes. It is therefore a useful resource for understanding how the provisions analysed in this paper fit into a broader governance system.

Each set of decisions covered by the charter relates to a specific area of policy decisions and is termed a *precept*. Examples of successful governance and management of resources from around the world have underpinned the principles that these precepts are built upon.

Precept 1 discusses the need for an inclusive and comprehensive national strategy, clear legal framework and competent institutions, as well as the need for an appropriate legal and institutional framework.

Precept 2 reviews the need for those making decisions on the governance and operations of the extractive sector to be accountable to the public, to ensure that they work in its best interests. This requires transparency and availability of relevant information, effective official oversight and an informed public.

Precept 3 covers exploration, production operations and rights allocations. It details the importance of having access to more and better quality geological information, choosing companies based on their competencies and ensuring that development plans reflect local and national priorities.

Precept 4 discusses tax regimes and contractual terms. It considers accountability issues as well as how governments can structure taxation optimally.

Precept 5 covers the impact of extraction on local communities, discussing compensation mechanisms, ways to identify and manage environmental and social risks, and how to ensure local benefits. This precept also considers how to manage small-scale and artisanal mining equitably in a way that respects local and national priorities.

Precept 6 discusses state-owned extractive companies and the importance of them having clearly defined roles, appropriate financing models and the need for them to be transparent, subject to effective oversight and free from excessive political control.

Precept 7 covers revenue distribution and saving, considering how to balance consumption and investment, and the distribution of revenues regionally and sub-nationally.

Precept 8 discusses the importance of stabilising expenditure in the face of fluctuating revenues from the extractive sector.

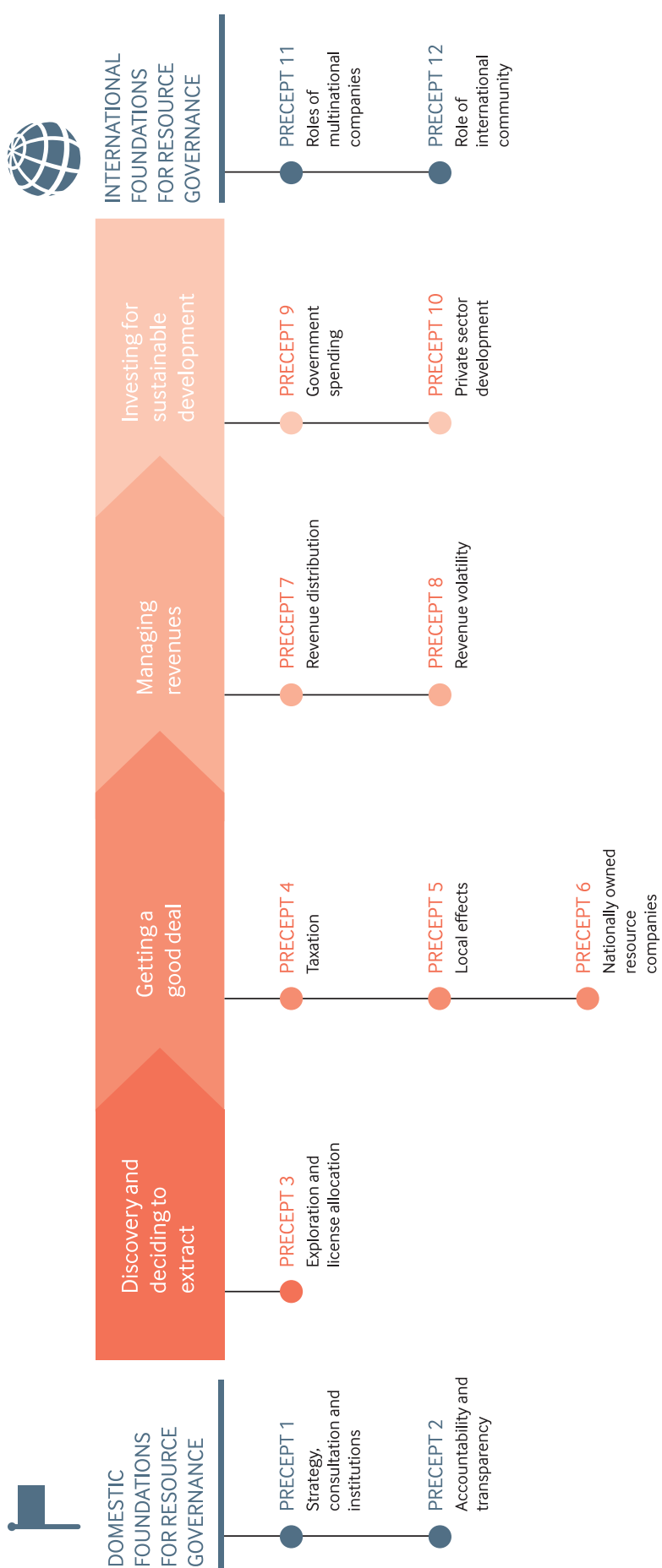
Precept 9 reviews the importance of using extractive sector revenues to enhance public spending capacity so that future spending can be more efficient.

Precept 10 discusses facilitating private sector investments to diversify the economy. This includes managing Dutch Disease pressures, developing infrastructure, enhancing local content in the extractive sector and ensuring efficient domestic supply of the commodity the extractive sector produces.

Precepts 11 and 12 are less in the control of the individual country but are nonetheless important for good governance of extractive sectors. They relate to international aspects of governance. **Precept 11** advocates that companies should commit to the highest environmental, social and human rights standards, and sustainable development while **Precept 12** advocates that governments and international organisations should advance global norms to support country-level efforts to benefit from resource extraction.

A schematic of the decision chain is shown on page 38. A full copy of the Natural Resource Charter can be downloaded from <http://www.resourcegovernance.org/issues/natural-resource-charter>

The Natural Resource Charter Decision Chain



GLOSSARY AND ACRONYMS

Absorptive capacity

The ability of the economy to respond to investments productively rather than with higher inflation or increased imports

Committee/EITA committee

The TEITA Committee, established under the TEITA act

DMO

Domestic market obligation. The requirement (usually legally mandated), that extractive sector firms sell some of their output to the host country, rather than exporting all of it.

Dutch disease

The tendency of a booming resource sector to cause an appreciating exchange rate and higher domestic inflation

EITI

Extractive Industries Transparency Initiative

EWURA

Energy and Water Utilities Regulatory Authority, the regulator of mid- and downstream activities

GDP

Gross domestic product

IOC

International oil company

LNG

Liquefied natural gas. The form into which natural gas must be processed for export by rail, road or sea.

MSG

Multi-stakeholder group, the body overseeing EITI activities. This can refer to the international EITI MSG or the MSG at the country level.

NOC

National oil company

NPGIS

National Petroleum and Gas Information System

Oil and Gas Fund

The fund established by the Revenue Management Act.

Petroleum Act

The Petroleum Act, 2015

PSA

Production sharing agreement, the contract between Tanzania's national oil company, TPDC, and a private petroleum company. The contract contains the cost gas limits and the other terms that dictate how benefits will be shared between the state and the private company.

PURA

Petroleum Upstream Regulatory Authority. The regulator of the upstream part of the oil and gas sector.

Revenue Management Act

The Oil and Gas Revenue Management Act, 2015

TEITA Act

The Tanzania Extractive Industries (Transparency and Accountability) Act, 2015

TPDC

Tanzania Petroleum Development Corporation

The Natural Resource Governance Institute, an independent, non-profit organization, helps people to realize the benefits of their countries' oil, gas and mineral wealth through applied research, and innovative approaches to capacity development, technical advice and advocacy.
Learn more at www.resourcegovernance.org



Oil, gas and mining for development