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Columbia University Advisory Group to the President of Sao Tome and Principe

Proposal for an Oil Revenue Management Law for Sao Tome and Principe:

Explanatory Notes

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Abstract

This note contains explanations of most of the elements in the Columbia group's draft proposal for Sao Tome and Principe's oil revenue management law. It follows the law draft title by title and gives an account of the group's thinking behind the provisions included in that draft as well as the specific solutions and language we have chosen, focusing especially on the principles the text was designed to implement. The team is willing to provide any further explanation that may be required.

TITLE I, ARTICLE 1.V
DEFINITION OF OIL REVENUES

For the purposes of the law, oil revenue is defined very broadly. There is no distinction within the law between different types of oil revenues and all elements of the law apply equally to all revenues from different sources. This stands in contrast, for example, with Chad's revenue management law, which distinguishes between direct and indirect revenues, with the latter not subject to the expenditure or oversight provisions of the law.

TITLE II
THE NATIONAL OIL ACCOUNT

The National Oil Account (NOA) is one of the main instruments for achieving effective and transparent governance of oil revenues. It provides a single destination for the payment of oil revenues, making it easier to monitor the transactions relating to the country's oil wealth and making it easier to put controls on how the account's funds can be invested, withdrawn and used.

The functions of the National Oil Account are to ensure:

- **transparency** of oil revenue management
- the **stability and sustainability** of oil-financed public spending
- **accountability** of those making decisions about oil revenue allocation, and
- **insulation from pressures** to overspend for political reasons

Title II of the Model Oil Revenue Management Law tries to ensure these functions through the following provisions:

1 The account is to held at an international bank (Article 4)

It is crucial in order for the NOA to be an effective instrument that it be isolated from Sao Tome and Principe's domestic economy and from short term pressures of domestic politics. A locally based bank is much more susceptible to undue pressure to finance excessive spending or to undertake non-transparent transactions than a well-established foreign bank, which, as long as its transactions with Sao Tome and Principe must be carried out in a transparent manner, has strong reputational incentives not to circumvent the rules. Similarly, the fate of a domestic bank could also be threatened by radical political changes in Sao Tome, whereas the fate of an international bank will be independent of such events. A second motivation for placing the account with an international bank is that the expertise required for effective and transparent management of the National Oil Account as provided is still weak in Sao Tome and Principe.

2 A single destination for all oil revenue payments. (Article 5)

Many oil-exporting developing countries have had problems with corruption. This has often been facilitated by a lack of transparency regarding how much oil companies are paying to government officials. To minimize the risks of non-transparency in Sao Tome and Principe,

the law requires all oil-related payments due to Sao Tome and Principe to be paid directly into the National Oil Account, and for the payments to be made public. This conforms with Sao Tome and Principe's commitment to abiding by the principles of the Extractive Industries Transparency Initiative.

3 Provisions for Prudent and non-politicized investment of NOA assets

(Article 6) Oil revenues are highly volatile while they last, and they last only for a limited amount of time. Sao Tome and Principe has the added challenge of receiving signature bonuses early in the process, after which there will be a number of years in which no oil money will be paid. The National Oil Account therefore has the function of storing excess revenues and stabilizing the country budget in the short to medium run, and of building up financial wealth that can be a permanent source of revenues in the long run.

The law attempts to secure prudent management in two ways. In the first period, the law specifically enumerates the only financial asset classes in which the funds may be invested. This limits National Oil Account assets to be placed in very low-risk securities. We believe such an explicit enumeration is most suited to safeguarding the signature bonuses so that they can last until regular oil revenues start flowing. By that point, the law calls for an investment committee to have been set up to govern the portfolio compositions of the permanent reserve of the National Oil Account (see below) and of the assets remaining in the National Oil Account for transfer to the national budget. The law charges the investment committee with choosing the investment policy that best fulfils the objectives of these two portfolios, in accordance with the "prudent investor" rule. The investment policy will guide the investment manager's choice of securities.

4 Transparency

To ensure maximal transparency, accountability and predictability in the disposition of National Oil Account assets, paragraphs 6.9, 6.10, and 6.11 assign duties of reporting regarding the NOA. The Central Bank is charged with reporting to the National Assembly the balance in the National Oil Account. Indeed, under Article 18 of the proposal, the holdings of the national account are public information, with on-line postings of balances updated at least monthly.

Finally, the National Petroleum Agency is required to make public its forecasts of the next two years' expected payments into the NOA. The Central Bank shall use these forecasts to forecast the Account balance two years ahead of time, and it makes these forecasts public along with details of the investment policy and the investment performance of the Account.

5 No Domestic Investment

If the financial assets to be held in the account are invested domestically, that will undermine the role of the budget process as being the unique vehicle for government planning and expenditure. This will reduce transparency, and make it harder to avoid investments being made to favor private interests. It is also likely to generate lower returns on assets given the limited opportunities for productive financial investments in Sao Tome and Principe. Article 6.6 therefore prohibits the NOA assets from being invested in Sao Tome and Principe or in companies controlled by Sao Tome and Principe nationals.

6 Transfers from the Account go to a single Treasury account. (Article 7)

The law provides that the only withdrawals of funds out of the NOA (except for custodial fees) shall be transfers to the government budget and hence shall appear as financing in the national budget (see the Annual Funding Amount below). This is for several reasons. One reason is that the unity of the government budget is important for the efficient governance of public finances. A second reason is that transparency requires that monitoring the flow of funds be as simple as possible. This is easiest if there is only a single recipient for the transfers. Allowing any off-budget spending weakens the protection against fraudulent or wasteful use of public funds, whereas requiring all funding to pass through the budget facilitates oversight.

6 Limitations on who can authorize transfers from the Account (Article 7)

The law provides a mechanism for protecting the Ministry of Planning and Finance from the inevitable pressures to spend oil money on ill-conceived and wasteful projects and for ensuring that no single individual is capable of accessing oil funds. It is a common experience for oil producers to use oil revenues unproductively. Even when the officials with budgeting and spending authority are aware of the dangers in spending too much too soon, it has proved near impossible to escape political demands for more spending. To make it easier for future Ministers of Finance to resist such pressures, the law requires that for any transfer to take place from the NOA to the general budget, the transfer request must also be signed by the President of the Republic and the Governor of the Central Bank. This will also minimize any risk that potential ill-intentioned public officials in the future may want to engage in corrupt transactions with the country's wealth.

7 No liens or encumbrances (Article 8)

To protect sound financial management, transparency, and economic stability, the law prohibits any legal commitment of NOA funds or current or future oil resources to future uses. Governments that are allowed borrow against future oil can be tempted to enter into unfavorable deals, since they would receive the benefit today but Sao Tome and Principe's side of the agreement would only have to be fulfilled by future governments. Similarly, lenders have incentives to provide loans that are backed by oil revenues even if these loans are unlikely to be put to productive use. In fact, this is a pattern observed in many oil-exporting countries: Oil booms tend to set off borrowing and spending binges, to such an extent that when oil prices fall and the boom ends, the country is saddled with *more* debt than before, and having to make very painful adjustments to spending. To avoid such outcomes, the law bans any legal liens or encumbrances on oil-related funds

We have included in paragraph 8.3 a prohibition on public borrowing during the period of oil production. The discussion of prohibiting liens and encumbrances above suggest that public borrowing could become a way of circumventing the limits this law establishes on how much of the oil money can be spent in a given year (see below). A government that wants to spend more than the permitted amount could engage in deficit spending, thus accumulating public debt and creating problems in the future.

There may nevertheless be an economic rationale for borrowing funds in the period before oil production starts, especially if the first signature bonuses are small. There is an urgent need for immediate spending on development priorities, which is compounded by the political frustration that will keep growing until promised oil revenues materialize in ways

that visibly benefit the population. It is very unlikely, however, that there will be any genuine economic need for borrowed funds once regular oil revenues reach a certain level, since if there is commercially exploitable oil, the revenues from such exploitation will be much larger than what Sao Tome and Principe can usefully invest domestically in the short term.¹

TITLE III EXPENDITURE OF NATIONAL OIL ACCOUNT FUNDS

As explained above, transparent and efficient public management demands that all public spending be channelled through the general government budget. To facilitate this, the only legal transfer of funds out of the NOA (except the payment of custodial fees) is a yearly transfer to the budget: **The Annual Funding Amount (AFA)**. Thus the law protects the general budget process and the prerogative of the Ministry of Planning and Finance to plan and manage public spending, subject to the approval of the National Assembly (Article 9). The experience of oil-exporting developing countries shows how difficult it is to spend public money rationally during an oil boom, and makes a strong case that the future success of Sao Tome and Principe depends on making certain commitments in the pre-oil period to how the future oil revenues will be managed and employed. Title III of the law achieves this by imposing three kinds of constraints on the magnitude of the Annual Funding Amount. The law includes three kinds of constraint: On the magnitude and stability of the AFA, on the distribution of parts of the AFA to the Autonomous Regional Government of Principe (and potentially to individuals), and on the nature of the expenditures of the AFA by the central government.

1. Magnitude of the AFA (Articles 10 and 11)

Most oil-exporting developing countries have had too little control on how much oil money was spent during oil booms, and as a result have suffered the economic problem of “Dutch Disease”, as well as problems of wasteful and corrupt spending. A necessary condition for minimizing these dangers is to establish constraints on how much oil-financed public spending can be carried out every year. For Sao Tome and Principe, the situation looks very different in the short run and in the long run. In the immediate future, the country’s only income from oil will be the signature bonuses to be paid to the JDA some time in 2004. Once oil production starts in the Joint Development Zone (and at some point, in Sao Tome

¹ We understand that under current law, the government of Sao Tome and Principe may not borrow more than 7% of GDP per year. If one can be sure that that limit is enforced, there is no need for a similar prohibition in this law. However, if the limit on borrowing is liable to being changed when the pressure for excessive spending grows with the advent of oil revenues — and the experience of other countries shows that general restraints on prudent budgeting are commonly removed once an oil boom is underway — then it is desirable to include an explicit ban on public borrowing (above a limit consistent with already existing law; or existing law could be modified to ban any increase in debt). This assumes that this oil revenue management law will take on a stature that makes it more likely to be retained or enforced than other laws on budgeting (we suggest below that it could be given the status of a constitutional amendment).

and Principe's Exclusive Economic Zone) yearly revenues will for some time vastly exceed the amount that the government can immediately put to good use. The law therefore provides two sets of conditions, one for each of these situations.

Before the start of oil production (article 10.2):

In the period before oil production starts, the signature bonuses should be spread out over the time remaining until oil production starts. The length of time involved is impossible to know with certainty. The Model Law assumes five years between signature bonuses and revenues from production, leading to an average spending rate of 20% of the initial amount per year. This calculation may need to be modified either if new signature bonuses (for other fields) are paid before the start of production on the first field, or if the field operators declare a commercially viable discovery and present a specific timetable for the start of production (or they may declare the field empty). In the former case, the spending ceiling should be adjusted up so that the newly available bonuses can also be spread over a five-year period. In the latter case, spending should be spread over the actual number years remaining before oil production is scheduled to start.

After the commencement of oil production

A goal of the oil law should be to promote a stable annual level of budgetary expenditures per person from oil earnings. The amount allocated each year to annual expenditure should allow Sao Tome and Principe to make capital investments in early years of oil production without waiting until a permanent fund is established. It should also ensure, insofar as possible, that expenditure is smooth and sustained from year to year. Finally, it must be consistent with actual revenues.

Subject to certain limitations, this can be achieved by permitting budgetary expenditures each year equal to the expected return on the remaining value of Sao Tome and Principe's oil reserves plus the expected return on amounts accumulated from prior earnings, the Permanent Reserve. As oil reserves are produced and hence the value of the remaining reserves goes down, the Permanent Reserve will be built up. The increased return from the Permanent Reserve will thus offset the declining return from oil reserves so that there can be a stable injection of funds into the budget.

The process would work as follows:

By 30 June of each year, the National Petroleum Agency will have the responsibility for calculating the "Expected Present Value of Future Oil Earnings." (Article 11) This calculation shall be verified by the Petroleum Oversight Committee (see "Public Oversight" below). The calculations will be made as follows. The National Petroleum Agency will determine an expected average US\$ price of oil per barrel that will apply for the calculations. This expected average price will be based on technical consultations with the World Bank, IMF, oil industry partners, and other experts. In no case will the expected average price exceed the average level of historical prices during the preceding [five] years.

Assuming that the fixed expected average price will apply for *all future years*, the committee will calculate the expected flow of oil income into the National Oil Account each year in the future, based exclusively on *existing* production facilities in already developed blocks, and not on expectations of the development of future blocks. The Expected Present Value of

Future Oil Earnings is then estimated at the end of each year by taking the sum of earnings in that year (that is, from 1 July of the previous year, to the 30 June of the year in question) plus the expected revenue of all future years, with all future earnings discounted by the Long Term Real Rate of Return.²

Each year the Government would include in the National Budget proposal an Annual Funding Amount to be drawn from the National Oil Account. This funding amount shall not exceed the sum of (i) an amount to be taken from the Permanent Reserve equal to the imputed return on the Permanent Reserve and (ii) an amount to be taken from current oil revenue up to the imputed return on the Expected Present Value of Future Oil Earnings, in both cases the imputed return would be calculated using the Population Adjusted Long Term Real Rate of Return (see “Saving” below).

The limit given by the Expected Present Value of Future Oil Earnings is such that the government can smooth expenditure over time. This accomplishes three things. First it means that, if estimations of future oil earnings are correct on average, then the expenditure level may be sustained in all subsequent years including the period after oil resources have been exhausted. This takes adequate account of the interests of future generations. At the same time, however, insofar as sufficient funds are available, Sao Tome and Principe can begin making current expenditures at the same level as expected future expenditures even in the early stages of oil production. Present expenditure is not kept back to wait for the build up of the permanent fund. Rather funds can be put to work immediately in order to meet the development needs of Sao Tome and Principe. A Permanent Fund will be built up but at a slower rate in order to accommodate a higher level of current spending. Finally, except in early years if there are large revisions of the expected future oil price, the fact that the Annual Funding Amount is constant from year to year (in real terms) automatically shields the budget from being destabilised by short-term fluctuations in the current oil price.

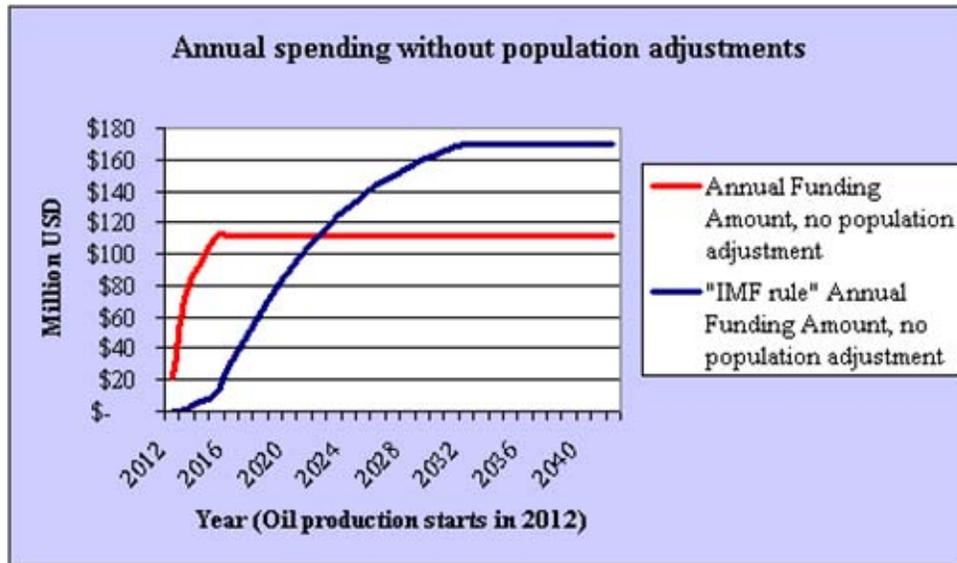
The following is a simple illustration of the proposed rule for spending oil revenues. The charts below compare the rule with a more conservative rule—referred to informally as the IMF rule in Sao Tome—of placing *all* oil revenues into a Permanent Fund and only spending the returns on the assets in the Fund. The example assumes reserves of 500 million barrels of oil extracted over 20 years (2012-2031). The oil revenues are derived assuming an oil price of 20 US dollars per barrel, a typical time profile of production, and the Joint Development Authority’s Model Production Sharing Contract and Tax Regulations. The real rate of return is assumed to be 6%, although the comparison is not affected with somewhat lower returns. More details can be found in the Columbia team’s projections of oil revenues for Sao Tome and Principe under different scenarios.³ For the sake of simplicity this illustration ignores population growth adjustments. (As explained below, the non-adjusted rate maintains a constant *total* Annual Funding Amount, while the adjusted rate maintains a

² Mathematically, if in year t , the expected revenue to be earned in year s is given by $E_t(R_s)$, and we use r_t to denote the Long Term Real Rate of Return, as estimated in year t , then the Expected Present

Value of Future Oil Earnings (EPV) in year t is given by $EPV_t := \sum_{s=0}^{\infty} \frac{E_t(R_{t+s})}{(1+r_t)^s}$.

³ See http://www.earthinstitute.columbia.edu/cgsd/STP/index_oillaw.htm

constant *per capita* Annual Funding Amount, which would show an increasing total Amount in the chart below.)



The difference between the two rules is that the more conservative rule delays spending. The less conservative rule starts using oil revenues immediately and arrives at the constant level within a few years. The more conservative rule, in contrast, spends almost nothing at all in the beginning, and awaits the accumulation of assets in the Permanent Fund to increase spending. The more conservative rule spends less for about ten years after oil production starts (2022), when it bypasses the constant spending level of the less conservative rule.

2 Saving and the Permanent Reserve. (Article 16)

The Permanent Reserve is a sub-account of the National Oil Account which is designed to convert the oil assets into permanent financial wealth. This will make Sao Tome and Principe's oil revenues into a source of earnings for all future generations of Saotomeans. This goal necessitates a good choice for the appropriate rate of withdrawal from the Permanent Reserve. The key principle is that the permanent reserve constitutes a financial asset from which Saotomeans can benefit in perpetuity. This means that the corpus of the Reserve must be protected in real terms, in particular by adding to the Reserve a yearly amount that offsets the appropriate rate of inflation (note that the relevant inflation rate is that of the currency in which the reserve assets are denominated, likely a combination of US dollars and euros). If it is desired that the principal should be protected in real *per capita* terms, then one must add to the Reserve and a yearly amount that offsets the *per capita* decrease caused by population growth in Sao Tome and Principe. Whether or not this should be done is discussed below. Note that to avoid destabilizing the budget, the withdrawal should be at a constant rate, rather than actual investment returns from year to year, which are more volatile than the balance in the reserve (and which may in some years be negative). So the rate of withdrawal should be the expected long-term yearly rate of return on the assets. The Ministry of Planning and Finance must determine the rate, but a ceiling is necessary, to avoid any temptation by future governments to raise the rate above what is

sustainable in order to increase current spending at the expense of future generations. The law puts an upper limit of 5%.

Adjusting for population growth or not?

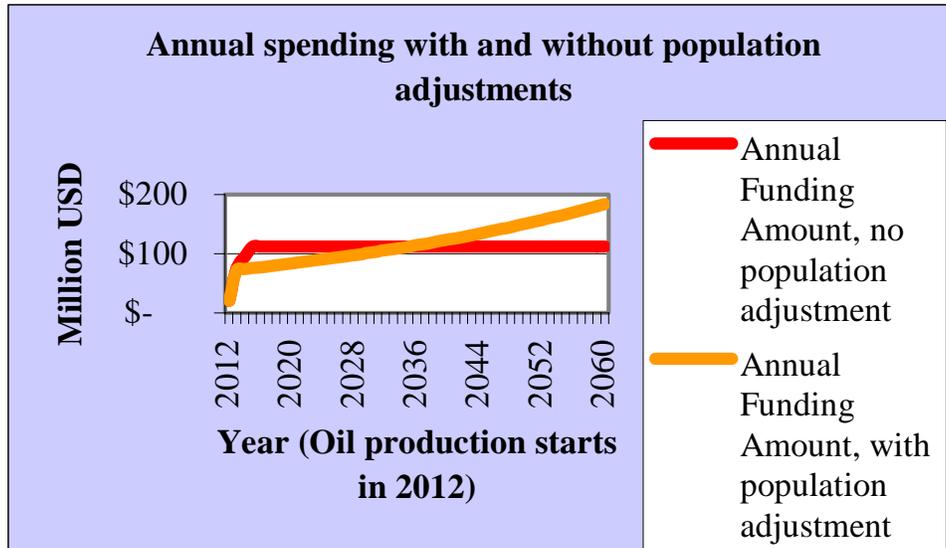
We recommend that the real rate of return be adjusted by the rate of population growth. This is a question that must ultimately be determined by representative political officials, but we here list the considerations for and against such an adjustment.

If the real rate of return on financial assets in the permanent fund is 5% per annum, and population growth is 2% per annum, then adjusted rate of return is 3% per annum. The adjusted and unadjusted rates both ensure a sustainable rate of spending of oil revenues, but in two different senses. Applying the *unadjusted* rate of return in the rule described above makes it possible to spend a constant total Annual Funding Amount in perpetuity (but a declining Amount *per capita* when the population is growing). Applying the *adjusted* rate of return makes it possible to spend a constant *per capita* Annual Funding Amount in perpetuity (the total Amount increasing at the same rate as the population over time). In the long run, we may expect that the rate of population growth will fall in which case the distinction becomes less important. However, in the short run, population growth rates may even increase.

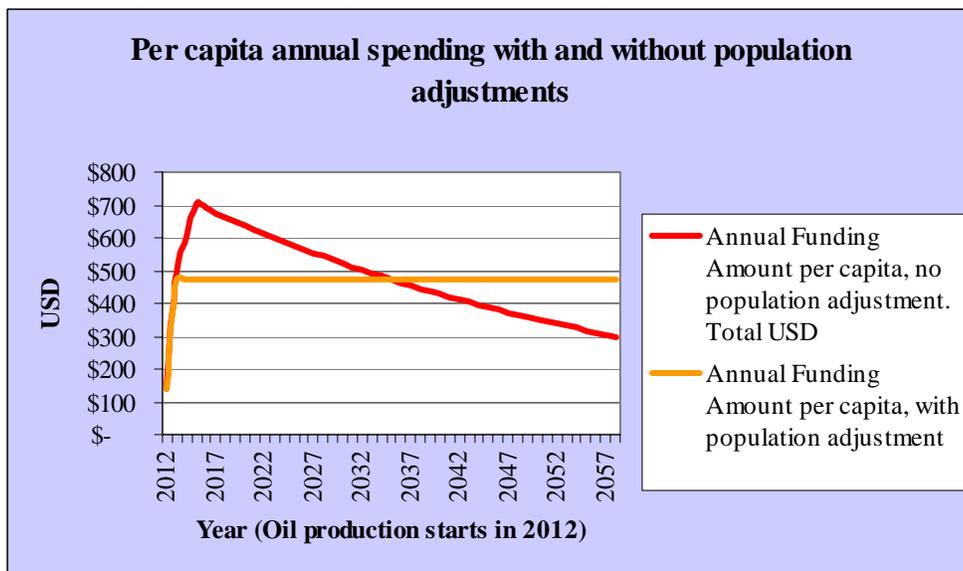
In determining which type of sustainability is most appropriate, there are concerns of efficiency and of intergenerational equity. One reason for using the unadjusted amount. Is that the Annual Funding Amount will in large part be spent on infrastructure and social spending which will improve the standard of living and increase the incomes of future generations of Saotomeans. This means that even aside from oil-financed spending, future generations can be expected to be richer than the current one. Given the urgent needs of the current generation, and given how today's spending can also benefit future generations, intergenerational justice may therefore not require adjusting for population growth. However, while it is true that future generations will benefit from the expansion of infrastructure and social spending carried out today, a growing population will also have growing infrastructure and social spending needs. As the population expands, the existing infrastructure becomes crowded. In addition to maintaining existing infrastructure and services there will be a need to expand the existing government services. This would be more difficult to do with a declining *per capita* Annual Funding Amount.

A simple example:

This example makes the same assumptions as the chart above. The following two charts compare the proposed rule with (orange line) and without (red line) population adjustment. The first chart projects the total Annual Funding Amount:



The second chart projects the *per capita* Annual Funding Amount:



The graphs clearly show that with the population-adjusted rule, the Annual Funding Amount is increasing in total terms but constant in per capita terms. With the non-adjusted rule, the Annual Funding Amount is constant in total terms, but declining in *per capita* terms.

3. Committing oil revenues to development priorities. (Article 12)

In order to avoid wasteful and politically motivated spending, to encourage long-term planning, and to ensure the confidence of the people of Sao Tome and Principe that their oil wealth will be employed for their benefit, the law commits a percentage—80%—of the Annual Funding Amount (net of the transfers to Principe and to individuals, explained below) to national spending priorities. This limits the use of funds for private projects or for example for large increases in military expenditure. We strongly encourage the Saotomean

authorities to pass a long-term plan for the development of the country, aiming to fulfil the United Nations' Millennium Development Goals. We recommend that the annual funding amount should be used first to finance priorities identified in such a plan: The commitment of funds will provide necessary year-to-year coherence in spending plans, which is more difficult to ensure simply through the yearly budgetary process. In the absence of a Development Plan the law charges the Ministry of Finance with allocating the same proportion of funds to the education, health, and infrastructure sectors.

Regional and direct distribution. (Articles 13 and 14) As oil revenues increase, a very large share of GDP will come from the oil sector. One result is that the central government will control an extremely large share of Sao Tome and Principe's economy. A way to address this imbalance is to establish automatic transfers of part of the Annual Funding Amount away from the central government expenditures to the Autonomous Regional Government of Principe (Article 13), or to individual citizens (14).

Regional distribution

The law recommends that a minimal transfer of funding from annual oil financed expenditure be made to the Regional Government of Principe. Principe has the special status of Autonomous Region under Sao Tome and Principe's Constitution, with its own regional government and its own budget, currently funded by transfers from the central government, but amounting only to about 1% of the central government's budget. This special status, as well as its particular situation of "double insularity" and the general feeling of Principe's population that they are ignored by the main island, warrants a transfer of a share of the AFA to Principe's Regional Government. The establishment of such automatic transfers presupposes that the Regional Government has adequate and transparent budgeting and accounting procedures, and that has the capacity to spend the increased revenues efficiently. The law therefore makes the start of transfers conditional on the National Assembly's passing of a resolution recognizing that the Autonomous Regional Government possesses the necessary capacity.

Principe has a population of around 6000 inhabitants, which amounts to 3-4% of the population of Sao Tome and Principe as a whole. In the Model law we tentatively suggest a 5% allocation to Principe. The reasons for giving Principe a larger than proportionate share of the Annual Funding Amount include:

- The "double insularity" of Principe means that the island requires greater funds to provide the same services, in particular because of larger transport costs
- The general level of development in Principe is lower than that in Sao Tome island, so the population is in even greater need of public services
- The legal status of Principe imposes on it the costs of a local layer of government
- The deep frustration of Principe's population may suggest a larger share
- The fact that Principe lies closer to the oil fields in the Joint Development Zone. While in fact both Sao Tome and Principe lie far from the zone, there are many instances in other countries wherein frustrations are significantly deeper in regions closer to oil fields when those regions feel sidelined by expenditure policy; a minimal guarantee of expenditure for the region can help waylay these concerns.

The choice of the percentage to allocate is a difficult one, and the final determination must be made by the *ad hoc* commission and the National Assembly. The final determination will have to take account of the share of central government budget that is spent in or on Principe. The more public services Principe will receive from the central government, the less the Autonomous Regional Government should require for its locally determined projects.

Whatever amount is allocated, other laws may need modification so that there is no conflict in the allocations determined under this law and those based on prior laws on the finances of Principe. What this law imposes should supersede whatever is provided for in earlier legislation.

Direct distribution to individuals

A way of reducing the public / private sector imbalances is to distribute a share of the AFA in cash to individual citizens. This is a very uncommon system. It has been used however, for example in Alaska, where the Permanent Fund receives 25% of oil revenues, and pays out dividends that are evenly distributed in cash to all Alaska residents.

There are good reasons both for and against direct distribution. We outline a number of these arguments below. Because as yet the evidence in favour of direct distribution is mixed, we do not provide a strong endorsement of the policy. We suggest however that the law could usefully permit such a policy to be easily implemented, should the authorities decide to adopt it.

The beneficial economic and distributive effects of direct distribution are that it may:

- put purchasing power directly in the hands of the poorest of the poor and as such be one of the most egalitarian ways of employing the oil revenues
- monetize the rural economy of Sao Tome and Principe and create markets for the poor, which could facilitate poverty alleviation. A monetized economy could also improve the division of labor, which would increase rural productivity.
- transfer some of the decisions about how to invest resources to the people who are most affected by the decisions, and best informed to make those decisions.
- stimulate a deeper local financial market and expand the banking system. Plausibly, distributions on the order of 100 USD per person per year, would make it economically viable to establish private bank accounts for every citizen in Sao Tome and Principe.
- encourage a local credit market since some people would save parts of their distributions. This could bring interest rates down, helping local investment.
- have beneficial implications for governance. If direct distribution were a fixed share of the Annual Funding Amount, that part of government financial transactions would be much more transparent to ordinary citizens and make them more keen on monitoring the state of the government's finances. This effect could be enhanced if direct distributions are taxed, a measure that while administratively inefficient could help citizens engage more with government economic policy choices

Against these there are possible dangers:

- Citizens may use the money unwisely, leading to inefficient allocations of expenditure to consumption and investment or to suboptimal investments. (Although this assumes that wasteful spending is more prevalent among individuals than in government agencies, a claim that is not-self evident)
- Cash salaries could produce disincentives for workers to supply labour, leading to greater shrinking of the non-oil sector and an even more extreme dependence of the economy on oil rents.
- The actual process of distributing income could lead to opportunities for corruption and abuse.

In response to these arguments there are alternative ways to think about distribution. We encourage the government to reflect on these possibilities. One is to impose certain conditions to access payments. For example, distributions can be made conditional on participation in basic health and education programs, or filing tax returns. The Model law contains clauses that allow the National Assembly to determine such conditions.

TITLE IV TRANSPARENCY AND THE PUBLIC INFORMATION OFFICE

We strongly believe all oil revenues of Sao Tome and Principe, and their uses, should be fully transparent. The law therefore establishes transparency as a fundamental principle in oil revenue management. It charges all the institutions with the authority to transact, allocate or disburse oil-derived revenues to make public the decisions they make in that capacity, in detail and in advance of their actions. The law does make an exception for commercially valuable information that is clearly intellectual private property – in particular, this would cover geological and seismic research by oil companies. All contracts and financial information, however, are explicitly not covered by that exception. The law aims insofar as possible to put in place institutions to ensure that transparency is more than a catchphrase. The key innovations are the institution of mandatory auditing and the creation of a public information office, discussed below, and the creation of an institution for oversight, discussed under Title V.

1. Mandatory auditing. (Article 19)

In the Model Law, the auditor-general's (*Tribunal de Contas*) responsibility to audit National Oil Account is established and complemented by a requirement of a parallel audit by an international audit firm. In the absence of regular and public audits, the state institutions charged with managing oil revenues in accordance with the law will have less of an incentive to prevent slack or corrupt procedures. The auditing requirement makes institutions liable to be exposed for any errors or wrongdoing that may occur, and thus increases the incentive for compliance. To ensure this salutary function of audits, it is necessary that they be made on a regular and public basis. Since Sao Tome and Principe's auditor-general is a young and still inexperienced institution, we recommend that a parallel audit be carried out by an independent, internationally respected auditing firm. This will reduce the risk of error and

creates a benchmark for the auditor-general's own performance, which in turn encourages that institution to carry out its tasks with the highest possible degree of diligence.

2 Creation of a public information office

We recommend the creation of a Public Information Office and the institution of a legal requirement that all oil-related information be put in the public domain through mandatory filing with the Public Information Office.

A number of features distinguish the public information office from a simple depository for official documents. First, the office has rights to copies of a very wide range of documents, as specified in the law. Second access to these documents is very wide, indeed the Model Law proposes that access be publicly available both to hard copies and to electronic versions of all relevant documents through the internet. This would ensure for example that the balance of the national oil account, all production sharing contracts and all national budgets be available to a national and global audience at all times. Third, there are legal provisions to help ensure that the Public Information Office will, in effect, be able to access the documents specified in the text. One important innovation in this regard is found in Article 27, which establishes that failure to deposit public contracts with the public information office may be construed as a violation of the contract. Another is that have the Office would have legal obligation to appear before the National Assembly on an annual basis to testify about the compliance of the authorities of Sao Tome and Principe with the information disclosure provisions of the oil revenue management law.

A concern related to the establishment of a Public Information Office relates to the possible administrative and human capacity burden that the creation of a new (governmental) institution in Sao Tome and Principe may entail. One response to this very real concern is to establish the Public Information Office as a section, branch, or subdivision of an already existing governmental body, in the physical form of an office or cabinet where documents would be filed, indexed, kept, and made readily available to the public. A shortlist of Sao-Tomean institutions that may be best equipped to house the Public Information Office, would include: The National Library, The National Archives, The Library of the National Assembly, The Ministry of Justice, The National Statistics Office.

Among these institutions, the National Library, the National Archives, and the Library of the National Assembly seem to have the most significant experience in filing and indexing documents. In addition, each of these institutions already perform document-keeping functions, the latter two having the advantage of already being freely accessible by the public.

TITLE V PUBLIC OVERSIGHT

Title V of the draft law sets forth provisions for public oversight. Articles 21 and 22 establish the Petroleum Oversight Committee, a specialized institution intended to oversee the implementation of the law and respond to public complaints. Articles 23 and 24 detail the rights of individual citizens and others to obtain information, initiate complaints and pursue litigation on petroleum matters.

Establishment of Petroleum Oversight Committee. (Article 21)

Article 21 of the draft law establishes a Petroleum Oversight Committee to oversee the use and development of STP's oil resources under the oil revenue management law. The Committee is a new institution that draws on the model of independent oversight found in the operations of ombudsman, human rights commissions and electoral commissions. It is not intended to replace the courts or tribunals which retain exclusive authority to sanction violations of law; generally, its role is one of investigation, communication and, eventually, collaboration. It is meant to provide visible security to Santomeans that the law is respected and that their oil wealth is being protected.

The mandate of the Oversight Committee broadly covers the scope of the law itself. Its members are drawn from diverse constituencies, as explained below.

Petroleum oversight Committee under the auspices of the National Assembly (Paragraph 1)

We have proposed that the President of the National Assembly establish the Oversight Committee. This is largely symbolic though it reflects the important continuing role of the National Assembly in the Committee. Two of the members of the Committee come from the National Assembly, which also approves the budget and the internal regulations for the Committee. But the Committee acts in its own name before domestic and international bodies.

Mandate of the Oversight Committee (Paragraph 2)

The mandate of the proposed law includes three primary elements

- Monitoring and ensuring *procedural* compliance with the law by government agencies and the National Assembly;
- Monitoring and ensuring *substantive* compliance with the limitations on the annual funding amount and budgetary expenditures; and
- Responding to public complaints.

Monitoring will require the Committee to follow the different stages of the implementation of the law. It will have to hire staff and implement procedures with appropriate competence for the task. But in most cases, its task will be limited to ensuring that those charged with responsibilities under the law execute those responsibilities. They should identify cases of wrongdoing, but not engage in second guessing professional decisions or discretionary choices that are delegated to others.

Finally, the Committee has an important educational and 'truth-telling' role vis-à-vis the public. It is likely that there will be many misunderstandings about the law and rumors that could undermine the confidence of the population. At the same time, citizens may also identify serious problems in the implementation of the law. The draft law makes the Committee primarily responsible for reviewing and responding to complaints.

Membership and Decision making (Paragraphs 3-6)

Under the Model Law, the petroleum Oversight Committee would have seven voting and three non-voting members. The seven voting members are:

- Two deputies selected by the National Assembly, according to a process that seeks to ensure that the two members will not be members of the same political party or coalition of parties.
- Three members selected by Santomean civil society. These members will be individuals who are actively engaged in non-governmental organizations, community based organizations, churches, professional associations, or labor unions. The National Assembly will select the first three civil society representatives; thereafter, the organizations will select their own representatives, according to procedures prescribed by the National Assembly. The law also sets forth criteria that civil society representatives must meet that are aimed at ensuring their independence.
- One member selected by the government of the Autonomous region of Principe. We included this member because we believe that it will enhance Principe's confidence in the Oversight Committee's work and in the government's good faith in treating it fairly with respect to decisions about the use of oil revenues.
- One member selected by the President of the Republic.

This composition reflects a desire to link the Committee to existing democratic institutions while ensuring that its membership will retain a strong interest in functioning independently of state control.

The Committee also includes two non-voting members, representing international institutions with which STP has a strong relationship. We have suggested that non-voting representation be accorded to a representative of the UNDP and one other international organization. The purpose of including these non-voting members is to increase the transparency and credibility of the Committee's deliberations and to provide the Committee with the benefit of outside viewpoints and/or relevant expertise.

The voting members of the Committee make decisions by a simple majority vote. Each voting member serves a four-year term, while each non-voting member serves at the discretion of the appointing authority. Voting members will be paid a small honorarium for their services. The Committee shall draw up its own annual budget, providing for the necessary staff and other resources, and submit it to the National Assembly

Internal operating procedures (Paragraph 7)

The Oversight Committee will establish its own internal regulations, subject to approval by the National Assembly.

Allowing the Committee to draft its own regulations has the virtue of allowing the institution that is going to have to carry out the law's mandate a role in deciding how it can most efficiently do so. It also allows for greater flexibility in responding to changing situations on the ground and experimenting with different solutions to different issues.

It is crucial that the Oversight Committee be given funding for a permanently staffed office. The Committee members themselves will not be remunerated on a full-time basis and cannot be expected to carry out the detailed investigative work that may be required. Instead their role is to assess when irregularities may have taken place and take appropriate actions,

based on the investigations they direct their staff to undertake. This function can only be fulfilled if the Oversight Committee is adequately funded, and if its budget is sufficiently secure that budget reductions are not used to discourage or prevent the Oversight Committee's work when other branches of the government want to do so.

Powers of the Petroleum Oversight Committee. (Article 22) Article 22 sets forth the powers the Oversight Committee will have at its disposal in carrying out the mandate described in Article 21. It has strong investigative powers, in order to ensure that it can gain access to all necessary documents and people. However, as suggested in the discussion of Article 21, it is limited in its enforcement powers. The Committee cannot enforce its decisions directly; it must go through the courts or use informal methods such as public disclosure or mediation. In exceptional circumstances, , the Committee may suspend the transfer of funds from the National Oil Account. Such action may be reviewed and reversed by the Supreme Court or the affirmative vote of three quarters of the members of the National Assembly.

Power to investigate (Paragraph 1)

The Oversight Committee has broad authority to carry out its mandate by conducting investigations, either on its own initiative or when prompted by individual complaints of wrongdoing. Article 22 deliberately leaves this power open-ended, with the terms for initiating an investigation left to the Committee's internal regulations. This decision reflects the notion that Committee's investigative powers should be left relatively unfettered if it is to function effectively, especially given the limits placed on its powers of enforcement.

Right to request investigation (Paragraph 2)

The law allows any citizen or domiciliary of STP to request the Oversight Committee to launch an investigation into suspected instances of wrongdoing involving oil revenues or resources. It is left up to the Committee to decide whether to investigate and what, if any, additional action should be taken. This is the primary way in which ordinary citizens will be able to give voice to their suspicions and complaints about malfeasance involving the use of oil monies. This mechanism should lead even individuals who are not willing or able to interact with the courts to feel as though their voices matter, and should also help defuse unfounded rumors of corruption or other wrongdoing.

Exercise of investigate powers (Paragraphs 3-4)

In the course of fulfilling its mandate, the Oversight Committee will have the power to:

- conduct interviews
- compel the production of testimony, documents and other evidence
- review oil-related contracts entered into by the state.
- Commence legal action before the courts of STP and the *Tribunal de Contas* to enforce its powers; compel public officials to comply with their obligations under the oil revenue management law; or to force the surrender of benefits obtained through violations of the oil revenue management law.

Exceptional measures (Paragraph 5)

In truly exceptional situations, where the Oversight Committee finds a grave violation of the oil revenue management law that cannot be remedied by other means, it may suspend the disbursement of monies from the National Oil Account. This power is meant to be used only as a last resort and will play no part in the Oversight Committee's normal course of business. It is meant to allow the Committee to safeguard the nation's oil wealth in times of extreme urgency, as would for example be the case if STP's normal constitutional process were somehow subverted.

If the Oversight Committee does exercise this power, its decision can be overridden by either the Supreme Court or a vote of at least three quarters of the members of the National Assembly.

Access to Information. (Article 23) Article 23, like Article 24, allows individuals to act independently of the Oversight Committee in certain circumstances. It allows any citizen or resident of STP to request the production of any information required to be made public under the oil revenue management law, and requires public institutions and officials to comply with such requests. This right is an important part of realizing the vision of transparency embodied in the law, and will empower individuals to be informed and critical observers of the process of allocating and using the nation's oil revenues.

Private Right of Enforcement. (Article 24) Article 24 allows individuals to bring legal actions aimed at ensuring compliance with the oil revenue management law on their own in certain circumstances. However, this sort of legal action can normally only be filed after the complainant has first attempted to seek redress by filing a complaint with the Oversight Committee. If the Oversight Committee declines to act on the complaint, the complainant may then proceed to initiate legal proceedings directly. In urgent circumstances, the courts may waive the requirement of filing a complaint with the Oversight Committee altogether.

These provisions help ensure that the Committee will retain primary responsibility for monitoring compliance with the oil revenue management law without monopolizing it altogether. They also reflect the law's understanding that the Oversight Committee's complaint procedure should be individuals' primary, but not exclusive, method of seeking redress.

TITLE VIII FINAL PROVISIONS

Amendment quorum and Constitutional Amendment appropriateness. (Article 29) The Model Law imposes a supermajority requirement for amending the law, whereby three-quarters of the National Assembly deputies have to assent for any amendment to be valid. This provision is in recognition of the strong incentives that will exist for strong political players to attempt to circumvent or weaken the constraints in the law. Given the central

importance of oil revenues to the future economy of Sao Tome and Principe, it may be desirable also to adopt a Constitutional Amendment addressing certain key elements of the oil revenue management law.

In addition to the oil revenue management law, a constitutional amendment would significantly strengthen the controls over the collection and use of oil revenues, and would limit the ability of any party or subdivision of the state, now or in the future, to arbitrarily or unilaterally change the rules governing the National Oil Account.

In the unlikely event that an unconstitutional government attempts to seize power in Sao Tome and Principe, such an amendment might also help protect Sao Tome and Principe from the seizure of funds, especially if the funds are held in an international institution outside of Sao Tome and Principe.

An amendment could reaffirm key principles of the oil revenue management law, including, among others: that all petroleum resources and the revenues derived from them are the property of the people of Sao Tome and Principe, that all revenues from such resources must be deposited in the National Oil Account, that all transfers from the National Oil Account to the general funds of the Treasury must be approved by the appropriately designated institution or institutions, that the activities of the National Oil Account, including all deposits and withdrawals shall, be public, that monies from the National Oil Account can only be made available for particular uses, and that pledges or other encumbrances on the petroleum resources of the state and the assets of the National Oil Account are prohibited. The Constitutional Amendment could be passed in conjunction with the oil law.