



**IFFs and Oil Commodity Trading Series**

# **ILLICIT FINANCIAL FLOWS IN OIL AND GAS COMMODITY TRADE: EXPERIENCE, LESSONS AND PROPOSALS**

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# Abstract

Oil trade activities constitute the most significant source of domestic resource mobilisation for oil producing developing countries. Yet, corruption and illicit financial flows (IFFs) also expose them to macro-critical risks of economic instability, exacerbating their often-high vulnerability to chronic poverty, fragility and episodic conflict.

Although the numbers are rubbery, the domestic resources lost to oil producing developing countries on account of IFFs in oil trade activities are estimated to exceed the value of foreign direct investment (FDI) and official development assistance (ODA). There are also clear links between oil trade activities, IFFs and rapidly escalating debt distress involving private creditors, oftentimes-independent commodity traders. Given the nature of these risks and in the context of commitments to a net zero transition, the role and impact of ODA both in attenuating IFF risks and in facilitating an effective transition have never been greater.

This paper synthesises the results of the first phase of a two-phase programme of work on IFF risks in oil commodity trading and development activities. Phase one aimed to better empirically analyse the nature of IFF risks and the current and potential role of ODA in ameliorating those risks. Phase two involves consultation with industry actors, DAC members, policy advocates and African oil producing governments, designed to produce a series of rational, feasible and actionable policy recommendations, principally for OECD DAC members.

Two features of this first phase of work are distinctive: the focus on equity oil, which far outstrips the collection of oil tax revenue in value, yet remains understudied; and the global systems approach, which regards IFFs as relational, multi-scalar phenomena shaped by complex global market networks, corporate interests and practices, and enablers such as lawyers, financiers and accountants. Indeed, a major contribution of this work resides in the links that it draws between oil producing developing economies and the trade and market activities of those entities hosted by OECD countries.

# Foreword

Tackling illicit financial flows (IFFs) has gained prominence in recent years on account of the 2008-09 global financial crisis, the revelations of the Paradise and Panama Papers in 2016-17 and the all too frequent high profile scandals involving some of the world's largest corporations. The OECD Development Assistance Committee (DAC) has made substantive contributions to this field by measuring [OECD Responses to Countering Illicit Financial Flows from Developing Countries \(2014\)](#), tracing the efforts of OECD member countries to increase [investigation](#) and [repatriation of stolen assets to countries of origin \(2014\)](#), and through its 2018 Report, the [Economy of Illicit Trade in West Africa](#), by catalysing a shift in focus away from IFFs as financial crimes, towards a greater appreciation of their economic, security and developmental impacts.

Launched in March 2019 by the Anti-Corruption Task Team (ACTT) of the DAC, the aim of this new program of work is to examine the vulnerability of oil producer countries to IFFs in the oil sales process, review the efficacy of ODA efforts to date in mitigating these vulnerabilities, and suggest ways to enhance the impact of future efforts.

This paper, which synthesises the empirical research, analysis and findings resulting from the first phase of work, was delivered through three intersecting workstreams, each focusing on particular relationships and entities:

1. the nexus between national oil companies (NOCs) and buying companies, and the direct and indirect impacts of official development assistance (ODA) activities, the most significant of which are directed at increasing trade transparency;
2. the nature and structure of traders – international oil companies (IOCs), large independent traders, small and mid-sized firms, and NOCs – in terms of their ownership, equity and accounting arrangements, and how their structures and practices impact on IFFs risks; and
3. trends in trade finance, and the links between traders and financiers, to study their broader implications for oil-producer countries.

Annex B summarises the methods of work and executive summaries that have resulted from these three workstreams.

The second phase of work, presently underway, involves consultations with governments, industry and sector specialists to validate the findings reported here, and inform the development of a series of policy recommendations. The scope of these recommendations is expected to respond to the challenge of IFFs in countries at source and destination, with opportunities for their uptake by the OECD-DAC, and partner OECD policy committees and institutions.

This work is the product of a collaborative multi-disciplinary dialogue on IFFs and development between the OECD, the African Union Commission and African oil producing countries.

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# Abbreviations and acronyms

ACTT	Anti-Corruption Task Team
ADB	Asian Development Bank
AfDB	African Development Bank
BMA	Biens mal acquis
CSO	Civil society organisation
DAC	Development Assistance Committee (OECD)
DFID	United Kingdom Department for International Development
DRM	Domestic resource mobilisation
EITI	Extractive Industries Transparency Initiative
FATF	Financial Action Task Force
FDI	Foreign direct investment
FOSTER	Facility for Oil Sector Transparency and Reform
FTC	Fiscal Transparency Code (International Monetary Fund)
GDP	Gross domestic product
GFC	Global financial crisis
GNPC	Ghana National Petroleum Company
GOGIG	Ghana Oil and Gas for Inclusive Growth
IFF	Illicit financial flow
IMF	International Monetary Fund
IOC	International oil company
JV	Joint venture
NEITI	Nigeria Extractive Industries Transparency Initiative
NGO	Non-governmental organisation
NNPC	Nigerian National Petroleum Corporation
NRGI	Natural Resource Governance Institute
ODA	Official development assistance
OFC	Offshore financial centre



PEA	Political economy analysis
PEFA	Public Expenditure and Financial Accountability
RBL	Resource-backed loan
RGI	Resource Governance Index
SSA	Sub-Saharan Africa
SOE	State-owned enterprise
Sonangol	Angola National Oil Company ( <i>Sociedade Nacional de Combustíveis de Angola</i> )
SNPC	Société Nationale des Pétroles du Congo
Sinopec	China Petroleum & Chemical Corporation
TAI	Transparency, accountability and integrity
TAP	Transparency, accountability and participation
TWP	Thinking and Working Politically
UNCTAD	United Nations Conference on Trade and Development
WBG	World Bank Group

# Executive summary

In the past decade, sub-Saharan African oil-exporting countries have become increasingly vulnerable to corruption when selling their oil wealth. The scale of illicit financial flows (IFFs) arising from corruption represents an astonishing imposition on government revenue and export earnings, and thus on the development of those countries already grappling with chronic poverty, fragile public institutions, episodic conflict and the enormous challenges of COVID-19.

The risks of corruption arise mainly around three points in the oil sales process: when buyers are selected to trade the producer country's oil wealth; when the terms of sale are negotiated; and when the proceeds of sales are transferred into national treasuries.

This paper examines the unbridled world of oil commodity trading so as to better appreciate its links to IFFs in sub-Saharan Africa, domestic resource mobilisation, and development. It is divided in two parts. Section 2 distils the “red threads”, or leading insights from the first phase of this programme of work, as revealed by a common set of questions: How has the problem of IFFs and oil commodity trading been framed and addressed by development actors? How has the understanding and response of development actors evolved over time? In terms of ODA engagements, what has worked, why and with what approaches?

Following the evidence produced by these guiding questions, and mindful of the constraints rendered by the modest scope and capability of this work, the opaque and multiscale nature of the trading ecosystem, and the potential for unintended impacts, Section 3 considers proposals for carrying this programme of work forward to expressly engage with IFF risks. These proposals, are centred on the insights and findings resulting from this analysis, and comprise several different activities and sub-themes that are clustered into four areas:

First, the prerequisite for success in mitigating oil trade IFF risks is that they are informed by a better understanding of the corporate structures, accounting practices and the motivations and incentives for the high use of offshore financial centres, by the trading entities involved in these oil trade transactions. Five sub themes are proposed for special focus, including on the possibilities for corporate governance and regulation, better understanding how commodity traders have previously responded to regulation, and the role of banks, so as to anticipate the impact of future proposals.

Second, opportunities are being missed to assist National Oil Companies to develop capabilities that would both enhance their overall performance and potentially reduce their vulnerability to corruption, while at the same time supporting a transition to a low carbon economy. Some of the opportunities that could be seized by DAC members could include extending public sector reform initiatives already supported by ODA programs – such as in procurement, accounting and risk management – to include NOCs. Other opportunities would require more novel approaches to be taken, but examples exist, even in some of the more highly challenging African producer country contexts.

Third, successful efforts to investigate and prosecute instances of IFFs and advocate for systemic change in norms, regulatory standards and practices have most often involved engagements at domestic, regional and global levels, sustained efforts by international financial institutions like the IMF, bilateral aid agencies, and advocacy organisations, working through public media, or in association with justice sector institutions. These experiences offer some insights as to potential strategies to reinforce the impact of the transnational policy or juridical efforts and the IMF's FTC Pillar 4 commitments.

Finally, consistent with the adage that transaction transparency is a necessary but insufficient response to the challenges of IFF risks, the fourth cluster of work argues for strengthening the results or impacts of data disclosures, through corollary actions – such as tackling problems of price manipulation, speculative market behaviour, future trading and tax evasion.

# Overview

Although the numbers on illicit financial flows (IFFs) are inherently rubbery and definitions vary, current estimates of illicit capital flight from the African continent amount to some USD 88.6 billion per year, or the equivalent of 3.7% of Africa's total gross domestic product (GDP). This is significantly more than the value of official development assistance receipts, USD 37 billion, or of foreign direct investment, at USD 45 billion. Current estimates suggest that some EUR 40 billion in IFFs from the African continent each year are linked to the extractives industries, with the overwhelming share of these flows attributed to oil.

The extractives industries sector is highly prone to IFFs and corruption. Of the USD 1.2 trillion generated each year by the sale of oil and gas commodities, on average just 22% of the proceeds are remitted to government treasuries. While a share of these funds may be used for onward investments, some may also be lost, depleting the prospects of domestic resource mobilisation across oil-producing countries. Since 2013, the level of debt among oil-rich sub-Saharan African (SSA) producing countries has also increased by more than 40%, reaching 73% of their combined GDP in 2018. Much of this debt is on commercial as opposed to concessional terms, which means higher interest rates and shorter maturities. Capital outflows from a selected number of developing and emerging economies (including Angola, Ghana, Kenya, Nigeria, South Africa and Zambia) reached the record level of USD 100 billion in the early months of the COVID-19 pandemic, which alongside the accompanying oil price volatility is exacerbating the vulnerability of SSA oil and gas producers to IFFs.

Given the economic consequences and integrity challenges raised by the COVID-19 pandemic and the far-reaching responses to the crisis – as seen for instance in the declining terms of trade, expedited procurement procedures and an uptick in the global movement of capital – reducing or containing IFFs in low-income and fragile economies, through carefully tailored official development assistance (ODA) strategies, remains as important as ever.

## IFFs and oil commodity trading: Resulting insights

### ***Oil trading: A constantly changing industry***

Oil trading is a complex and rapidly changing industry. Moreover, international energy companies, traders, NOCs and their affiliates, and the country and global contexts in which they all operate are highly diverse and not readily quantifiable. There are few commonalities among traders in terms of the commodities they trade and transform, the types of transformations they undertake, their financing, and their forms of ownership. Equally striking are the contrasts across developing producer countries and their NOCs, as evidenced by the significant differences in their scale, organisation and maturity; the regulatory, and institutional complexity of their national oil and gas sectors and the degree to which they rely on oil for exports and government revenues (Gillies, Malden and Williams, 2020<sup>[1]</sup>). This diversity in oil trade and producer firms has profound implications for how these entities participate in the oil commodities market. International energy firms, which tend to be more heavily invested across the spectrum of oil and gas production activities, are often more encumbered and have sophisticated and integrated mechanisms for

risk management across their respective business units. By contrast, independent traders market their ability to optimise risk and returns across different jurisdictions, times and prices, capitalising on their high-volume, low-margin industry, while NOCs in sub-Saharan Africa, for the most part, have a comparatively less dynamic and complex corporate footprint.

The oil trading industry is also constantly changing, responding to crises and globalisation in myriad different ways over the past four decades. This has resulted in major shifts in the nature of traders; how business is transacted and regulated; the instruments and sources of finance used; and the nature of relationships between sellers and producers. Each of these shifts has served to accentuate or attenuate market opportunities for oil and gas producers as well as IFF risks.

Large banks have retreated from direct engagement in the trade of physical commodities in recent years due to new regulatory requirements following the 2008 global financial crisis. This retreat has created space for new industry actors such as large independent commodity traders and regional banks, some with dubious financial standing and limited transparency measures, to pick up the business left by financial institutions. Although banks continue to provide trade finance, this service tends to be directed principally (or only) to traders as counterparties, thus limiting the application of due diligence and risk assurance measures to NOCs or third-party intermediaries.

In the context of tightening global financial liquidity, international traders are increasingly acting as lenders of last resort, using mechanisms of pre-payment or oil-backed loans, swaps, and processing agreements to provide long-term financing to producer country counterparties with limited to no fiscal regulatory oversight. Industry actors also warn of further de-risking due to the combined effects of COVID-19, the oil price shock and the energy transition, as banks come under increasing pressure to divest from the fossil fuel sector rather than pay the additional fees now levied against banks for trade or capital finance of the so-called “brown” industries. In the face of the long-term structural decline of the fossil fuel sector and steady pace of the energy transition, heightened prospects of de-risking, and enhanced opportunities for new and potentially less scrupulous investors, it appears that IFF risks will accompany the transition towards a low-carbon economy.

### ***IFFs and oil commodity trading: The role and effectiveness of ODA***

Taking the inherent diversity and dynamics of the oil trade sector into account, this research draws out three findings regarding the efficacy of current donor-supported engagements against IFFs. First, since the mid-2000s, donors have supported an impressive array of efforts to improve the transparency of relationships between NOCs and traders. These have improved disclosures of contracts, payments and revenue while at the same time highlighting that trade transaction transparency is a necessary yet insufficient response to IFF risks in the sector. Indeed, the underlying assumption that the existence of public information would trigger collective action and accountability or change the underlying incentives that lead to corrupt activities now seems unfounded. Corollary actions are also needed to prevent price manipulation, enable enhanced risk management and incentivise political decision makers to invest now for the future, including through more sustainable energy investments.

This observation parallels the growing and now prevalent realisation among governance practitioners of the need to work in politically savvy ways to align anti-corruption reforms with elite political incentives for change and more effectively leverage those incentives. There is some evidence of this in the second wave of donor-supported governance programmes. Examples reviewed during this research include the Facility for Oil Sector Transparency and Reform, or FOSTER, (Nigeria) and Ghana Oil and Gas for Inclusive Growth, or GOGIG, (Ghana), both supported by the United Kingdom. The limits of a political economy approach (PEA) are by now well documented. Demand for a second wave of PEA-informed governance and anti-corruption approaches is now gaining momentum, and their merits and potential replicability deserve iterative development and testing.

A second domain of ODA-assisted reforms involve NOC engagements. ODA has not fully appreciated the complex multifaceted roles that NOCs play and the contradictory pressures they face. NOCs are typically assigned not only resource or fossil fuel production, development and marketisation. They also are charged with enabling “think big” sovereign energy or infrastructure investments and, in some cases, carrying out service delivery functions. Frequently, NOCs also carry lofty nation-building aspirations and overbearing obligations as the mainstay of the economy. They are often also the principal source of investment financing and government revenue. Typically, NOCs in resource-rich developing countries are hampered in meeting these expectations by their status as deal takers in oil trade negotiations as a result, in part, of the difficulties they face in attracting competitive trade finance. There appears little likelihood that the government owners of NOCs will ease the pressure they place on these entities to maximise both investment and revenue from production. Rather, it is anticipated that NOCs will increasingly shoulder the burden of raising much-needed capital to respond to the looming macro-fiscal crises their countries face, including as a result of the COVID-19 pandemic.

Presently, donor ODA investments in NOC capabilities are limited and have been on a steady downward trajectory, although they increased marginally in 2019. In 2018, approximately USD 17 million was spent by bilateral DAC donors to support the oil and gas sector, down from USD 25 million in 2017. In 2019, ODA spending increased to USD 34 million. In terms of total numbers, for 2018 this represents 0.015 percent of total ODA from bilateral DAC members and 0.02 percent for 2017. At the same time, DAC donors have committed to support and encourage fossil fuel producers to transition to low-carbon futures; one relatively straightforward way may be to include the core public financial management (PFM) and procurement functions of NOCs in donor country programming, while expanding the nature of support to NOCs to asset marketisation or enhanced NOC risk management.

Given the multi-scalar and contingent nature of IFF risks and influences, a further conclusion reached by this programme of work is that the impact of ODA, which is traditionally focussed at country level, will remain limited unless its scope is enlarged so as to tackle the networks and enabler of IFFs that operate through off-shore and transnational networks. These networks and enablers profoundly impact on the decisions NOCs make and their resultant exposure to IFF risks, and thus remain a critical constituency to engage. On this, the roles of the International Monetary Fund (IMF) and global and international advocacy and investigative firms become crucially important and would be worthwhile further exploring. Transnational investigative and advocacy work has the potential to correspond with the transnational nature of IFFs, and its multi-scalar political economy, in a way that could serve to accentuate IFF risk mitigation. These efforts could also serve to catalyse a shift in the macro-fiscal advisory services of the IMF and due diligence of the financial sector.

### ***Oil trading: Arbitrating risk for opportunity***

The oil commodity trading system is among the most complex and opaque of global value chains due to the diversity of actors, complex arrangements and transactions, and intrinsic volatility that characterise the sector. Yet, this programme of work has also revealed that the internal structure of independent traders, and the roles played by and links between traders and financiers, raise questions that warrant exploration, given the potential impact that some of these structures or behaviours may have on the fortunes or foibles of oil-producing countries.

Oil commodity traders play an important role in bringing goods to market and can accrue significant rents by successfully managing risks and arbitrating variations in price, time and regulation across different jurisdictions. In examining the ownership, equity and accounting structures of the large integrated energy firms, independent traders and NOCs, at least three features are striking.

- First is the exceptional – and as yet unexplained – degree to which offshore financial centres (OFCs) are used by large independent traders. While OFCs are a controversial though established feature of globalisation, among the top 100 global corporations, an average of just 18% of their

group subsidiaries are owned via OFC-based holding companies. By contrast, 97% of independent trading companies' subsidiaries are owned via OFC-based holding companies.

- A second striking feature is the fragmented ownership, equity and accounting arrangements of these same trading companies, including the centralised pooling of value among different entities and the mixing of trading and treasury functions.
- The complex structures of the buying companies contrast with the third feature, which is the comparatively less dynamic and complex corporate footprint of NOCs as the counterparties to the trade, which enables traders to effectively arbitrage risk through extant corporate arrangements.
- Third, and partly as a consequence of banking regulations introduced following the global financial crisis, the rise of local banks and traders and joint venture arrangements between them is a clear trend, one sometimes referred to as localisation or nationalisation of trade finance and business entities. This feature, which is likely to be enhanced as a result of further moves towards de-risking in the sector, adds additional challenges to corporate governance and regulation.

Each of these features warrants further enquiry in and of itself. But taken together, they also highlight the potential limits of national or domestic regulation as responses to IFFs: What, one might ask, would be the object of regulation?

### ***Prospects for engagement: Enhancing the development dividend of oil trading activities***

An initial mapping of the multi-scale and multi-jurisdictional properties of the oil trade ecosystem reveals the hard constraints associated with tackling IFFs to enable sub-Saharan Africa's oil producers to optimise the development benefits derived from their oil commodity sales. In thinking about potential policy responses, two further considerations warrant mention. The first is the growing prominence of traders and the accentuated role they are expected to play in providing trade finance to oil-producing developing countries, particularly in the context of a carbon transition. The second is the limitations of regulation or hard requirements in addressing the IFF problem, both in terms of reach and application. In light of these considerations, there are at least four areas in which ODA and reciprocal OECD and partner policy engagements could serve to limit IFF risks.

The first is to take necessary steps to clarify the basis for the existing corporate governance structures, practices and obligations of actors engaged in commodity trading, given their potential to heighten IFF risks. Traders assert that the three lines of defence – business-led risk assessments and controls, compliance oversight, and independent assurance – offer the best bulwarks against behaviours that heighten IFF risks. They also assert that internal controls have been strengthened in response to high-profile scandals. Yet this contrasts with the evidence that highlights features of the corporate governance of trading firms that are concerning and, as experience shows, associated with heightened IFF risks. This evidence also reveals the limits of official regulatory bodies and the increasing prominence of players from non-OECD member states. Countering the effects of the retreat of the big banks and assisting traders to gain an appreciable sense of their potential role in the development finance architecture would potentially add value.

Second, DAC members are missing two kinds of opportunities to better engage NOCs. One is to help them develop their ability to engage in the global market, including by strengthening oil-pricing and trading capabilities, enforcing the compliance of buying companies with both rules and regulations as may apply from home and producer country jurisdictions, and assisting NOCs to provide the necessary risk guarantees that might soften the risks faced by potential financiers. Greater trading expertise combined with proper price risk management could increase the profitability of NOCs, reduce their reliance on high-risk deals, and improve their ability to manage market fluctuations to their advantage. A second opportunity is to support enhanced NOC capabilities by extending existing PFM and procurement support to include NOCs. In order for these efforts to be effective, it would also be helpful for development actors

to gain a greater appreciation of the diverse character of different NOCs and of the transnational networks that they engage through their trade, finance and business affiliations.

Third, creating space for a new generation of governance interventions to better account for and interact with prevailing political interest and incentives that could serve to attenuate IFF risks. This could be supported by an augmented role for the IMF in providing just-in-time information and advisory services on macro-fiscal and IFF risks – not just to producer country governments but also via engagement with prospective private sector creditors, and countries home or host to those corporate entities. This would draw on the expertise of accomplished investigative firms and researchers and have the effect of enhancing the impact of the IMF's Article IV and Fiscal Transparency Code functions.

The fourth area that merits ODA investment is identifying feasible ways to strengthen the data disclosure results chain, to maximise the impact of existing transparency efforts. Activities could include identifying what kind of information is relevant and necessary for external and internal stakeholders to scrutinise the behaviour of firms and addressing corollary areas of concern that have the potential to reduce IFF risks and leverage trade transaction transparency for better development effect.



# 1 Oil trading and development

**Oil trade activity, particularly the nexus between national oil companies (NOCs) and commodity trading firms, is a highly strategic arena for oil-producing developing countries and one that is particularly susceptible to corruption and illicit financial flow risks.** In resource-rich sub-Saharan Africa (SSA), oil and mining on average account for 28% of gross domestic product (GDP) and more than three-quarters of export earnings. First trades made by 35 NOCs with commodity traders and other buyers generated over USD 2.1 trillion in 2018, up from USD 1.4 trillion in 2016, and equal 22% of the countries' total government revenues (Institute, 2019<sup>[2]</sup>). Yet, despite their considerable domestic resource potential, more than two-thirds of extreme poverty is to be found in commodity-rich developing countries (Longchamp and Perrot, 2017<sup>[3]</sup>). What is special about the extractive industries, and oil resources in particular, is that the industry tends to be state-controlled, it creates large economic rents to which politicians and civil servants have direct access, and it is often characterised by a lack of transparency. The sector is also particularly prone to corruption. Corruption risks may arise at any point, but the award of mineral, oil and gas rights and the regulation and management of operations account for almost 75% of all corruption cases (OECD, 2016, pp. 11-12<sup>[4]</sup>).<sup>1</sup> Corruption in commodity trading has been designated by the OECD as an “emerging area of heightened risk” (OECD, 2016, p. 12<sup>[4]</sup>). Trade mispricing practices, complex kickback schemes, sophisticated vehicles for channelling illegal payments – disguised through a series of offshore transactions and complex layers of corporate structures often involving shell companies – are all recurring features of a landscape of “increasing sophistication of constantly evolving patterns of corruption in this field” (OECD, 2016, p. 12<sup>[4]</sup>).

## Box 1.1. Oil sales to revenues among African producers

In 2014, the Berne Declaration – now known as Public Eye – and SWISSAID analysed the oil sale activities of the top ten oil exporters in sub-Saharan Africa and found that from 2011 to 2013, the governments of these countries generated more than USD 250 billion in sales revenue, equalling 56% of their combined government revenues

Source: (Gillies, Kummer and Guéniat, 2014<sup>[5]</sup>).

**The scale of IFFs constitutes a significant drain on domestic revenue and financing for development.** Recent research estimates that between 1980 and 2018, SSA received nearly USD 2 trillion in foreign direct investment and official development assistance, but emitted over USD 1 trillion in IFFs: Four of the top seven African emitters of illicit flows (totalling almost USD 200 billion) are oil producers (Signé, Sow and Madden, 2020<sup>[6]</sup>). Net recorded outflows from West and Central Africa – and from the trio of oil producers Angola, Nigeria and Republic of the Congo (hereinafter Congo) – also swamped recorded transfers into other regions over the decade ending in 2009.<sup>2</sup> According to recent work by the United Nations Conference on Trade and Development, the African continent lost USD 88.6 billion in capital flight<sup>3</sup> annually over 2013-15; almost half of this, or at least USD 40 billion, was due to IFFs related to the export of extractive commodities.<sup>4</sup>

**Strikingly, indications are that the vulnerability of SSA oil and gas producers to IFFs is increasing and that the COVID-19 pandemic is exacerbating it** (OECD, 2020<sup>[7]</sup>). In the current crisis brought about by COVID-19 and the drastic fall in global oil prices, capital outflows from selected developing and emerging

economies (including Angola, Ghana, Kenya, Nigeria, South Africa and Zambia) reached a record high of USD 100 billion between February and early June 2020 (G20 High-Level Ministerial Conference, 2020<sup>[8]</sup>). Such outflows are not illicit per se. Nonetheless, the risk of IFFs increases in a context of augmented capital movements due to the expedited administrative measures adopted to deal with the economic and social crisis and to already overstretched administrative, oversight and audit functions. Increased debt levels also add to IFF risk vulnerabilities, with the evidence pointing to potential links between the increased incidence of debt distress and the scale and incidence of IFFs among oil-producing African economies, although a direct correlation is unproven (Kretzmann and Nooruddin, 2011<sup>[9]</sup>). From 2013 to the end of 2018, oil exporters' median debt-to-GDP ratios grew from 31% to 54% of GDP. Excluding Nigeria, the public debt level of oil-rich SSA producers increased by more than 40% since 2013 (to 73% of GDP in 2018). Much of this debt is on commercial as opposed to concessional terms, which means higher interest rates and shorter maturities. The higher risk profile of debt in African producer countries is in part due to these countries' considerable exposure to less conventional lenders compared with traditional Paris Club bilateral creditors and multinational institutions. A growing volume and share of sub-Saharan African government debt is owed to private bondholders and commercial creditors (Calderon and Zeufack, 2020, p. 12<sup>[10]</sup>).

**Heightened oil market volatility and long-term downward pressure on oil prices, coupled with the inevitable fiscal burden of responding to COVID-19, will further reinforce the subordinate position of oil-producing countries in global trade, exacerbating IFF vulnerabilities.** As elaborated in this synthesis paper, SSA countries and their NOCs are, for a host of reasons, often deal takers in oil-trading negotiations, and there is little likelihood that the government owners of NOCs will ease the pressure they place on these entities to maximise revenue from production. Rather, it is anticipated that NOCs will increasingly shoulder the burden of raising much-needed capital to respond to the looming macro-fiscal crises their countries face. Their challenge will be to maximise the dividends from oil commodities sales while at the same time avoiding the vicious trap of credit facilities that cannot be serviced, pitiful returns from sales, ill-considered fast-tracked spending of sales windfalls, and illicit financial outflows and corruption.<sup>5</sup>

## 1.1. Illicit financial flow risks in the oil trade sector

**This research examined commonly identified areas of illicit financial flow (IFF) risks to better understand the potential for official development assistance (ODA) and reciprocal policy actions to attenuate these challenges.** IFFs are defined as “money illegally earned, transferred or used” (OECD, 2018<sup>[11]</sup>). However, the objective of this research was not to calculate the scale of IFFs in the sector. Rather, in light of the definitional and empirical difficulties associated with measuring hidden illicit financial flows, this report identifies risk factors that measure the likelihood of particular flows being significant in specific contexts and sectors as a way of indirectly estimating their magnitude and severity (Turkewitz et al., 2018<sup>[12]</sup>). A broad range of IFF risks arise in oil and gas trading, among them the potential for tax evasion and money laundering associated with misinvoicing as well as the possibility of bribery, collusion and below-market pricing associated with the largely opaque oil-backed loans and oil-for-product swap agreements (Table 1.1).

With a focus on the sale of first trade equity oil, this programme of work examines the manner in which IFF risks are mutually sustained on both sides of the trading relationship and at three key points of vulnerability:

- **The selection of buyers and allocation of buyers' rights** - As is the case in government contracts in general, the allocation of the rights to buy oil or gas from national oil companies (NOCs) can attract corrupt behaviour. Problems can include bribery by buying companies in order to secure business, conflict of interest on the part of officials in charge of allocations and the allocation of rights to companies with politically exposed persons as their beneficial owners.
- **The negotiation of terms of sale** - The terms of a NOC oil or gas sale determine whether the selling country receives the best possible value for its natural resources. As with the award of trading rights, suboptimal terms of sale could result from bribery or favouritism.

- **The collection and transfer of revenues into national spending systems** - Once the NOC sells its oil, the resulting revenues can be spent or retained by the NOC and portions of the proceeds can be directed along the way towards public works, social programmes, or corrupt purposes and extra-budgetary spending before reaching the national treasury. NOCs usually collect oil sale revenues themselves. While the volume of revenues collected is often not publicly disclosed, this has, since 2013, featured as part of the Extractives Industries Transparency Initiative requirements, under the remit of requirement 4.2.

**Table 1.1. First trade IFF vulnerabilities**

IFF risk vulnerabilities in the first trade process	Examples of governance and reputational risks	Common transparency measures
1. Selection of buyers and allocation of sales contracts	<ul style="list-style-type: none"> <li>• Bribery of officials to secure contracts</li> <li>• Conflict of interest by officials in charge of allocations</li> <li>• Selection of buying companies with insufficient capacity to lift and market the products</li> </ul>	<ul style="list-style-type: none"> <li>• Open, competitive and rule-based allocation process to ensure a level playing field</li> <li>• Transparency of the identity of the buying companies and their ultimate beneficial owners</li> </ul>
	<ul style="list-style-type: none"> <li>• Discretion in negotiation of terms</li> </ul>	<ul style="list-style-type: none"> <li>• Accessible and standardised sales terms</li> </ul>
2. Sales transactions and collection of revenues	<ul style="list-style-type: none"> <li>• Oil theft</li> <li>• Under invoicing at expert terminals</li> <li>• Lack of public understanding about the payments made from buying companies to the government</li> </ul>	<ul style="list-style-type: none"> <li>• Regular disclosures by sellers and buyers of the volumes sold and values received from the sale of the state's oil, gas and minerals</li> </ul>
3. Collection and transfer of revenues into national spending systems	<ul style="list-style-type: none"> <li>• Revenue leakages</li> <li>• Exposure to foreign banking intermediaries</li> <li>• Misallocation or diversion of revenues</li> <li>• Public mistrust of how revenues from the sale of state's oil, gas and minerals are managed and benefitting the country</li> </ul>	<ul style="list-style-type: none"> <li>• Disclosures of the revenues collected and transferred to the treasury or other government agency</li> </ul>
	<ul style="list-style-type: none"> <li>• Lack of public understanding of special financing arrangements ( such as resource-backed loans and pre-payment deals)</li> </ul>	<ul style="list-style-type: none"> <li>• Transparency of special sales agreements that affect governments revenues accrued from the first trades</li> </ul>

Source: Based on Poretti (2019, pp. 8-9<sup>[13]</sup>).

Table 1.2. Country NOC scores: Buyer selection, negotiation of terms, revenue transfers

Question	Congo	Ghana	Mozambique	Nigeria
Overall 2017 RGI Score	Poor	Satisfactory	Weak	Poor
Buyer Selection				
1.4.7a: Are there rules that govern how the NOC should select the buyers of its production?	Failing	Failing	Good	Failing
1.4.8d: Does the NOC or government publicly disclose the names of the companies that bought the production sold by the NOC?	Failing	Failing	Weak	Failing
Negotiation of terms				
1.4.7b: Are there rules that determine the prices at which the NOC should sell its production?	Good	Failing	Good	Failing
1.4.8a: Disclosure of volume of production sold by NOC	Failing	Good	Failing	Weak
1.4.8b: Disclosure of value of production sold by NOC	Weak	Good	Weak	Weak
1.4.8c: Disclosure of sale date of production sold by NOC	Failing	Failing	Failing	Weak
1.4.7b: Are there rules that determine the prices at which the NOC should sell its production?	Good	Failing	Good	Failing
1.4.8a: Disclosure of volume of production sold by NOC	Failing	Good	Failing	Weak
Collection and transfers of revenues				
1.4.7c: Are there rules that govern how the proceeds from the sale of the NOC's production should be transferred to the government?	Good	Good	Good	Failing
1.4.2b: NOC-government transfer of revenue disclosure	Good	Good	Good	Good

Source: (Institute, 2019<sup>[2]</sup>).

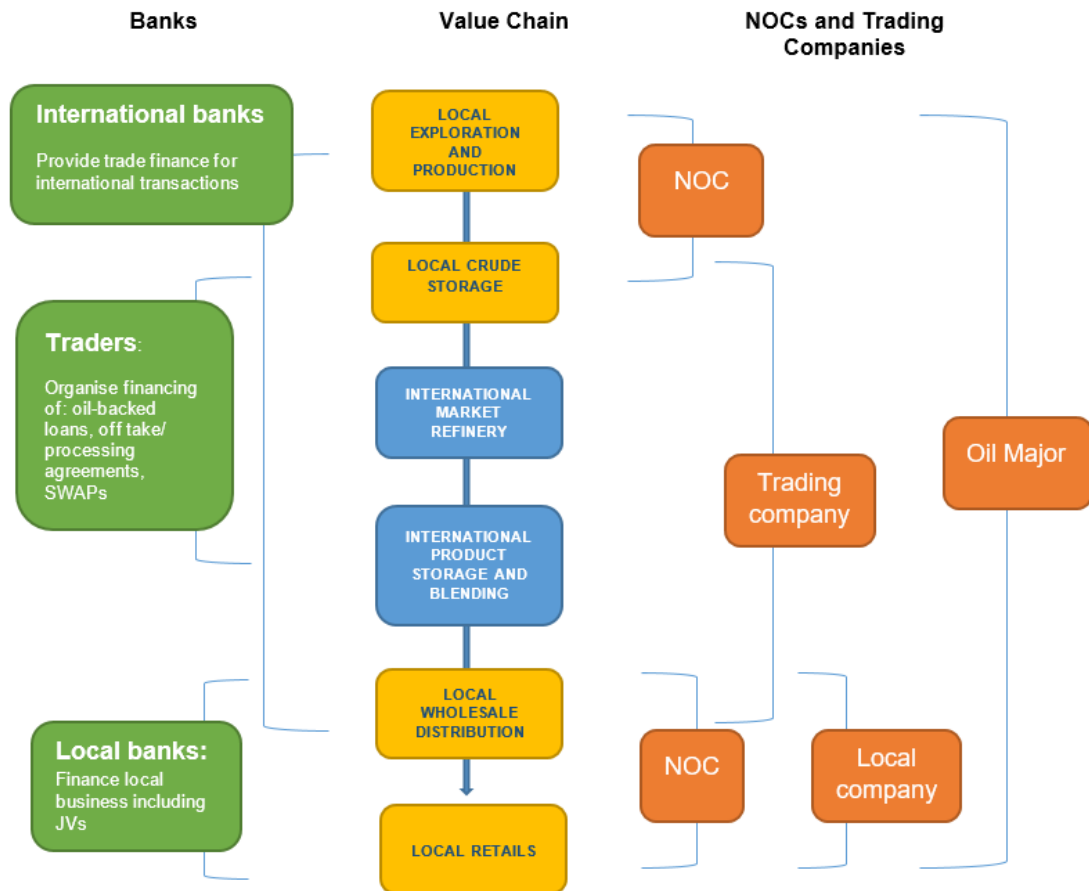
**Oil-rich developing countries face common IFF vulnerabilities, yet they experience and respond to these risks in different ways.** Oil-rich countries challenged by fragility, episodic conflict and entrenched poverty are often seen as afflicted in similar ways by the pathologies of the so-called resource curse: state deficits, endemic corruption, exchange rate appreciation and inflation, fiscal over runs, conflict, and political turbulence. Nonetheless, there are important differences in the nature of risks countries face and standard measures countries adopt to mitigate these risks. This programme of work paid particular attention to how oil sales-related IFF risks manifest and are responded to in the four countries of Congo, Ghana, Mozambique and Nigeria. Table 1.2, which highlights their Resource Governance Index (RGI) scores, depicts common challenges among these countries – for instance, especially weak governance standards around allocation of buyer rights and negotiation of terms – but also considerable variation with respect to risk reduction measures in the negotiation of sales.

## 1.2. Trading and traders: Unconventional development actors

**Oil trading is a complex and rapidly changing industry that has responded in various ways to crisis and globalisation over the past four decades.** Four major shifts have occurred: in the nature of traders; how business is transacted and regulated; in the instruments and sources of finance; and in the nature of relationships with sellers and producers, the implications of which are further explored in the main body of this report. The 1980s liberalisation, the launch of commodity indexes by financial institutions in the early 1990s and the more permissive regulatory environment of the 2000s (resulting from enactment in the United States of the 2000 Commodities Future Modernization Act) opened up the oil commodity markets to mutual funds, insurance institutions and banks<sup>6</sup> (Gkanoutas-Leventis, 2017<sub>[14]</sub>). As oil became an increasingly popular asset class among investors, it widened the opportunities for hedging and gave rise to paper trades and speculation, a process otherwise known as the financialisation of oil. This, in turn, has made oil prices both volatile and largely independent of physical trades and market fundamentals, producing new sources of fragility and risk as well as opportunities for a new cadre of actors – independent commodity traders.

Figure 1.1 is a simplified representation of the oil trading ecosystem, indicating how different actors such as traders and national oil companies (NOCs) interact at different points in the value chain, which is depicted by the central column with different parts of the chain shown in yellow and blue starting with exploration and ending in wholesale and retail sales.

Figure 1.1. Simplified representation of the oil trading ecosystem



Source: (Culbert, Dawson and Isaieva, 2020<sub>[15]</sub>).

**The oil trading ecosystem of buyers, sellers and trade financiers is one of the most dynamic and complex aspects of the global oil assemblage (Box 1.2).** Both traders and NOCs, their affiliates and the country and global contexts in which they operate are highly diverse. In the 1970s, trading was largely controlled by international oil companies (IOCs) that are vertically integrated oil companies such as the oil majors, BP, Shell, Total, etc. Today, the sector hosts a number of intermediary players, including large independent traders, which operate at different parts of the value chain. In one indication of these shifts, it is estimated that between them, BP, Shell and Total traded 15 million barrels of crude a day in 2016, while the five independent traders (Vitol, Glencore, Trafigura, Gunvor and Mercuria) together traded 18 million barrels that same year (Sheppard and Hume, 2016<sub>[16]</sub>). In total, around one-third of global crude production is traded through intermediaries.<sup>7</sup> Unlike IOCs, independent traders for the most part have not traditionally engaged in production, and they do not have fully integrated supply chains. This means that they are also lighter on assets, chartering vessels and entering into joint ventures with local counterparties (Culbert, Dawson and Isaieva, 2020<sub>[15]</sub>). Independent traders are typically privately held,<sup>8</sup> despite some having revenues comparable to the largest Silicon Valley companies. By 2019, the combined revenues of the ten largest independent traders amounted to USD 1.4 trillion. Still, the key message from the Phase 1 enquiries is that the industry has, since the early 2000s, become so tremendously diverse that there is no common pattern in terms of the commodities they trade and transform, the types of transformations they undertake, their financing, and their forms of ownership (Culbert, Dawson and Isaieva, 2020<sub>[15]</sub>).

### Box 1.2. Oil assemblage

“The oil assemblage refers to the vast institutional fields of oil and gas operations: typically this refers to transnational, and national oil companies and the host country government/petro-state; however key actors in the complex include construction and banking corporations, private and other security forces, local chiefs and forms of customary rule, NGOs and transparency organizations, cultural and social organizations (youth groups), multilateral development agencies, and increasingly the organized local social groups and ‘enterprises’ (insurgents, armed militias, organized crime) that seize upon opportunities to acquire oil rents.”

Source: (Watts, 2016, p. 70<sub>[17]</sub>).

**There are also striking contrasts in developing producer countries.** This is clearly illustrated by the producer countries that were more systemically reviewed in Phase 1 – Congo, Ghana, Kenya, Mozambique, Nigeria, Tanzania and Uganda. These exhibit differences in the scale, organisation, maturity, and regulatory and institutional complexity of their national oil and gas sectors and, importantly, in their reliance on oil for exports and government revenues (Watts, 2020<sub>[18]</sub>).<sup>9</sup> This diversity is reflected in their NOCs and how these entities participate in the trading market (Table 1.3). In 2018, Ghana sold ten cargoes to three buyers, whereas Nigeria sold 453 cargoes for a total of USD 13.2 billion to 61 buyers. The buyers comprised Glencore, Trafigura, BP and Total; Duke Oil and Carlson Bermuda, trading subsidiaries of the Nigerian National Petroleum Corporation (NNPC); other domestic buyers (e.g. Sahara Energy) including a number that are seemingly shell companies with no perceptible operations; and foreign national oil companies.

**Table 1.3. Profiles of oil and gas sectors for country case studies**

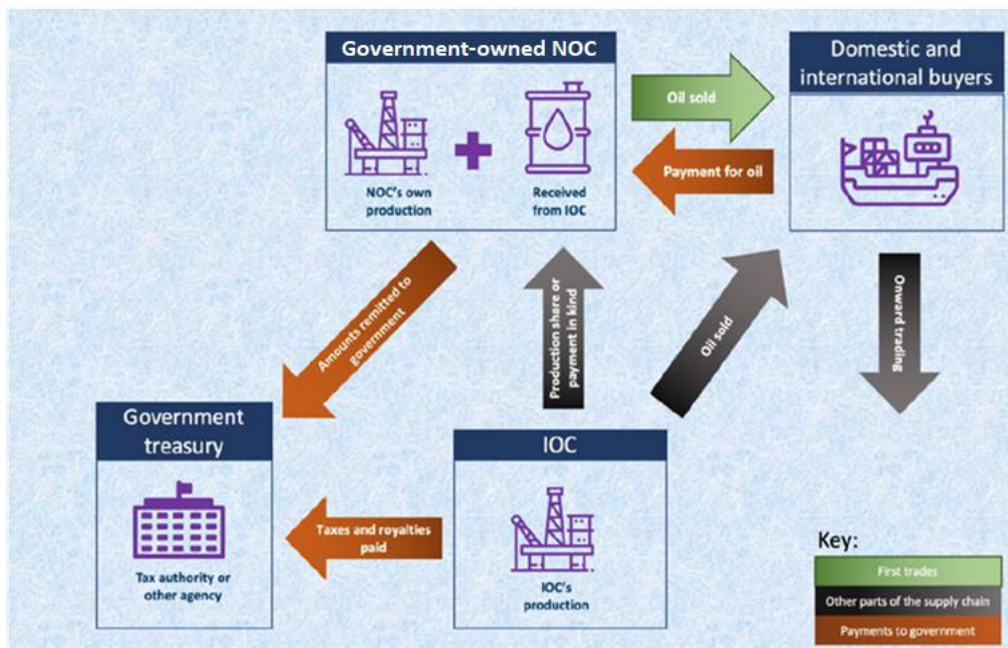
COUNTRY VARIABLES	Nigeria (NNPC)	Ghana (GNPC)	Congo (SNPC)
General government revenue (USD million)	13,200	8,224	2,482
Oil Production (b/d)	1 810 000	100 000	240 000
Oil and gas product sales (USD million)	13,200	501	1,300
Oil, gas and product sales as a percentage of government revenue	57%	6%	52%

Source: Authors based on (Gillies, Malden and Williams, 2020<sub>[11]</sub>).

**The diversity of the trading ecosystem is reflected in the range of actors, nature of sales contracts and price negotiations as well as its linked networks of companies, buyers, finance capital, audit houses and credit rating agencies.** Figure 1.2 illustrates one aspect of this trading ecosystem. Buyers and sellers are often linked in complex financial and joint venture agreements. Traders depend upon liquidity and loans to enable simultaneous financing and settling of accounts, and they work to secure these credit facilities through a suite of financial instruments – as seen, for example, in the opaque, complex structured crude-for-product swaps, oil-backed loans or off-take agreements. Although there are commonalities in terms of the financial tools that may be used, the deals themselves and their implications are profoundly heterogeneous. This is due to deals being nested in and contingent on their own complex

commercial partnerships and arrangements and the prevailing country context. In each deal, there may be many different constellations of actors involved. Domestic buying companies tend to operate only in the producing country and are heterogeneous in their scale and operations. Some are large and established; others are more akin to middlemen or what are sometimes termed briefcase companies, often acting as intermediaries between the NOC and other larger buyers. NOCs may have subsidiaries that trade in commodities that either they or third parties produce (e.g. Sinopec of the People’s Republic of China (hereinafter China) and Azerbaijan’s SOCAR). Other actors include investment banks that trade commodities such as Goldman Sachs and Citigroup – the number of these has fallen dramatically due to bank regulatory changes after 2008 – and the end users such as refiners, smelters and processors (e.g. Sinopec and Société Ivoirienne de Raffinage, or SIR, of Côte d’Ivoire).

Figure 1.2. The landscape of “first trades” and NOC-buyer relations



Source: (Watts, 2020<sub>[18]</sub>).

**Regulatory arbitrage is a defining quality of the global financial system that permits commodity markets to thrive in between the plethora of regulatory niches in global finance.** Most traders operate in and through trading hubs (such as Houston and Chicago) or offshore financial centres that offer favourable regulation and tax rates, strong capital markets, trade and shipping, and human capital resources (e.g. Hong Kong, Bahrain, Singapore) (Enger, de Klerk Wolters and Wong, 2020<sub>[19]</sub>). Traders might be involved simultaneously in the buying, selling, transportation, storage and refining of physical oil. At the same time, in value terms, the overwhelming majority of trades are in so-called paper trades (the futures and derivative markets).

**Although the global trading space is changing rapidly, independent traders have emerged as key sources of finance for sub-Saharan African oil producer countries, a trend that is expected to be reinforced in the shift towards decarbonisation.** Independent traders depend on liquidity and loans that large banks most often provided in the past. But the nature and corporate identities of banks have shifted in the wake of the 2008 global financial crisis (GFC) (Box 1.3). The role of investment banks such as Goldman Sachs and Citigroup in oil and gas trading has changed dramatically, whereas the role of East Asian banks, hedge and investment funds, and special purpose vehicles linking multiple sources of private



equity and entrepreneurial capital has increased.<sup>10</sup> In tandem with this shift towards more diversified sources of finance, the range of instruments used to enable financing and settling of accounts has changed. International traders have thus begun to act as banks for producer countries via the mechanisms of pre-payments or oil-backed loans, swaps and processing agreements, and open accounts for clients and by providing long-term financing to their producer country counterparties (Culbert, Dawson and Isaieva, 2020<sup>[15]</sup>). As these instruments became a central part of the trading process, independent traders emerged as important sources of development finance in SSA oil producer countries finance provided both directly as part of the oil sales process and indirectly by facilitating producer country access to non-traditional providers of concessional financing for national development. The implication of these dynamics from an illicit financial flow (IFF) perspective are discussed further below.

### Box 1.3. The impact of banking regulation on commodity trading

One of the regulatory responses to the 2008 banking crisis was to increase banks' capital adequacy ratio. This means raising the levels of capital that banks are required to hold to cushion complex trades, which are considered high-risk assets. Therefore, despite the collateralised nature of a physical commodity trade, which serves to limit risk and enhance the recovery rates, banks need to set aside considerable regulatory capital to participate in this type of financing. Moreover, the international capital requirements framework agreed by the Basel Committee on Banking Supervision, Basel III, requires banks' assets to be of a high quality and liquid nature, which is not the case for physical commodities. Rather, banks' ability to manage commodities as collateral in the event of default is limited. As a result of Basel III requirements, many international banks have sold or shut their active physical and commodity businesses, dramatically impacting liquidity in the market. The retreat from commodities has left space for commodity traders to pick up the business, while banks have replaced their physical trading businesses with a loan portfolio to these commodities traders as well as space for regional banks, some of which have limited transparency and more dubious financial standing.

Source: (Culbert, Dawson and Isaieva, 2020<sup>[15]</sup>).

**The global oil trading industry is confronting a raft of new challenges that impact on IFF risk vulnerabilities.** The industry has always responded to crises and ruptures – take those of 1972-73, 1978, the mid-1980s, 2008 and 2014, for instance – in dramatic and unforeseen ways, demonstrating an impressive capacity for adaptation and resilience. Traders typically flourish in contexts of volatility<sup>11</sup> (Trafigura, 2018<sup>[20]</sup>). Nonetheless, it is also reported that the combination of low commodity prices, deepening competition, capital requirements and increased price transparency since the GFC has eroded trading margins and changed the nature of arbitrage opportunities; in this period, the players participating in this competitive arena have also changed (Culbert, Dawson and Isaieva, 2020<sup>[15]</sup>; KPMG, 2015<sup>[21]</sup>). Banking regulations introduced after the GFC have also changed the financial architecture of the trading system: Large independent traders have become active in the financial and credit markets, extending credit to producer countries and becoming part of the unregulated segment of the financial system, or the shadow banking system (Box 1.4). As international investment banks de-risk – i.e. terminate or restrict business relationships with clients or categories of clients that are seen as posing excessively high risks – oil traders are tapping into new and innovative sources of funding, a trend that is expected to expand given the further downward pressure being brought to bear on banks through the introduction of additional fees and levies for investments in or related to fossil fuels. Increasingly, smaller banks, which are subject to less stringent regulation and thus have a higher risk appetite, are coming to the forefront. A number of Chinese banks also are looking to participate in syndicated facilities. Moreover, for securitisation, traders are incrementally using hedge funds, private equity funds, as well as pension funds as financing alternatives. This new environment is characterised by both a limited understanding of NOC operations (compared with other parts of the value chain), and by uneven and dispersed forms of regulation and authority that create varying spaces in which risks (and IFFs) can flourish. It has thus radically altered the risk environment and the character of the NOC-trader nexus.

#### Box 1.4. Resource-backed loans

First trades have been linked to a class of risks surrounding highly opaque resource-backed loans (RBLs). These are loans provided to a government or a state-owned company wherein 1) the repayment is made directly in natural resources (i.e. in kind or from a natural resource-related future income stream); 2) repayment is guaranteed by a natural resource-related income stream; or 3) a natural resource asset serves as collateral. RBLs are simply one set of transactions linking buyers and NOCs, but they carry significant risks because of their size and opacity. New analysis for the Natural Resource Governance Institute (NRGI) demonstrates that RBLs are remarkably opaque – only in a single case was the key contract document made public – and carry major public finance risks due to, among other factors, their repayment terms being tied to volatile commodity prices. Of the 14 RBL recipient countries in sub-Saharan Africa and Latin America studied by NRGI, ten experienced serious debt problems after the commodity price fall in 2014.

Source: (Mihalji, Adam and Hwang, 2020<sup>[22]</sup>).

### 1.3. Oil trade IFFs: This programme of work in the wider arena of ODA engagement

**Consistent with Goal 16.4 of the 2030 Agenda for Sustainable Development and the financing for development agenda, tackling illicit financial flows (IFFs) has long been a priority of the OECD DAC.**<sup>12</sup>

The DAC has made several contributions to the field, including by measuring [OECD Responses to Countering Illicit Financial Flows from Developing Countries](#) (2014) and tracing the efforts of OECD member countries to increase [repatriation of stolen assets to countries of origin](#) (2014). More recent work on the [Economy of Illicit Trade in West Africa](#) (2018), undertaken in partnership with pan-African institutions including the African Development Bank, the New Partnership for Africa's Development and the Inter-Governmental Action Group against Money Laundering in West Africa, constituted a shift in focus away from a concentration on the illicit financial proceeds of crime to a better understanding of the criminal networks and activities that underlie the financial flows as well as their economic, security and development linkages.

**As a specific arena, IFFs arising from oil and gas commodity trading only recently emerged as a n object of scrutiny and of policy and donor engagement, despite sales transactions being highly opaque and currently not subject to specific regulations or international standards.** While the European Union (EU) and World Bank Group (WBG) agencies commit significant funds to the oil and gas sector (amounting to USD 226 million in 2018), bilateral DAC members for the most part have limited direct experience and thus knowledge of the sector.<sup>13</sup> With the possible exception of those DAC members that provide official development assistance (ODA) to the oil and gas sector (Canada, Japan and Norway are the three most prominent of such providers), the EU and the WBG, a great deal of what is known by DAC members about the political economy of the nexus between national oil company (NOCs) and buyers has emerged thanks to scrutiny by advocacy organisations such as the Natural Resource Governance Institute, Global Witness, and Public Eye. It was only in 2012 and 2013 that the first efforts to discuss the trading system as a regulatory arena were entertained by the Extractive Industries Transparency Initiative (EITI)<sup>14</sup> (Gillies, Malden and Williams, 2020<sup>[11]</sup>). And only more recently has the new IFF policy frontier of oil and gas trading come to feature in aid-supported IFF risk mitigation programming (as was acknowledged at the UN Conference on Trade and Development's 2020 Expert Meeting on Commodities and Development).

**By 2017, the members of the OECD DAC Anti-Corruption Task Team (ACTT) had come to appreciate the particularly heightened IFF vulnerability associated with first trade crude oil, equity oil and derivatives, oil-backed lending, commodity swaps, and contracting intermediaries.**<sup>15</sup> This recognition, in turn, resulted in a policy decision by the ACTT to focus on oil and gas commodity trading, given that IFFs arising

through commodity trade finance and trade-based money laundering constitute a large imposition on the domestic revenue and development prospects of oil-producing states. This paper provides a synthesis of the work completed to date as part of the ACTT's multi-year programme of work on IFFs and oil commodity trading. A second phase of work is now underway, with the principal purpose of verifying findings and consulting with stakeholders in the oil sector and in the academic and aid communities to define future activities (see Section 3).

**The OECD DAC's programme of work on IFFs in oil and gas commodity trading focused on a key though understudied sector of the oil and gas global value chain**, namely what are referred to as first trade oil and gas transactions. This focus had three objectives: 1) to review ODA to discern what works and under what conditions in reducing IFFs in oil trade activities; 2) to identify points of ODA intervention that offer the greatest returns, given the constraints and opportunities of oil trade networks and jurisdictions that are engaged in first trade transactions; and 3) to make recommendations targeting both ODA in developing countries and initiatives taken in DAC members' home country jurisdictions.

**Activities conducted under this programme of work have so far been organised through three workstreams**, each of which is summarised in Annex A. These workstreams are logically interrelated but do not bear any order or priority.

**Workstream 1: Oil and gas trade transaction transparency.** In considering trader-NOC transparency and potential synergies with ODA policy and practice, the focus is on efforts made to improve transparency of transactions between oil traders and NOCs, principally over the last 20 years, and as a result strengthen their accountability and integrity. The workstream aimed to identify approaches to transparency that appear to yield the best results and examine what might be done to more deliberately draw on ODA experiences in other relevant sectors and areas of reform. Three areas of high-profile ODA programming were reviewed: public procurement, revenue management and the reform of state-owned enterprises.

**Workstream 2: Mapping networks of corporate arbitrage in oil and gas trading and identifying risks in energy traders' financial conduct using due diligence information.** This workstream placed NOCs, traders and financiers on a larger canvas – that is, as part of a global trading ecosystem. Thus, the aim of this work was to better understand how corporate trading firms are organised and operate, and identify potential IFF risks and vulnerabilities that these practices might create. Corporate trading firms included international oil companies (IOCs) independent, mid-sized and small-sized traders, and NOCs.

**Workstream 3: Understanding the relationship between traders and bankers in oil and gas transactions.** This workstream explored the hypothesis that IFF risks can be traced to and/or are fostered by the relationships between commodity traders and the parties involved in trading and by the instruments used to finance these trades. The role of enablers such as financiers remains largely understudied in the IFF literature, thus this workstream provided new information needed to develop IFF policy responses.

**These workstreams are distinctive in two ways.** First, unlike extensive existing work in the extractive sectors that focuses on the revenue stream, this programme of work includes (but is not being limited to) equity oil – that is, a government's equity share in joint venture operations and oil collected in kind, either in lieu of royalties and revenues to be paid to the government by private companies or in-kind payments of oil made to government or NOCs as a result of upstream activities. Also distinctive is that the programme of work highlights and investigates the mutually sustaining incentive systems between the countries where IFFs originate, those countries through which the proceeds may transit and those destined to receive the proceeds and benefits of IFFs. IFFs, in other words, are 'relational': unless IFFs in outflow countries are understood in relation to how incentives are structured by global IFF harvesting and inflow networks, the risks are high that interventions will be ineffective and possibly harmful. This programme of work focuses on physical trading engaged in mainly by commodity trading firms, in particular large, independent trading firms. Paper trading, principally carried out by financial institutions, falls outside the scope of this programme of work.<sup>16</sup>

## 2 Insights and red threads

### 2.1. Governance through transparency and disclosure: Limits and possibilities

**The oil and gas sector has, since the 1990s, been the object of unparalleled efforts by development actors to promote good governance through policy instruments aimed at transparency and disclosure** (Carothers and Brechenmacher, 2014<sup>[23]</sup>). By the early 2000s a wide array of what are often referred to as social accountability approaches had been adopted in response to successive crises, the scale of corruption, and the human rights and ecological abuses associated with extractive industries. Transparency initiatives, in particular, gained currency as part of international anti-corruption efforts accompanying programmes for state reform. These were an integral part of the communities of practice on democracy, governance and human rights that arose in the aftermath of the Cold War. This period saw the emergence of a suite of transparency and accountability initiatives (TAIs) focusing on the extractive sector, the most prominent being Publish What You Pay and the Extractive Industries Transparency Initiative (EITI).

**The first wave of TAIs in the extractives industry were founded on a distinctive theory of change.** Diverse in the forms they took and in their points of focus, these initiatives were characteristically concerned with “a range of actions and strategies, beyond voting, that societal actors – namely citizens – [could] employ to hold the state to account” (O’Meally, 2013, p. ix<sup>[24]</sup>). Efforts reflect a common logic of engagement embodied in a so-called action cycle. This anticipates that citizens, with the aid of organised civil society, will make use of disclosed information to pressure political leaders to change the behaviours of governments and corporate players so they act in ways that reduce integrity risks and improve development outcomes. The launch of the EITI Standard typified this TAI logic: The release or disclosure of corroborated information was expected to generate policy debate and exchange and galvanise political action where needed (Box 2.1).

### Box 2.1. Transparency and accountability initiatives in the extractives sector

The first phase of EITI requirements largely focused on linking national oil companies (NOCs), international oil companies (IOCs) and the treasuries of oil states by reconciling payments and receipts by oil operators to governments. Over time, voluntary disclosures were to be applied to other areas such as policies, contracts, beneficial ownership, etc. Reports are prepared by an independent administrator who is supervised by a multi-stakeholder group responsible for reconciling the numbers, highlighting discrepancies and recommending further steps to improve transparency. The logic underpinning this approach is that the release of data would generate a public dialogue, aided by data analysis and governance advocacy, about government revenues and expenditures. This dialogue, in turn, would pressure political and administrative elites to improve scrutiny of the sector and the predictability and integrity of government revenue streams, thus providing a solid foundation of sustainable development and spending.

Source: (Engebretsen, 2020<sub>[25]</sub>).

**It is too early to fully assess the effectiveness of efforts to reduce corruption and curb illicit financial flows (IFFs) by improving the transparency of oil sales transactions, though prior experiences of TAIs are instructive.** Although it has long been acknowledged that the transactions through which oil is sold expose producer countries to high IFF risks, targeted policy and programmes to reduce these risks have gained momentum only recently. Strikingly, even relatively recent synopses of risk mitigation and governance issues in the oil and gas sectors have tended to neglect the role of traders and NOCs and the nature of the oil trading system (Huurdeeman and Rozhkova, 2019<sub>[26]</sub>; World Bank, 2020<sub>[27]</sub>; Addison and Roe, 2018<sub>[28]</sub>). Nonetheless, much can be learned from the unparalleled efforts to promote good governance in the extractives sector through the first wave of TAI. Following their comprehensive review of EITI's first wave of work across 16 EITI-compliant countries from 1996 through 2014, Sovacool et al., (2016<sub>[29]</sub>) concluded;

**We find, interestingly, that in most metrics EITI countries do not perform better during EITI compliance than before it, and that they do not outperform other countries.** We postulate four possible explanations behind the relative weakness of the EITI: a limited mandate, its voluntary nature, stakeholder resistance, and dependence on strong civil society.

These conclusions have been persistently documented in scholarly and policy work on transparency and accountability initiatives at large (Rathinam, Cardoz and Siddiqui, 2019<sub>[30]</sub>; Brockmyer, 2016<sub>[31]</sub>; Gillies, Malden and Williams, 2020<sub>[1]</sub>). A recent comprehensive review<sup>17</sup> of the empirical literature for the Brookings Institution concluded, "The common assumption, or at least aspiration, of these initiatives has been that the existence of public information would trigger collective action and effective accountability leading to disincentives for corrupt activities. Research has been clear in dismissing this linear and simplistic story" (Eisen et al., 2020, p. 49<sub>[32]</sub>). In other words and leaving aside noteworthy improvements in transparency in extractives industry governance since the early 2000s, which in numerous instances can be directly attributed to the efforts of EITI among others, it is clear that transparency and accountability initiatives will not automatically result in collective action or shift regressive underlying incentives. This conclusion, drawn about this first wave of TAI engagements, is much the same across sectors and is by no means applicable only to extractives industry governance or to EITI.

**The efficacy and beneficial impacts of transparency and civic engagement in the domain of natural resource governance are increasingly contested.** EITI was criticised, for instance, for overreliance on publishing information in its first wave of efforts, and, in some country contexts (Nigeria is a case in point), observers argued that increased information disclosure served as a means of legitimising the weak and

corrupt reporting systems and practices of government agencies on which EITI based its audit reporting (Ejiogua, Chibuzo and Ambituunic, 2019<sup>[33]</sup>; Watts, 2020<sup>[18]</sup>). Others have pointed to the challenges of producing intelligible, useable information to engage with the target audience, while numerous studies have documented the limited capacity, and operating space of the Multi Stakeholder Group as a modality for promoting effective political dialogue and reform (Rustad, Le Billonb and Lujala, 2017, p. 159<sup>[34]</sup>; Ross, 2015<sup>[35]</sup>; MSI Integrity, 2015<sup>[36]</sup>; Scanteam, 2011<sup>[37]</sup>; Kolstad and Sørreide, 2009<sup>[38]</sup>; Ölcer, 2009<sup>[39]</sup>; Kolstad and Wiig, 2009<sup>[40]</sup>).

**A large body of literature also now exists on the so-called “political pathologies” generated by oil rents that often impact on state-society relations and can work against realising the benefits of transparency.** See, for example, Moore (2004<sup>[41]</sup>) and Ross (2015<sup>[35]</sup>). These pathologies include the relative autonomy of the state from citizens; the reluctance of political leaders to cede influence to other groups lest this become a foothold for the takeover of the state; the absence of incentives for civic politics as a result of dependence on oil revenues; and the relative insulation of state oil companies from political scrutiny by other organs of the state, particularly in the areas of fiscal management. Alert to these realities, EITI operates politically in its own way, recognising the inevitable constraints to what its numerous members, supporters and stakeholders can accommodate. Its national secretariats work strategically within the oil and gas and regulatory institutions and are attentive to the power of political interest. Furthermore, even in country contexts in which the recent record of EITI compliance has been limited and where the oil sector has experienced (especially after 2010) a serious decline in its governance and an eruption of oil theft, the local multi-stakeholder group produced hard-hitting reports on IFFs in the sector. An example of this is Nigeria (Watts, 2020<sup>[18]</sup>), where the Nigerian Extractive Industries Transparency Initiative was able, in 2019, to launch a new beneficial ownership portal (NEITI, 2019<sup>[42]</sup>). EITI members are also alert to the potential for government and corporate transparency washing, as illustrated by the grave concerns that EITI membership is especially attractive to corrupt and autocratic states or corporate firms that use its mechanisms for purposes of legitimation and reputational enhancement so as to better position themselves for foreign aid or other concessions<sup>18</sup>. Overall, the picture is clear and conclusive: Adoption of and adherence to transparency norms may reflect political logic and incentives that that may be unrelated to the initiative’s intended purpose (Porter and Watts, 2017<sup>[43]</sup>; Eisen et al., 2020<sup>[32]</sup>; David-Barrett and Okamura, 2013<sup>[44]</sup>; Furstenberg, 2018<sup>[45]</sup>; Brockmyer, 2016<sup>[31]</sup>).

**It is too early to generalise on the efficacy of the few pilot cases chosen to implement Requirement 4.2, and there has been no formal evaluation of EITI activity in the NOC-trader space.** The picture on the impact of transparency efforts in relation to oil and gas trades is incomplete and exhibits considerable cross-country variation. Workstream 1 does not profess to draw clear conclusions. Indeed, most of what is known about these trading relationships arises from prior EITI evaluations and case-by-case scrutiny by advocacy organisations such as the Natural Resource Governance Institute (NRGI), Global Witness and Public Eye. Nonetheless, evidence collected during Phase 1 enquiries affirm that important strides have been made – as represented, for example, by Requirement 4.2, among others – and yet fundamental challenges remain. These include the incomparably complex task of achieving transparency in the NOC-trader nexus, where sovereign (and vested) interests are heightened and where opacity appears to be intentionally manufactured. The tensions between NOCs and IOCs around data disclosure obligations are magnified by the inherent complexities of the data themselves. Not least, there is the obvious fact that this complex process can overwhelm the capabilities of even the most specialised civil society organisations (CSOs) to fully comprehend and make use of the information put into circulation (Gillies, Malden and Williams, 2020<sup>[11]</sup>).

**A greater appreciation of power, the politics of reform and local contexts is the hallmark of a second wave of social accountability approaches to extractives industry governance.** This second wave of efforts to mitigate extractive industries corruption, including IFF risks associated with oil and gas trading, reflects the recognition among development actors that informational asymmetries are rarely an accidental outcome of deficiencies in the ways organisations operate. Rather, as the World Bank’s 2017

World Development Report concluded, they are “often the result of powerful actors intentionally withholding information or resisting attempts to make it accessible – in other words, information asymmetries are also embedded in existing power asymmetries” (World Bank, 2017, p. 247<sup>[46]</sup>). As argued in the following sections, the opacity of networks of buyers, sellers and financiers, corporate entities and instruments, and transactions, although by no means *sui generis*, is a distinctive property of the oil and gas trading ecosystem (see Section 2.4) that has significant implications for accountability (Gillies, Malden and Williams, 2020<sup>[11]</sup>) and for what might fall within the rubric of effective responses.

**Looking ahead, stakeholders and contributors to the second wave of efforts to impact on IFF and corruption risks arising from oil and gas sales highlight similar strategic challenges.** Three elements are particularly salient. First, the transparency and disclosure of information around first trade sales is only one aspect of a country’s extractive value chain that may be relevant to reducing IFF risk vulnerabilities arising during oil sales. For instance, in the case of EITI, there are several other sites in the value chain that impact directly on IFF risks: among others, Requirements 2.6 on state participation, 4.3 on infrastructure provisions and barter arrangements, 4.5 on transactions related to state-owned enterprises, and 6.2 quasi-fiscal expenditures and, as evident in the 2019 Standard, the more explicit attention to beneficial ownership and the requirement, from 1 January 2021, that countries disclose data relating to contracts and licenses. This menu of vulnerabilities highlights the risk of concentrating the lion’s share of official development assistance (ODA) efforts on transparency and disclosures of oil sales at the cost of other plausible policy actions.

**Second, just as the need to more systematically understand what conditions success at the country level has been recognised, so too has the need to work in politically savvy ways.** This programme of work concludes that the presumption that simply adding more requirements and generating new or more complex data – much of which to date have not been fully analysed – will at some time reach the threshold necessary to influence or alter politics seems like a perilous gamble (Watts, 2020<sup>[18]</sup>). Political economy and thinking politically not only point to the very different political biographies of EITI activities in African oil states (and the role of the national political context and elite incentives), but also pose substantial operational challenges.<sup>19</sup> From the introduction of EITI Requirement 4.2 in 2013, it became evident that actions to improve information disclosures required politically savvy ways of operating and would need to be complemented by other actions, including where sales transactions occur, and in the networks, global and local, that formally and informally support, enable and regulate these transactions. As Section 2.3 highlights, development actors have internalised this learning and are gradually, iteratively testing new and potentially promising ways of working.

**Third, recent studies on the second wave of social accountability and related engagements have made clear that the jury will remain out on these initiatives until more evidence is accumulated.** The work conducted under Workstream 1 of this programme of work reinforces the message of recent evaluations (Brockmyer, 2016<sup>[31]</sup>; Eisen et al., 2020<sup>[32]</sup>; Wilson, 2020<sup>[47]</sup>). In the world of extractives industry governance, there is renewed focus on the measurement of results and questions of attribution. See, in the case of EITI, the scope of work proposed in Wilson (2020<sup>[47]</sup>). Along with this has come a recognition of the need for more nuanced, cross-country comparative data to better understand what works, to help multi-stakeholder groups better tune tactical approaches to their countries’ diverse and changing conditions and, not incidentally, to assemble much-needed evidence to justify continuing donor support. Nevertheless, although the empirical measurement of country results and impacts and the attribution issue will be important, it is widely recognised these will not be sufficient; as other sections make clear, more systematic attention to context and to multi-scalar engagements also will be required. The Brookings-sponsored TAP-Plus is one thoughtful example of an integrative approach that encompasses the contextual factors to be considered in addition to the traditional focus on the adoption of transparency, accountability and participation (TAP) measures (Table 2.1).

**Table 2.1. TAP-Plus: Five contextual factors of interest**

Contextual factor	Working definition
State capture	Efforts by non-state, corporate and/or private interests to determine the rules of the game
Social trust, political trust and conflict	Social trust: the degree to which individuals share and believe others or share mutually beneficial goals Political trust: citizen confidence in political institutions Conflict: contexts marred by ongoing war, confrontations between communities and companies, and armed insurgencies
Civic space and media freedom	Basic democratic rights to freely associate, assemble, share information and express opinions without fear of reprisal or censorship
Rule of law	Presence of an institutionalised, understood, trusted, shared and enforced system of rights and rules that applies to everyone equally; protects all members of a society from harm; provides means of redress, resolution and relief when harmed; and fairly determines and metes out punishment for those who break laws or violate rights
Government effectiveness and capacity	The financial and/or technical capacity to carry out the functions necessary to properly manage natural resources and support anti-corruption efforts

Source: Based on Eisen et al. (2020, p. 92<sub>[32]</sub>).

**In highlighting these factors of context, the authors recognise that the hard work yet to be undertaken is showing how these factors operate together in different settings as a foundation for understanding politically savvy interventions.** Fundamentally, institutions are always exercises in and products of power, and this has two implications. One is that governance institutions are always more or less constrained or enabled by how they are embedded in the time and place-specific dynamics of political settlements which reflect the patterns of power, historical bargains and interests that come together around differing forms of political economy. This programme of work refers to these dynamics as the “conditions of possibility”. Another implication, as the experience of EITI again usefully underscores, is that the global value chain (from resource extraction all the way through to the proceeds being realised in improved services and development outcomes) involves actors operating at different yet interconnected levels of scale – global, central or national, local state, and community – where the conditions of possibility may favour, constrain or foreclose the likelihood of effective engagements.<sup>20</sup> Section 2.2 elaborates each of these points.

## 2.2. National oil companies as the lynchpins of reform: The benefits of multi-scalar approaches

**NOCs of the diverse character found in the sub-Saharan African countries are typically the product of a contradictory set of structural pressures.** On one hand, NOCs command a phenomenal volume and value of commercial transactions and yet, according to some commentators, the oil and gas industries have entered into an irreversible period of structural decline. On the other, NOCs play a deeply political and contentious role in oil-producing states, and as the rise of resource nationalism since the 1970s illustrates, they frequently act as a key vehicle for national development aspirations and national sovereignty. Not only is the oil sector a critical and frequently dominant industry, the national oil company’s activities also generate substantial economic rents via oil and procurement schemes and subsidiary partnership ventures. In many countries, the NOC is critical for the stability of the state, insofar as it directly underwrites government revenues while also, at the same time, fundamental for public order and sustaining the social compact.



**Although several Gulf monarchies have managed to create highly profitable and well-managed NOCs<sup>21</sup> (Hertog, 2010<sub>[48]</sub>), NOC reforms have always posed knotty problems for the few DAC members that have maintained engagements with NOCs over time.** Donors, including bilateral and multilateral agencies, have predominantly supported two types of country-level interventions to support NOCs: upstream interventions that support reform of the policy, regulatory and institutional environment for state-owned enterprises (SOEs) to improve their performance and downstream interventions focused on addressing firm-level SOE reform. Other kinds of intervention, less commonplace, focus donor support on reducing risk in commercial ventures, such as through the suite of risk guarantee and equity-sharing instruments available to the World Bank Group, or on local, community-level benefit sharing arrangements and on mitigating the adverse social or environment effects of NOC operations (Westcott, 2020<sub>[49]</sub>). A review of the comparative track record of support by the Asian Development Bank (ADB) and the World Bank Group to SOEs in general shows that for the most part, ODA assistance has been less successful in achieving governance outcomes in SOEs than it has in other public sector agencies.<sup>22</sup>

**Although diverse, and although development actors have learned to recognise the NOC as a politically contentious and challenging domain for reform, ODA engagements with NOCs have remained remarkably uniform and consistent over time.** Hickey and Mohan (2020<sub>[50]</sub>) conclude that natural resource governance agenda of ODA (including the ways in which NOCs are seen and engaged) has been “increasingly challenged on strategic, theoretical and ideological grounds”, although there are important differences between the engagements of multilateral agencies such as the World Bank and those of DAC bilateral agencies. It is not unusual, for instance, for the World Bank and regional development banks to promote SOE reforms through development policy operations involving budget support – a modality less commonly used by bilateral aid agencies, which more often rely on project modalities to deliver technical and other forms of assistance. This point of distinction aside, Hickey and Mohan (2020<sub>[50]</sub>) and Westcott (2020<sub>[49]</sub>) both observe that donor engagements with NOCs tend to draw on a narrow and common range of activities and approaches (Box 2.2).

### Box 2.2. A tendency to take uniform approaches

A remarkable degree of uniformity has come to characterise the institutional reforms being advocated, many of which derive from Norway’s experience but also draw together longer-standing tenets of neoliberal governance. The key elements involve the separation of policy, commercial and regulatory functions, often through the “unbundling” of NOCs that have been performing multiple roles; new rules on transparency and accountability (particularly with regard to agreements between international oil companies and governments on the management of oil revenues); and new public financial management rules regarding the management and expenditure of oil revenues, including a focus on sovereign wealth funds.

Source: (Hickey and Mohan, 2020<sub>[50]</sub>; Westcott, 2020<sub>[49]</sub>).

**Previous efforts to reform NOCs were profoundly shaped by strong commitments amongst DAC member countries to public sector privatisation and deregulated markets.** For development actors operating in the 1980s and 1990s, this often implied restricting the scope of NOC operations to a few points in the value chain where their engagement was deemed necessary for the functioning of the market (including policy stability, the award of private sector rights, security of tenure and contracts, dispute resolution or arbitration arrangements, etc.). Engagements by multilateral development banks would often promote policy decisions to disaggregate – or unbundle – the functions performed by the NOC that were deemed to be inappropriate according to the prevailing global norms and standards (e.g. capital investments in development infrastructure or downstream service delivery that tended to be regarded as quasi-budget or off-budget activities). At the same time, both multilateral and bilateral assistance to NOCs

maintained a strong emphasis on disciplining NOC fiduciary behaviours, for example, through different forms of privatisation in state-owned enterprises, anti-corruption efforts and reforms to the manner in which they are regulated and relate to other state agencies (Watts, 2020<sub>[18]</sub>). The example of Norway's aid relationship with NOCs is analysed in detail by Hickey and Mohan (2020<sub>[50]</sub>).<sup>23</sup> Building on its much-lauded governance of the Norwegian oil sector, Norwegian assistance to NOCs and oil sector governance at large has, among other things, entailed the administrative separation of functional responsibilities for commercial operations and sector policy – including the granting of exploration and production rights – and of regulation and oversight<sup>24</sup> (Thurber, Hults and Heller, 2011<sub>[51]</sub>). It may also involve ensuring that parliamentary budget processes decide how to spend the proceeds of oil sales following a fiscal rule and only after all of the net cash flows have been channelled into a dedicated savings account. As noted by the development and academic community, the merits of narrowing the remit of NOCs and the merits of unbundling NOCs have been taken for granted (Watts, 2020<sub>[18]</sub>).

**Where the institutional prerequisites are absent, unbundling or a separation of functions can be counterproductive** (Hickey and Mohan, 2020<sub>[50]</sub>). A survey of five of Africa's new producers – Ghana, Kenya, Mozambique, Tanzania and Uganda – shows that in some instances, however, “pockets of effectiveness” have emerged as a result of an unanticipated alignment between externally promoted reforms and existing political interests or institutional capabilities (Hickey and Mohan, 2020, p. 3<sub>[50]</sub>). The survey also shows how these pockets of effectiveness can ebb and flow with changing political settlement dynamics.<sup>25</sup> Aside from the observation that one size does not fit all<sup>26</sup> Hickey and Mohan (2020) observe that it is not clear that engagements modelled on the Norwegian experience of administrative separation have improved NOC performance and accountability, despite that this rich experience has been subject to considerable academic review (Thurber, Hults and Heller, 2011<sub>[51]</sub>; Al-Kasim, 2006<sub>[52]</sub>; Moses and Letnes, 2018<sub>[53]</sub>).

**Donors engage on the basis that NOCs are highly susceptible to corruption and yet their generic responses can crowd out home-grown, tailored fiduciary solutions to these risks.** World Bank evaluations of engagements with SOEs in Ghana, Mozambique and Uganda show positive outcomes have been achieved (Hickey and Mohan, 2020<sub>[50]</sub>). Nonetheless, for the most part, donor policy has operated on the basis that NOCs are highly susceptible to corruption risks (and on a grand scale) due to their ownership and regulatory and hybrid public-corporate governance arrangements and because of the chronic weaknesses they present in accountability and corporate disclosure.<sup>27</sup> A raft of benchmarks and metrics have been developed to reveal and measure the myriad ways that NOC corruption manifests in the award of exploration and production rights, procurement of goods and services, and the trade in oil-related commodities and products; at the intersection of the NOC and agencies responsible to manage revenue through sovereign wealth funds and the like; and how near and medium-term public spending decisions are made. Across this range of activities, whether focused on how the NOCs perform or more generally targeting reforms of SOEs, public procurement and public finance management, the record shows that wholesale reforms can crowd out home-grown substantive changes while also thinning already scarce professional capability and opening new sites for intra-elite contest and rent seeking (Hickey and Mohan, 2020<sub>[50]</sub>; Westcott, 2020<sub>[49]</sub>).<sup>28</sup>

**A review of evaluations finds cases at the project level where “a series of interventions have likely kept IFFs to a minimum in a particular industry segment and/or subnational jurisdiction in a country”** (Westcott, 2020, p. 30<sub>[49]</sub>). This review mainly included evaluations conducted by multilateral agencies – ADB, African Development Bank (AfDB), World Bank and International Monetary Fund (IMF) – and may thus not necessarily apply in the case of particular bilateral aid agencies. Nonetheless, “at the level of reducing overall IFFs of leading, politically exposed persons in the same countries, these interventions are only having a marginal effect” (Westcott, 2020, p. 30<sub>[49]</sub>) This is consistent with an analysis of SOE reforms supported by the IMF, which found that governance reforms and financial target setting had no significant overall impact on the extractives sector, including oil and gas. The need to better align donor engagements with the incentives and so-called pacting of elites is by now also widely appreciated

among development actors, resulting in the ascent of politically attuned approaches, variously known as problem-driven iterative adaptation, Thinking and Working Politically, and doing development differently. These have been much remarked over the past decade and are discussed further in Section 2.3.<sup>29</sup> A political economy interpretation of these seemingly modest results would likely conclude that the nature of the ruling coalition, the political settlement and the state of institutions have had crucial implications for how, why and with what effect the reforms promoted by external agencies will be embedded and whether oil resources are governed in the national interest (Watts, 2020<sub>[18]</sub>).

**The Phase 1 review of evaluations of aid programming documenting experience in sub-Saharan African oil producer countries and NOCs points to the need to reach beyond the national producer country to include collateral supporting activities.** Aid agencies acknowledge the need to closely tailor engagements in light of the enormous variation in the character, complexity and capabilities of NOCs. These agencies also recognise that this may require them to be less prescriptive and uniform in the norms, systems and outcomes they seek to promote with respect to NOCs. However, the tendency to focus on the producer country level needs to be augmented by appreciation of the offshore networks and relationships that impact on the performance of NOCs and, on this basis, by enrolling other parts of DAC member governments in combatting IFFs. The tendency of aid programming to focus on recipient country national and domestic politics is by no means unique to this sector. But with few exceptions – for example the AfDB, as discussed by Westcott (2020<sub>[49]</sub>) – this orientation towards domestic politics has tended to produce narrow and sometimes only mildly effective engagements with NOCs, and it has come at some cost in terms of missed opportunities. Certainly, efforts to address the national causes of IFFs should aim to improve transparency, accountability, controls and other systems, and these need to remain part of the suite of donor responses. But the impact of DAC member efforts would be greater if complemented by actions in other parts of government, beyond the development agencies; for instance, those targeting offshore enablers that provide the architecture and expertise on which IFFs rely. Two quite different examples are illustrative. One is the United States Foreign Account Tax Compliance Act of 2010, which impacted some European banking practices and the adoption of common reporting standards and tax information-sharing protocols. Another example are the actions in 2005 by the United Kingdom Metropolitan Police Service that led to the arrest of the governor of Nigeria’s Bayelsa state in the oil-rich Niger Delta region in Nigeria on money laundering allegations. Examples like these show the merits of aid agencies working closely with other parts of government in their home country to reinforce reforms and downstream programming in producer countries. Reforms can be reinforced by introducing collateral actions that help synergise efforts to address control weaknesses both in oil- and gas-producing countries and across global networks involving company registrars, banks, courts, real estate businesses, hedge funds, accountants, auditors, passport brokers and myriad other fixers. Parts A.3 and A.4 discuss further how engagements to support the potential of NOCs as economic lynchpins’ need to be multi-scalar, reaching beyond the IFF source country to track their destination and the contributory cross-jurisdictional factors at play. This is equally the case to ensure the effectiveness of IFF interventions.

**DAC members are increasingly aware of the need to define their support, whether as part of aid programming or other means, in terms of the multi-scalar nature of the oil and gas industry.** Multi-scalar thinking and practice also lie at the heart of this programme of work despite that it is only now becoming fully apparent that IFF mitigation efforts are required to respond effectively to the exceptionally diverse landscape of NOCs and their affiliated state agencies. As activities under this programme of work show, this means, first, that it is sometimes feasible for NOCs to combine commercial, regulatory and developmental mandates and achieve positive outcomes in all three mandates.<sup>30</sup> Second, while best practice reforms that aim to reduce the government’s control over the appointment of the NOC’s chairperson and the NOC budget can make sense, they can also be counterproductive by inadvertently undermining the NOC’s relational links to the executive. Similarly, whereas fragmenting institutions can fuel elite fights over new rent-seeking opportunities, thus disabling performance, concentrating functions in one institution can be efficient and promote accumulation of experience in the industry’s operations and business. Where professional skills are scarce or where formal parliamentary politics highly discount the

value of investments with medium-term outcomes, it can make sense for governments to assign to NOCs developmental functions, such as investing in non-oil related public infrastructure which may have inter-generational benefits.

**Given how much is now known about the variance of NOCs (in terms of policy and operational responsibilities) and the relative merits of different ODA approaches, it is puzzling that this empirical variety is not more apparent in the portfolios of bilateral and multilateral aid agencies.** Why, for instance, is there not a greater balance between elaborate ODA support for country adoption of global transaction, transparency and accountability standards, on the one hand, and building capacity on a systemic basis, on the other? The latter is necessary to successfully support NOCs to adopt and embed their complex roles and for other agencies of the government that are responsible for governing other parts of the oil value chain (Box 2.3). A second, closely linked puzzle is that development partners have extensive experience assisting public sector reforms and capacity building that are directly relevant to better NOC performance in the domains where the three IFF risks appear – for instance, public sector procurement; contract management (negotiation, oversight, interdiction); and revenue administration. Yet, development partners only rarely provide such support in sub-Saharan African oil-producing countries that include NOCs in their development assistance programmes. For instance, several leading DAC multilateral partners, including the World Bank and AfDB, are extensively engaged with procurement reforms, including support to high-level procurement agencies, sector-specific agencies and subnational governments. While oil and gas sector procurement has unique features, the need for policy, laws, regulations and administrative protocols for selecting buyers, negotiating the terms of sale, and contract award and oversight is common across sectors. There would appear to be significant opportunities for synergies in ODA programming to more deliberately include NOCs and other state agencies with functional responsibilities for oil and gas trading.<sup>31</sup> Similarly, there are few examples among the many World Bank and bilateral agency projects supporting public finance management reforms of this programming deliberately including NOCs and their relationships with the mainstream ministries responsible for treasury, revenue and expenditure management.<sup>32</sup> The highly political and contextualised nature of NOCs makes it difficult and unwise to produce generalised solutions, but this conclusion from Hickey and Mohan (2020, p. 4<sub>[50]</sub>) is interesting: Oil sector regulatory authorities, either independent from, or as part of NOCs, have tended to emerge in stronger shape than their commercial counterparts “partly ... because they have received higher levels of external support from international actors”.

### Box 2.3. Multi-functional and co-ordinating capacity

Aside from the short-lived push for higher levels of co-ordination within Tanzania’s oil sector, external actors have largely failed to prioritise the important challenge of maintaining coherence while at the same time introducing a fragmentary dynamic into fledgling oil assemblages. This includes not only splitting policy, regulatory and commercial entities but also the much broader introduction of oil governance responsibilities and functions across many parts of the government, including within the treasury, budget function, revenue authority, audit office and central bank.

Source: (Hickey and Mohan, 2020<sub>[50]</sub>).

**Promising commitments have been made at the policy level but are yet to be realised in practice.** For instance, a 2017 World Bank Board Paper recognised the value of co-ordination in areas where efforts to improve public sector revenue mobilisation and combat IFFs overlap, including, for instance, work around beneficial ownership of firms and trusts and within specific institutions (e.g. ports and customs authorities and supreme audit agencies. “To be fully effective,” the Paper argued, “responses must draw from both the DRM and IFF lines of work to concurrently address both: (i) the tax policy and administration aspects enabling IFFs; and (ii) underlying activities and recovery efforts to further prevent IFFs” (World

Bank Group, 2017, p. 2<sup>[54]</sup>). The survey of World Bank engagements since 2017 was unable to find evidence of follow-through on this commitment in country operations (Westcott, 2020<sup>[49]</sup>). However, a project was identified in Mozambique, involving multiple bilateral and multilateral development partners and led by the World Bank Group, which clearly demonstrated the merits of engaging with NOCs at high-value points in the value chain, building capability and dividends across a range of regulatory, commercial, revenue-raising and benefit-sharing ventures. This project, the Southern African Regional Gas Project between Mozambique and South Africa, illustrates the multi-scalar, multi-modality approaches more attuned to the range of pressures bearing on NOCs. The project involved a public-private hybrid arrangement: commercial finance and government equity), plus two International Bank for Reconstruction and Development partial risk guarantees, a guarantee from the World Bank's Multilateral Investment Guarantee Agency, and an International Finance Corporation equity investment. This arrangement enabled commercialisation of the country's first gas development; improvements in Mozambique's business environment; an uptick in foreign direct investment, gas exports and government revenues that exceeded targets; and, at local scale, implementation of benefit-sharing agreements in the project's impact areas (Independent Evaluation Group, 2018<sup>[55]</sup>; Westcott, 2020<sup>[49]</sup>). Initiatives to replicate or scale up opportunities of this nature would seem worthy of consideration, particularly in the context of increased momentum on blended finance.

### 2.3. The limits of managerialism and the potential of plural, cross-jurisdictional and opportunistic approaches

**This section highlights promising examples of how the challenges faced by aid-financed engagements can be alleviated.** Specifically, it responds to the remit under Phase 1 of this programme of work to look beyond existing conventions of ODA engagements to identify approaches to corruption and IFF risks in the oil trade ecosystem that may also be responding to such challenges.

**The survey conducted during Phase 1 found that development assistance practice can sometimes rely unduly on a managerial view of how institutional change occurs** (Hickey and Mohan, 2020<sup>[50]</sup>). Managerialism refers to policy approaches and practices that assume the insertion of business logics into the affairs of public administration will be an effective response for a wide range of economic and social ills. A longstanding and controversial feature of aid practice, it is often accompanied by the tendency, in the name of good governance, to export a series of best practice reforms initially rooted in OECD country experiences and to then embark on regimes of capacity building in the anticipation that the new rules and procedures will become administratively and politically embedded (Tendler, 1997<sup>[56]</sup>; Therkildsen, 1988<sup>[57]</sup>; Barder, 2009<sup>[58]</sup>; Gulrajani, 2011<sup>[59]</sup>). Managerialism is particularly well suited to those contexts where bureaucratic capacity is high and political competition has been strongly institutionalised over a long period, although these conditions seldom apply in developing country oil states such as Congo, Ghana, Mozambique and Nigeria. Moreover, recent research argues that these kinds of reforms can have damaging effects, especially in countries that are yet to actually produce oil and, at best, impose a costly bureaucratic apparatus for oil sector governance (Frynas, Wood and Hink, 2017<sup>[60]</sup>; Weszkalnys, 2016<sup>[61]</sup>; Hickey, Kunal and Bukenya, 2015<sup>[62]</sup>; Hickey and Mohan, 2020<sup>[50]</sup>).

**Growing appreciation of the shortcomings of managerial ODA approaches has resulted in three disparate yet equally noteworthy responses, each complementary and having the potential to buck conventional ODA trends.** The first is the emergence of a new generation of thinking and working politically (TWP) practice, as evidenced by at least two innovative donor operations discussed next, though independent research would be needed to evaluate their outcomes and the likely durability of impacts. The second is the function of investigative and advocacy work, which brings a potentially influential multi-scalar political economy to an IFF problem. The third response is the potential multidimensional advisory role of the IMF and how this might be further leveraged to reduce IFF risks.

**In the past five years, concerted efforts to develop more flexible, adaptive and politically informed ways of thinking and working in aid practice have featured in oil sector governance engagements, as they have elsewhere.** Lessons have been learned about why politically informed approaches can prove to be more successful in areas where more conventional programming can fall short. High-profile examples have emerged of these politically informed ways of thinking and working in the oil and gas sector, which is not surprising given the leading role that extractive industries governance and anti-corruption reform efforts have played in setting the tone, pace and sensibility of wider good governance in other fields of aid practice. Notable among these are projects known by their acronyms: GOGIG (Ghana Oil and Gas for Inclusive Growth) in Ghana and FOSTER (Facility for Oil Sector Transparency and Reform in Nigeria) in Nigeria. Each offers important lessons as to what works, with what approaches and under what conditions – that is, contextual factors consistent with the TAP-Plus approach discussed in Section 2.1 and explored, for example, by Lopez Lucia et al. (2019<sub>[63]</sub>).

**FOSTER was one of the earliest programmes with an explicit thinking and working politically approach.** The first phase of this programme, funded by the United Kingdom Department for International Development (DFID), ran from December 2010 to mid-2016 and a second phase is scheduled to conclude during 2021. Both phases took a “politically savvy” approach to implementation aiming to “enable swift, contingent responsiveness to demands from reform-minded partners, seizing opportunities which hold promise” (Oxford Policy Management Limited, 2012<sub>[64]</sub>). Operations are grounded on three core principles: undertaking deep, regular political economy analysis to identify shifts in context that can sometimes create opportunities for reform and, at other times, close down previously promising avenues; using this intelligence to nurture relationships with sympathetic stakeholders, both inside and outside of government, and to develop contextually relevant interventions; and working discreetly to minimise risks to DFID and programme staff (Lopez Lucia et al., 2019<sub>[63]</sub>). FOSTER includes support for a suite of both demand side and supply side initiatives ranging from the passage of Nigeria’s Petroleum Industry Governance Bill to media and advocacy work to stimulate public debate about key oil and gas sector reforms such as the potential uses for gas resources.

**Evaluations have begun to identify both the successes and shortcomings of these projects and to document the wider influence of adaptive, politically informed approaches.** Overall, given the mixed results of transparency and accountability programming discussed in Section 2.1, FOSTER stands out. Evaluations variously attest to its success in improving the level of public debate about oil sector governance, reform commitments and performance and in exposing systemic corruption (Lopez Lucia et al., 2019<sub>[63]</sub>; Katsouris and Sayne, 2013<sub>[65]</sub>). Several generally applicable features of the approach have been important to this success: the quality, political savvy and networks of project staff; the flexibility with which the project could (dis)engage with partners, whether governmental and non-state; the ability to work under the radar rather than through high-profile, donor-branded modalities; and the regularity with which the approach commissions political economy analyses of the sort that could iteratively guide design and review of engagements (Lopez Lucia et al., 2019<sub>[63]</sub>; Williams et al., 2019<sub>[66]</sub>). At the same time, many of these positive attributes can also prove to be the FOSTER Achilles’ heel. It can be extraordinarily difficult to attract and retain the right mix of staff, for instance, and political analysis does not always help advance a project. Well-executed political analysis is as likely to reveal the extent to which circumstances foreclose the possibility of success, given the instruments typically available to donor programming (Hudson and Leftwich, 2014<sub>[67]</sub>; Williams et al., 2019<sub>[66]</sub>; Porter and Watts, 2017<sub>[43]</sub>). Nonetheless, the ways of thinking and acting exemplified by FOSTER and similar programmes oriented to Nigerian oil sector governance have had positive spillover effects on how donors were operating in Nigeria, both in other sectors and country wide. With respect to DFID (Lopez Lucia et al., 2019<sub>[63]</sub>) and the World Bank (Bain, Porter and Watts, 2015<sub>[68]</sub>; Bain, Booth and Wild, 2016<sub>[69]</sub>; Porter et al., 2015<sub>[70]</sub>), this is evident in the ways that country strategies were being fashioned as a result of more targeted use of political economy analysis and in the multi-scalar engagements launched by both agencies at the political, federal and state levels. Revealingly, and again this finding appears to be applicable elsewhere, evaluations have continued to note that donors’

“own political economy has distorted incentives affecting programmes in ways that work against the principles of TWP” (Williams et al., 2019, p. 45<sub>[66]</sub>).

**A shift is underway in how donors engage with the oil sector and this is producing informative analyses of what works, with what approaches and under what conditions, and yet a greater appetite for risk may be needed.** The approaches referenced by the term TAP-Plus that feature deliberate attention to what are referred to as contextual factors in Section 2.1 ) are informing a significant new research agenda. Challenges and limitations remain but, encouragingly, they are being openly and frankly discussed. For instance, evaluations of TWP at large in Nigeria conclude that “TWP has proved to be relatively successful in terms of generating and supporting ‘islands of effectiveness’ but has had more limited impact in terms of generating more systemic, transformational change” (Williams et al., 2019, p. 46<sub>[66]</sub>). Indeed, in largely favourable evaluations, as Laws and Marquette (2018, p. 1<sub>[71]</sub>) conclude in their survey of examples of TWP, “Much of the evidence ... is anecdotal, does not meet the highest standards for a robust body of evidence, is not comparative (systematically or otherwise), and draws on a small number of self-selected, relatively well-known success stories written by programme insiders” (Lopez Lucia et al., 2019<sub>[63]</sub>).<sup>33</sup> Laws and Marquette (2018, p. 7<sub>[71]</sub>) go on to note that “the programmes reviewed here – by and large – look very similar, regardless of political context, sector or organisation”. They added that it was not at this point possible to say whether this reflects the efficacy of a limited set of ways of operating or “if, in fact, this reflects growing ‘group think’ among TWP insiders” –in other words, whether it reflects a “confirmation bias” that causes programmes to reiterate the main features of influential papers, as has been the case with Booth and Unsworth (2014<sub>[72]</sub>). Such points of critical reflection are informing an active research and learning process among the community of practice that broadly encompasses TAP-Plus, TWP and the like see the proposed policy tasks and activities set out in Section 3.2.

**Transnational investigative and advocacy work has the potential to bring a new multi-scalar political economy that can directly impact IFF risks.** Consistent with this, Naval (2020<sub>[73]</sub>) reports an episode of transnational investigative and advocacy work conducted by NGOs to engage with corruption and IFFs in Congo, one of the Phase 1 country cases, that synergised with macro-fiscal transparency initiatives under the aegis of the IMF. This case has many dimensions, but it came to involve aspects of all three IFF risks (buyer selection, terms of sale, and collection and use of the proceeds of sale). Of prime interest here is that the case shows how different actors coincidentally operating in unison across different scales (and in this case, across OECD member and non-member jurisdictions) can have a disproportionately powerful impact on IFF risks at crucial moments. The power of investigative journalism is widely acknowledged, and the FOSTER programme in Nigeria commissioned several pieces of investigative research into systems and processes for the sale of crude oil, along with the waste, politicisation and abuse of discretion on the part of the NNPC (Lopez Lucia et al., 2019<sub>[63]</sub>). The Luanda Leaks is the most recent example of how revelations of grand corruption and illicit wealth can expose and provide the evidence needed to bring to account actors responsible for the systemic networking of high-capability banking, accounts and legal services agencies, including in jurisdictions supposedly compliant with the Financial Action Task Force (FATF) (Collin, 2020<sub>[74]</sub>).

**Dedicated attention and advocacy by different organisations targeting similar objectives can have favourable reform impacts.** What is particularly interesting in the Luanda Leaks case is how dedicated attention and advocacy targeting objectives similar to those pursued by quite different organisations, each with different politics, capabilities and resources, can produce favourable conditions for additional organisations to operate or gain traction. The Biens Mal Acquis (BMA) affair<sup>34</sup>, a series of corruption scandals that emerged in oil and mineral-rich central African states in 2007 is a textbook example of how transnationally networked advocacy groups, investigative journalists and legal experts can seize hold of particular information and political and legal openings and pave the ways not simply for prosecution of transnational grand corruption cases but also wide-ranging spillover effects across domains, jurisdictions and organisations (Naval, 2020<sub>[73]</sub>). The ramifications of the BMA included legislative reform in France (and strengthening of French judicial independence), the confiscation of assets, and the development of an illicit

wealth allocation system. Its revelations and momentum fed into the push for tax transparency and information exchange as well as measures such as the United Kingdom's Unexplained Wealth Orders, which require individuals and corporate bodies to explain how they acquired property. Recent legal challenges of traders, bankers and enablers have also been propelled by similar investigative work by groups such as Public Eye and Global Witness.

**It is easy to distinguish this multi-scalar mode of engaging IFFs from the approaches DAC members devote the bulk of ODA to, but it would be a mistake to overstate the distinctions or to set them in oppositional terms.** The BMA revelations and the fallout from litigation did not come without costs: The hostility of political elites to transnational advocacy movements prompted the Congolese government to temporarily withdraw from transparency programmes; local NGOs were subject to intimidation from state security forces; some businesses and firms moved offshore to more opaque and even more poorly regulated environments; and judicial proceedings were, inevitably, costly and extended.<sup>35</sup> Nonetheless, the BMA case demonstrates the clear and direct impact that networked coalitions of actors can make by operating across jurisdictions and scales. While the incremental managerial conventions embodied in the first wave of TAI and NOC engagements differs from the multi-scalar juridical way of engaging of the BMA, more intriguing is how the different conventions they represent can, by their synergies and disconnections, produce positive changes over time. The latter was the case in Congo from the mid-2000s to the present, and in this case the IMF Fiscal Transparency Code is illustrative.

**The BMA and Congo cases are part of the history that culminated in the adoption by the IMF of the Fiscal Transparency Code (FTC) in 2014 and its mandatory inclusion in IMF Article IV country surveillance reports.** Other elements that led to the FTC include the impact of criticism over the handling of the 2008-09 global financial crisis, the impact of corruption scandals (exemplified by the BMA), and the availability of a multi-donor trust fund.<sup>36</sup> IMF country experiences were also instrumental, including in Congo where a series of policy-based budget support programmes had for over a decade been wrestling with governance and fiscal transparency issues, especially serious discrepancies in accounting by the national oil company, Société Nationale des Pétroles du Congo. Many factors – domestic, corporate, geopolitical and cyclical – can interfere with the steadiness of IMF commitments to pursue IFFs and corruption and also disrupt the language of benchmarks and platforms and sequenced reform steps that typify IMF engagements. While there are many limits to IMF FTC interventions in Congo, the country nevertheless shows how the conjuncture of advocacy and civil society actors surrounding the BMA case and the interests and ways of working characteristic of the IMF became consequential. Despite the often-stark criticisms, tensions and obvious differences in approaches among the array of CSOs, the IMF, and foreign and domestic governments, they created an interdependent constellation of pressures and forces. The result was that a typically linear, cautious and reticent multilateral institution, coincidentally aligned with advocacy NGOs, pushed into the heart of structural political problems surrounding IFFs in the difficult conditions present in Congo. Section 3 of this report explores this experience further.

## 2.4. The oil trading ecosystem: Key properties that bear on IFF risk vulnerabilities

**The different perspectives on oil trading of the three Phase 1 workstreams allow for the identification of key trading ecosystem properties that will bear directly on the effectiveness of all engagements to counteract oil trade-related IFF risks and vulnerabilities.** As noted, the body of robust research on commodity traders, of any sort, is extremely thin compared to virtually every other aspect of the extractive global value chain. Workstream 3 documented the contours and practices of trading as far as possible from the perspective of industry actors, in particular traders and financing institutions. Workstream 2 was more green fields in nature, in that (for the first time, to the authors' knowledge) it looked into energy traders' corporate filings, examining the implications of how traders are structured in terms of ownership, equity, and financial accounting for IFF risk vulnerabilities. Workstream 1 made a third



contribution to understanding the oil trading ecosystem by assembling what has been learned about the industry through interventions, largely but not wholly aid-funded, to tackle IFFs in the oil industry, including via the comparatively recent focus on trading and the comparatively longer-running efforts to reform oil sector governance.

**Understanding IFF risk vulnerabilities relationally has significant implications for crafting interventions.** Phase 1 has shown what is necessarily the case with all interventions: The modalities, projects and instruments created and implemented to achieve specific aid objectives will each embody a particular logic of engagement and that this will inevitably highlight or problematise some issues more than others and, as a result, display different strengths and weaknesses. Recognition of the need to understand IFFs relationally – as products of networks of actors, instruments and operations that are highly influenced by context-dependent political economy, history and institutional arrangements – is helping to identify innovative approaches as well as the inherent limitations of aid programming. Donors have maintained support for efforts to improve transparency, corporate governance and regulatory oversight by national and supranational agencies so as to expose, sanction and prosecute transactions that relate to illicit financial flows or are at odds with the public interest. But development agencies, governments, corporate players and civil society advocates concur that the larger prize is to achieve durable changes in the ways institutions routinely operate and people behave to systemically reduce IFF risk vulnerabilities. This section draws the key findings of the three workstreams into a set of properties<sup>37</sup> of the ecosystem that drive IFF vulnerabilities and which the Phase 1 team concludes will need to be considered in crafting future interventions aimed at systemic change.

**Distilling the most important properties with respect to oil trade IFFs from the wider range of properties is a daunting challenge for several reasons.** Oil trading is part of what scholars describe as a gargantuan oil assemblage and the relatively understudied oil trade ecosystem has a history of rapid, unpredictable structural changes in response to crises. Thus, caution is warranted when arguing that a limited set of properties may be more significant than others. The ongoing COVID-19 crisis adds a further caveat on generalisations at this time. Observers have noted that COVID-19 presents the most profound challenge faced by the 100-year-old oil industry, with some predicting a permanent transformation. Any account of properties of the contemporary trading ecosystem must therefore be alert to how individual, historical conjunctures in markets have triggered unforeseen changes in the ecosystem, rendering obsolete what had previously been known or taken for granted and (sometimes quite rapidly) making what had been regarded as appropriate policy responses redundant, risky or in need of radical adjustment. The historical record shows that policy responses to such changes have sometimes amplified the ruptures or had unintended consequences for the liquidity or depth of the market, the roles of different players, new instruments, and path dependencies<sup>38</sup> (Box 2.4). With these caveats in mind, four properties of the oil trade ecosystem can be identified that, on the basis of work done to date, appear to play a key role in creating the conditions conducive to IFF risks, are most likely to bear on efforts to reduce these risks, thus need to be taken into account by donor governments, producer states or other industry actors.

**The vast expansion of international trading in energy products, minerals and food since the early 2000s has been one of the building blocks and enablers of globalisation.** The contemporary scale of movements in commodities would not have been achieved without new types of organisations that can connect locations of production, processing and consumption. Independent commodity traders have been key to these developments, harnessing both capital markets to finance trades and futures markets to offset risk and providing logistical and management services. Through these means, they have been instrumental in creating an industry that is particularly skilled at arbitraging uncertainties and variations in price, over time and across multiple jurisdictions (Trafigura, 2018, p. 56<sub>[20]</sub>).

### Box 2.4. It cannot be taken for granted that governments will maintain a conducive regulatory system

“There is a constant risk that regulators, in their understandable concern to limit systemic financial risk of the kind that nearly brought the global banking industry down in the financial crisis of 2008, will adopt measures that create unintended negative consequences for trading. It is not hard to imagine circumstances in which regulation could diminish banks’ appetite to provide trade finance or impose capital or hedging constraints on the trading business itself. It is in the interest of the global economy that such unintended consequences be avoided.”

Source: Trafigura (2018, p. 79<sup>[20]</sup>).

**Partly as a consequence of the need to reliably manage risk and optimise profits, at least four properties of the trading ecosystem appear to have amplified IFF risk vulnerabilities and/or will inevitably impact on concerted efforts by governments and industry players to respond in productive ways.** These four properties are the inherent volatility of the oil and gas market and commodity pricing; the predominant use by independent traders of offshore financial centres (OFCs) and the use of particular accounting practices; the implications of shifts in the actors, sources and instruments of trade financing for corporate governance and external regulation; and the pockets of capability that can emerge at the right conjunctures of conditions, even in frontiers that remain in most respects unpredictable and uncertain.

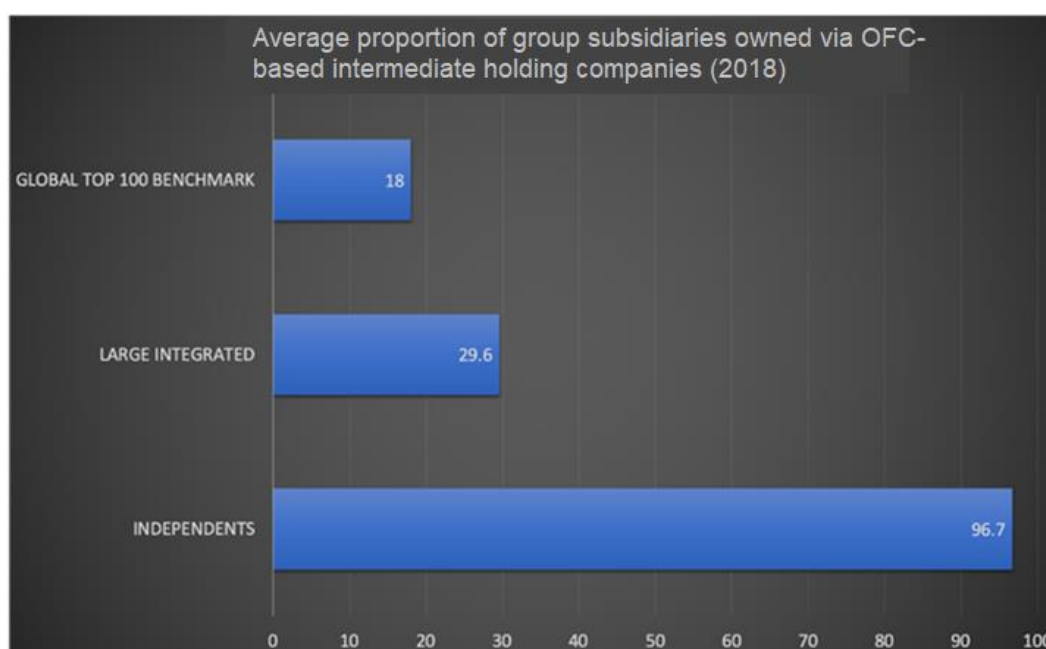
**First, while market prices are increasingly unpredictable, significant rents can accrue from successfully managing risks and arbitraging variations in price and in tax and other obligations in different jurisdictions.** It is widely understood that as the oil market has become more volatile<sup>39</sup> and thus less predictable, it has also become more capable of generating significant rents. The trading system is dynamic, and international trading houses have shown an appetite for entering into long-term structured trades on illiquid markets with higher risks. With erratic market prices, the risks are many – not least because the architecture of the system is changing partly in response to competitive pressures and volatility. Relations between market fundamentals and price have been further strained by the process of financialisation that began in the early 2000s, the advent of paper trade and the futures market.<sup>40</sup> These developments, coupled with the spectacular rise of China, transformed trading and, among other things, led to unprecedented market volatility (Trafigura, 2018<sup>[20]</sup>). At the same time, these developments also opened opportunities for speculative behaviour, making it increasingly difficult to determine the genuine market value of crude oil (Cheng and Xiong, 2014<sup>[75]</sup>). Faced with the need to arbitrage variations in price and regulation across multiple jurisdictions and time frames, trading firms use sophisticated risk management techniques to optimise the relationships between revenues and costs and operate effectively in volatile markets. Using a variety of risk management techniques, trading houses capitalise on opacity and corporate fragmentation to ensure that values and risks are manoeuvred within a corporate group, often putting them beyond effective public reporting requirements or public scrutiny. At a minimum, this can make it more difficult for policy makers and regulators to distinguish legal from illegal activities and to interpret the corporate intentions behind the following practices.

**Second, large independent traders are exceptional users of OFC jurisdictions.** On average, 18% of group subsidiaries of the top 100 global industrial firms in terms of revenues were owned via OFC-based intermediated holding companies in 2018. The analysis of the energy trading sector in Phase 1 of this programme of work found that for the large integrated firms in the sample, the proportion is an average of 29.6% and is dramatically higher for the independent trading companies, at to 96.7%. Although not expressly illegal, the use of OFC-registered subsidiaries remains highly controversial and the role of OFCs

in corporate organisation is far from settled. Nonetheless, the large independent trading houses are likely to derive substantial benefits from this disproportionate and exceptional presence in the offshore world.

**An overwhelming share of trading operations are conducted through legal domains and deploy accounting practices that purposively reduce tax commitments, but can also make transparency and regulatory scrutiny difficult.** While traditionally based in OECD jurisdictions, including Switzerland<sup>41</sup> and the United Kingdom, many traders have expanded their presence in East Asian trading hubs, among them the emerging offshore financial centres of Dubai and Singapore. These hubs are closer to expanding markets and are perceived by some independents to be more attractively taxed and regulated while at the same time offering economies of scope and scale.<sup>42</sup> OFCs and their various global hubs have become important features of the contemporary landscape of the global corporate economy (Saez and Zucman, 2019<sup>[76]</sup>; Zucman, 2015<sup>[77]</sup>; Shaxson, 2011<sup>[78]</sup>). But the large independent trading houses seem to derive substantial benefits from a disproportionate and exceptional presence in this offshore world (Figure 2.1).

**Figure 2.1. OFC-Controlled Subsidiaries**



Source: (Bureau van Dijk, 2021<sup>[79]</sup>).

**The disproportionate use of OFCs appears to be associated with several accounting practices that raise potential IFF risks, and therefore merit further exploration.** One is the practice of centralising and pooling value among different entities within the group, mixing trading; treasury (administrative and financial) operations; and the presence of internal shadow bank functions (that provide liquidity for trades). Doing so can be advantageous to the trader, but potentially creates IFF risks. Another is the common pattern of a fixed operating margin cost structure, whereby nearly all revenues are matched by a commensurate rise or decline in expenses on a yearly basis and which allows accounts to be managed (as illustrated in Box 2.5). Among other such practices is also the use of what has been identified as a class of dormant entities for which there appear to be no operational functions but could potentially be deployed as vehicles to accumulate the profits and/or returns on capital acquired elsewhere.

### Box 2.5. The Gunvor case in Congo

This case study pertains to illicit payments by Gunvor to a Congolese agent. These were discovered in 2011, when Credit Suisse, having acquired Clariden Leu bank, performed its own independent auditing and due diligence and noticed suspicious payments amounting to more than USD 30 million that Gunvor had to the accounts of several individuals. The case study also shows that when the energy trading firm becomes in effect a shadow bank, the operations and transfers among different legal persons, both internal and external to the group, produce fragmentation of compliance that can be exploited for IFF purposes. Although an external bank may be involved in the financing of a deal, the bank does not track the entire transaction through the series of legal persons and may only satisfy itself that its direct counterparty in the transaction complies with the relevant anti-money laundering rules.

Source: (Engebretsen, 2020<sup>[80]</sup>; Culbert, Dawson and Isaieva, 2020<sup>[15]</sup>).

#### **In general terms, the intensive deployment of OFC-based subsidiaries and novel accounting practices adopted by independent trading firms can be driven by privacy, secrecy, accounting or other purposes.**

Opacity in the system of governance, internal reporting, and the degree and quality of information available to external stakeholders may reflect either the group's organisational weakness or an intention on the part of management to obscure the firm from external monitoring and scrutiny. The concept of the OFC is highly controversial (Boise and Morriss, 2009<sup>[81]</sup>; Buckley et al., 2015<sup>[82]</sup>; Garcia-Bernardo et al., 2017<sup>[83]</sup>; Palan, 2010<sup>[84]</sup>; Zoromé, 2007<sup>[85]</sup>; Palan, Murphy and Chavagneux, 2009<sup>[86]</sup>). However, a body of empirical research shows that opacity can serve several functions or purposes:

*Taxation.* Whether or not they employ legitimate (or not legitimate) tax mitigation strategies, and taking into consideration the heavy reputational risks associated with tax avoidance, many groups structure their corporate organisation and financial activities so that tax mitigation schemes are not readily detected (Auerbach et al., 2017<sup>[87]</sup>; Desai and Dharmapala, 2018<sup>[88]</sup>; Giovannini, 1990<sup>[89]</sup>).

*Autonomy in relation to suppliers of finance.* Managers structure the firm's corporate holdings and financial transactions in a way that achieves a degree of autonomy from scrutiny by suppliers of finance (Aguilera and Crespi-Clader, 2016<sup>[90]</sup>; La Porta et al., 2000<sup>[91]</sup>; Bendell, 2016<sup>[92]</sup>; Shleifer and Vishny, 1997<sup>[93]</sup>).

*Commercial and strategic operations.* Corporate opacity is created in order to limit the ability of competitors to learn about the group's strategies and tactics (Chambers, 2006<sup>[94]</sup>; Holland, 2005<sup>[95]</sup>). Privacy, however, is often confused for secrecy. Secrecy is often used as a legal shield to cover up illegal actions by businesses (Nesvetailova et al., 2021<sup>[96]</sup>).

*Illicit finance.* Opacity is created to allow management discretionary use of funds generated by the group, either for international remuneration prizes or external payments to third parties, but not recorded in the group accounts (Mishra, 2005<sup>[97]</sup>).

**Opacity facilitates corruption and IFFs, and complex ownership structures are often seen as suspect and contrary to good corporate governance practices** (UNCTAD, 2016, p. 129<sup>[98]</sup>). That said, this report does not suggest that trading with a distant and opaque entity through accounting practices that are difficult to discern and/or track necessarily implies that the activities the firm is engaged in are necessarily illicit or involve illicit finance.

**Third, key emerging features of the trading ecosystem make effective regulation of transactions more difficult.** The complexity of corporate arrangements and accounting practices, coupled with trends in the sources of trade financing, pose greater challenges to corporate due diligence and internal governance as well as to scrutiny by external third parties. Independent energy traders have evolved into highly complex, multi-subsidiary, multi-jurisdictional organisations, often encompassing hundreds if not thousands of independent corporate entities linked together in a complex web of ownership arrangements. The preference (and comparative advantage) of

large independent traders for long-term structured trades with higher risks – that is, risks associated with counterparties, markets, pricing, operations and credit – means that deals tend to be financed by an increasingly diverse range of financiers and a wider range of more complex instruments such as offtake agreements, commodity swap arrangements and resource-backed loans. These deals enable traders to access resources below market prices, and can be struck in any jurisdiction, structured across tax regimes, financed offshore and delivered in a variety of locations, providing traders a distinct and competitive market advantage. According to industry insiders, punitive levies or fees increasingly commanded by the big banks for so-called “brown” investments, i.e. investment in fossil fuel industries, will likely further drive conventional lenders out of the commodity trading business, accentuating a growing market demand for non-conventional sources of development finance (including sovereign wealth funds, venture capital and independent traders). In other words, current trends, which have to a large extent eluded policy or market regulation, are likely to continue and perhaps pose insurmountable regulatory challenges, especially in conjunction with trends towards localisation.

**The rise of local banks and traders and of joint venture arrangements, a trend sometimes referred to as localisation or nationalisation of trading finance and business entities, is adding to the challenges of corporate governance and industry regulation.** This emerging property of the oil trading ecosystem appears to be having several effects of direct relevance to IFF risk vulnerabilities. It increases the relative difficulty of establishing the *bona fides* and identity of counterparties to the deal. This makes it harder to apply counterparty due diligence protocols and thus weakens internal corporate good governance. Similarly, it can make more difficult the consistent application of global norms and standards by external regulatory authorities. These observations are borne out by the FATF findings on the effectiveness of anti-money laundering measures, which show a trend towards reduced effectiveness outside of the traditional trading hubs of the United Kingdom, Switzerland and Singapore.<sup>43</sup> These challenges are magnified in the producer countries where joint venture or financing counterparties may be registered and where fewer effective regulatory mechanisms exist. In such areas, commercial trading entities tend not to be registered in global exchanges, which typically prescribe basic reporting obligations. There are pronounced constraints on audit and regulatory authorities in these country contexts; for instance, among the NOCs in the four country cases reviewed in Phase 1, only the Angola national oil company, Sonangol, presents financial data.

**In sum, corporate regulation whether through internal good corporate governance procedures or conducted by external regulatory authorities, would appear to be facing challenges from two directions.** On one hand, use of the terms nationalisation and localisation points to the fact that oil trade business is increasingly being conducted in contexts that academics refer to as “frontiers”<sup>44</sup> and “areas of limited statehood” (Korf et al., 2018<sup>[99]</sup>). The frontier conditions of Congo, Nigeria or Tanzania are challenging spaces where outcomes are not determined by a single, overarching formal code of law or business protocol. It is on the other hand misleading to see frontiers as ungoverned or disordered spaces, as they sometimes are referred to. Rather, the manner in which they are governed is the outcome of purposive political action and particular kinds of capabilities. Nonetheless, from the viewpoint of the kinds of good governance practice familiar in OECD country contexts, they will appear to be fuzzy and opaque – at best, only partly legible and often quite hostile to the kinds of corporate and third-party external regulation fashioned in OECD settings.

**Intensive use by independent traders of OFC jurisdictions, combined with the complexity of corporate holdings often running through OFC jurisdictions, can also significantly weaken the system of corporate governance.** It also renders the structure of corporate trading entities so fragmented and opaque that they become fathomable only to the parties – the corporate executives and the accounts and audit industry – directly responsible for establishing them. Such opacity can facilitate illicit financial dealings, including by making it difficult for auditors and regulators to determine the geographical and jurisdictional origin of economic activities and the true costs or profits made through energy trading (including isolating “higher than usual” profitable deals). These difficulties highlight the need to appreciate that frontier conditions, where statehood may be limited, prevail not only in those parts of the global value chain where producer states, NOCs, and their particular kinds of political and administrative arrangements are most prominent. Frontier conditions are increasingly found elsewhere in the oil assemblage including in OFCs that are populated by shell and dormant companies and consolidated and encased

by law, financial institutions, audit companies and the like. In these settings, extraordinarily capable expertise and resources are brought to bear in ways that pose unique challenges for public authorities to reach in and regulate, even in high-capability regulatory environments such as Singapore or Switzerland. This means that measures to impact on IFF risk vulnerabilities must address both kinds of settings where frontier conditions exist, each the product of purposive action, each marked by a radical lack of transparency and disclosure, and each deeply related to the other through the networks, actors and agents within the oil assemblage (Soares de Oliveira, 2020<sup>[100]</sup>).

**Finally, while some properties of the oil trade ecosystem make producer countries vulnerable to the adverse development impacts of IFFs, pockets of effectiveness do emerge under particular conditions to counteract these vulnerabilities.** When considered together, the four properties discussed here chart the enormity of the challenge of IFF mitigation. But the on-the-ground reality is far from a monochrome of insurmountable odds, deficient institutions or underlying political settlements that are only ever antagonistic to reforms (Box 2.6). The challenge is to understand why particular instruments – transparency measures, NOC reform packages or revenue management protocols, for instance – can gain traction, become embedded and serve to create pockets of effectiveness even in settings that are seen to exhibit the worst of the so-called resource curse<sup>45</sup> (Roll, 2014<sup>[101]</sup>). Reviewing experience, all research under Workstream 1 points to the crucial importance of the conjuncture (whether a moment of political or economic crisis, a corruption scandal, or the existence of conflict) and the absolute need to align reform measures (i.e. institutions) with elite incentives (i.e. the interests of particular social groups), both of which are grounded in a country’s prevailing political settlement. The existing knowledge of how these processes work does not, of course, provide a basis for ex ante prediction and certainly not for an order that could reliably be operationalised in donor programming.

### Box 2.6. Reforms and political settlements

Reforms have moved the furthest and capabilities have been built most effectively where cohesive ruling blocs offered political protection and support to key organisations, usually through mobilising a moderate version of resource nationalism (e.g. for certain periods in Ghana, Tanzania and Uganda) ... Reforms have been most strongly resisted and/or manipulated and the development of oil governance capabilities most restricted where political settlement dynamics can be characterised in terms of “resource factionalism”.

Source: (Hickey and Mohan, 2020<sup>[50]</sup>).

Scholarship has also progressed beyond the mere recognition that time, context and conjuncture matter. It is evident, as elaborated in Box 2.7, that moderate levels of resource nationalism can enable ruling elites to overcome the collective action problems created by elite factionalism, protect high-performing organisations, and to build a shared project between politicians and oil technocrats. An example, is Uganda and Tanzania in the mid-2000s). Conversely, considerable knowledge has now been accumulated across several sub-Saharan African producer countries that could reliably inform donor programming discussions about the likely consequences of pursuing various reforms and about strategic choices around the best modalities to engage with or to forgo opportunities. As noted in Parts A.1 and A.3, this knowledge can also inform donor conversations about how to apply the second wave of thinking about governance reforms in the extractives sector at large.

### Box 2.7. Localisation

“Opening accounts in terms of compliance is very different in Africa than by established Western banks. Furthermore, they don’t have the same capital requirements, which led to the resurgence of African banks, as European banks are very heavily regulated and cannot compete with local banks to finance high-risk African business.”

Source: Interview with the head of commodity trade finance in an international bank in Switzerland, conducted 26 November 2019.

# 3 Future engagements: Lessons and opportunities

What does the analysis in Section 2 imply for efforts to tackle the risks of illicit financial flows (IFFs) in oil and gas trading and deliver benefits for high-vulnerability countries? Phase 1 provided an initial mapping of networks and actors and a strong appreciation of the multi-scale and multi-jurisdictional nature of the oil trade ecosystem. It has also highlighted the conditions under which, at various times and places, opportunities for effective IFF risk mitigation may open and/or close and flagged some oil trading ecosystem properties that, on their face, appear to represent hard constraints on tackling IFFs. Further work is needed to determine how these constraints might impact potential mitigation measures and opportunities for engagement. Section 3 is divided into two sections. Section 3.1 sets the stage, summarizing key lessons and constraints. Part 3.2 considers proposals for carrying this programme of work forward and to expressly engage with IFF risks.

## 3.1. Lessons and constraints

**Two properties of the oil trade ecosystem are worth keeping in mind when considering policy responses or engagements.** First, the growing prominence of traders and trade financiers from non-OECD countries means that transactions increasingly occur in spaces that can be several steps removed from OECD member regulatory authority.<sup>46</sup> Moreover, the merits of extending global financial standards applicable in OECD settings to other jurisdictions, including developing countries, are contested (Knaack and Gruin, 2017<sub>[102]</sub>) even when circumstances appear favourable to their adoption (Jones, 2020, p. 3<sub>[103]</sub>). At the same time, for the most part, OECD members are able to engage directly only through development assistance programming. Even the large independent trading houses registered in Switzerland and the United Kingdom now also draw a significant share of trade financing from institutions outside the regulatory controls of these two jurisdictions, where equivalent regulatory standards do not apply (KPMG International, 2016<sub>[104]</sub>; Jones, 2020<sub>[103]</sub>).

**The second of these properties is the limitations of so-called hard requirements, which hold out the prospect of more systematic regulation of the oil trade ecosystem but are constrained in terms of their reach, application and effectiveness.** There is no reason why an OECD member could not regulate traders in its jurisdiction to render its dealings with national oil companies (NOCs) more transparent. The focus of existing legislation is general rather than on any particular risks associated with trading with NOCs.<sup>47</sup> The efficacy of indirect supervision, whereby transactions of trading companies are indirectly regulated by the banks that finance them, remains contested, with critics arguing that it has never been convincingly demonstrated<sup>48</sup> (Box 3.1). There is no regulation that requires banks to check the due diligence of a third party, or knowing your customer's customer. However, as Culbert, Dawson and Isaieva (2020<sub>[15]</sub>) note, transactions such as oil-backed loans or syndicated loans are subject to a high degree of scrutiny involving the lawyers of banks, the NOC and the trader. In sum, this means that the effectiveness

of regulation in identifying and mitigating IFF risks relies partly on the maturity of understanding of the regulated firms and partly on the ability of regulators to identify where regulations are failing and their ability to sanction violators or compel compliance. Moreover, as the Financial Action Task Force (FATF) mutual evaluations of the United Kingdom and Switzerland concluded, while firms display a strong fundamental understanding of the risks that they face in respect of IFF control frameworks, the application of these controls has been found to be inconsistent at times (Financial Action Task Force, 2018<sup>[105]</sup>; Financial Action Task Force, 2016<sup>[106]</sup>).

### Box 3.1. Indirect supervision

Obligations to perform due diligence and to monitor transactions apply to financial institutions and the regulated activities of commodity trading firms ... but these do not currently require any specific considerations in respect of clients or counterparties who are trading with a NOC.

Source: (Culbert, Dawson and Isaieva, 2020<sup>[15]</sup>).

**Early efforts to influence the oil trade ecosystem are helping define what is likely to be effective in reducing IFF risk vulnerabilities but implementation outcomes remain largely uncertain, reinforcing the need for highly flexible and adaptive approaches.** A steadily growing body of research and experience from operational engagements are shining a light into the black box of the oil trade ecosystem. But it remains difficult to predict what might work due to the significant diversity across country contexts and global affiliations. This creates IFF vulnerabilities; strengthens the incentives of buyers and sellers to manufacture and maintain opacity; and makes the trade system hypersensitive to crises and increasing market volatility. The diversity should not deter action. Rather, it reinforces the need for creative flexibility and adaptiveness: Using prior analysis to inform engagements and ensure they that they align with the networks and incentives that have the potential to create and expand existing pockets of effectiveness. Analytic tools may soon be available to help identify the ways in which different political settlements and country histories, settings and relations with global oil trade networks will support or undermine the emergence of pockets of effectiveness (Hickey and Mohan, 2020<sup>[50]</sup>). But given the sensitive, opaque and unpredictable nature of the issues at hand, it will be important above all to remain alert to the unforeseen consequences that engagements may produce.

**Interventions that aim to reduce IFF risks in oil trading are likely to continue to face an acute and possibly growing implementation gap.** This term refers to the persistent difference between what is intended and may have been agreed, on one hand, and what is actually adopted, implemented or complied with in practice, on the other (World Bank, 2017, p. 92<sup>[46]</sup>). Indeed, as Eisen et al. (2020, p. 6<sup>[32]</sup>) conclude in a report for the Leveraging Transparency to Reduce Corruption project, “Resource-rich countries, on the whole, have shown little progress over the past fifteen years in multiple dimensions; if anything, there has been some deterioration [and] evidence suggests that the corruption challenge has become even more dire”. Several conclusions are being drawn from these findings. One is that in relation to trade transaction transparency initiatives, “there are very few hard requirements” (Gillies, Malden and Williams, 2020, p. 40<sup>[1]</sup>). Another is that the current focus – the adoption of transparency and accountability initiatives – is unlikely on its own to deliver results without accompanying measures to regulate and limit the effects of the core systemic properties of the oil trade ecosystem<sup>49</sup> (see Section 2.4 for a summary).

**There is a high probability that policy and other engagements in the oil trade ecosystem will have unintended effects.** Although not free from self-interest, oil trade industry informants characterise oil trading as a “high-risk, high-volume and low-margin” enterprise that is “poorly understood” and thus especially prone to the unintended effects of policies crafted by those less well informed. One much-applauded consequence of policy introduced following the global financial crisis was that large banks



(e.g. Morgan Stanley, Deutsche Bank, etc.) faced stricter regulation and tighter constraints on capital movement. An unintended effect, to be verified during Phase 2 of this programme of work, has been the retreat of larger commercial banks from the trading of physical commodities, including oil and gas. Several unintended effects have been attributed to this. One is that the reputedly superior compliance capability and performance of large banks, by virtue of their legal obligations and depth of corporate good governance systems, are now confined to a narrower range of transactions and instruments. The adverse effects of this are reportedly felt both on a transactional basis and in terms of the wider compliance culture of the oil trade finance market. Another reported effect has been the entry of new players – traders as financiers and regional banks and joint venture partners as part of a localisation process – that are said to be less subject to regulation and operate with less assiduous regard for global norms and standards (Enoch et al., 2015<sub>[107]</sub>; Lund et al., 2017<sub>[108]</sub>; Culbert, Dawson and Isaieva, 2020<sub>[15]</sub>). Informants argue that these trends, by some measures attributable to policy interventions, have proliferated the risks of IFFs in the oil commodities trading sector (Lund et al., 2017<sub>[108]</sub>)

**The conjuncture of rising debt, increasingly volatile oil prices and the COVID-19 crisis is likely to increase the vulnerability of sub-Saharan African oil and gas producers to IFFs** (OECD, 2020<sub>[7]</sub>). As highlighted in Section 2, some countries were on the verge of debt distress even before the pandemic, having seen public debt levels rise above those prevailing at the onset of the 2008 global financial crisis. The risk profile of African producer country debt has also shifted. Much of current debt is on commercial terms with higher interest rates and shorter maturities. Many countries are exposed to non-Paris Club multilateral and bilateral creditors.<sup>50</sup> These shifts, coupled with the overall structural decline of the fossil fuel industry, heightened oil market volatility (both episodic and trend-wise) and market saturation, and now, with the inevitable fiscal burden of COVID-19, add to increased IFF vulnerability for high vulnerability countries.

## 3.2. Engagement opportunities

**Phase 1 of the programme of work identified several features of the governance structures and practices of oil trades and trade financing that warrant verification or further analysis in order to better understand their salience for IFF purposes.**<sup>51</sup> Building on these initial insights, this concluding section recommends four areas for future engagement to either better understand the risk of IFFs in the sector or to ameliorate their prospective impacts. These areas, comprising several activities and sub-themes, include:

- trader and financier corporate governance
- rethinking official development assistance (ODA) relationships with high vulnerability NOCs
- fostering multi-agency engagements including the potential of International Monetary Fund (IMF) Fiscal Transparency Code (FTC) Pillar 4
- assessing the comparative returns and potential of greater commitments to data transparency.

Although each area of engagement corresponds to particular aspects of vulnerability that accentuate the risks of IFFs in oil commodity trading, they vary considerably in their scope and character. Given the diversity of the policy and operational responses proposed, should this programme of work move forward, consideration would need to be given to identifying the appropriate entity to take a lead role and how best to organise these future activities. The end result of these proceedings may be that the activities proposed in the following subsections are further modified and adjusted.

Whereas Phase 1 was carried by the Anti-Corruption Task Team (ACTT) Secretariat (albeit in close collaboration with other relevant OECD policy directorates), some of what is recommended is more appropriately carried by other agencies. Subsection B.2.5 suggests how the results from Phase 1 could be packaged and disseminated and outlines a series of potential deliverables that could result from Phase 2.

### **3.2.1 Understanding the rationale for trader and financier corporate governance structures, practices and obligations**

**Several distinguishing features of trader and financier corporate governance structures, practices and obligations warrant further enquiry and expert consultation.** There is need to establish the motivations and implications of corporate entities' accounting practices, the ways in which they are structured, and their disproportionate use of offshore financial centres (OFCs) that were identified by Workstream 2 (Nesvetailova et al., 2021<sup>[96]</sup>) and are summarised in Section 2.4.

**The retreat of global banks from high-risk markets after the global financial crisis has also left space for less well-regulated and largely privately-owned actors to capture this business.** Another apparent consequence of new banking regulations and due diligence (know your customer) obligations is the rise of local banks and traders (and potentially joint venture arrangements) –a trend sometimes referred to as localisation or nationalisation of trade finance. These new trends appear not only to have increased the relative difficulty of establishing the identity of counterparties to the deal, thus weakening the effectiveness of corporate governance protocols and significantly increasing the IFF risks involved, but also to have resulted in relevant actors being subject to less onerous regulatory supervision. As noted above, there is high risk the policy and regulation aimed at curtailing IFF risks can have unintended effects. As commodity firm Trafigura (2018, p. 79<sup>[20]</sup>) notes, “There is a constant risk that regulators, in their understandable concern to limit systemic financial risk of the kind that nearly brought the global banking industry down in the financial crisis of 2008, will adopt measures that create unintended negative consequences for trading.”

**The following four policy tasks and activities are recommended to verify initial findings; better understand the risks of IFFs potentially arising from these corporate structures, practices and obligations; and identify suitable policy proposals to reduce or ameliorate any resulting IFF vulnerabilities.**

1. Engage in a series of consultations to verify findings and better understand the rationale behind emerging corporate structures and behaviours. Doing so will enable policy makers to better distinguish suspicious behaviour giving rise to IFF risks from behaviour motivated by legitimate commercial interests. Further consultations should be undertaken with key industry groups including the Swiss Trading and Shipping Association and members of the Extractive Industries Transparency Initiative (EITI) Commodity Trading Working Group (in which the ACTT Secretariat participates) along with a series of bilateral exchanges with integrated energy firms; large and small and mid-sized independent traders; and the United Kingdom and Swiss regulatory authorities. Such work would further benefit from the engagement of a forensic accountant and/or base erosion and profit shifting, or BEPS, specialist to understand the motivation behind the corporate structures that are emerging and help distinguish between legitimate and illegitimate behaviour.
2. Study past responses of selected commodity trading firms to increase understanding of how these firms are likely to respond in the future. Further research is needed to ensure that any proposal seeking to influence the behaviour of traders is well targeted and that unintended consequences are minimised. A potentially fruitful avenue could be studying how trading firms responded to past efforts to influence traders' behaviours through regulatory changes or scrutiny, media exposes, or industry self-regulation. Research could also examine the efficiency of existing mandatory and voluntary initiatives<sup>52</sup> in influencing commodity trading firms' IFF risk behaviour. While trading firms themselves often reference these initiatives as proof of their good behaviour, it is not clear how impactful they really are. By using time series data, the OECD could potentially track the behaviour of a selected number of large trading firms over time and observe their response to certain identified instances and events.
3. Conduct further research on activities that carry high IFF risks. Due to data and time limitations, WS 2 was unable to draw any conclusions about joint ventures, including for instance their rationale

and scope. This is an important gap, given that existing literature and the findings emerging from WS 3 suggest that joint ventures entered into by commodity trading firms on one side and NOCs or politically exposed persons<sup>53</sup> on the other potentially carry high IFF risks. Subject to OECD-DAC agreement, further research could take a more targeted approach towards studying complex relationships, such as joint ventures, as part of this second phase of work. This would involve focusing on a smaller number of corporate groups or countries than in Phase 1 of WS 2 and would be subject to the datasets researchers could leverage.

4. Introduce corporate good governance and regulation. Industry responses to Phase 1 surveys (under WS 3) suggested that corporate governance is the best bulwark against IFF risky behaviours, and specifically its three lines of defence: business-led risk assessments and controls, compliance oversight, and independent assurance. To a degree, the decision by some traders to participate in the EITI and report in line with EITI Requirement 4.2 reflect this view. It was further asserted that internal controls had been strengthened in response to high-profile scandals (Engebretsen, 2020<sup>[80]</sup>) and that external regulation was unnecessary given the high risk it might inadvertently affect the liquidity, depth, etc. of this high-risk, low-margin and volatility-sensitive trade system. These views contrast with the analytic findings that some features of trader corporate governance are concerning (e.g. the disproportionate use of OFCs, the shift towards more lightly regulated jurisdictions and the limited nature of corporate governance practices<sup>54</sup>). The views also contrast with findings regarding the evident limits on the reach in practice of official regulatory bodies (i.e. United Kingdom and Swiss findings by Culbert, Dawson, & Isaieva (2020<sup>[15]</sup>)) and the increasing prominence of players from non-OECD member states. Given these contrasting views, further discussion and exploratory work are required.

Targeted discussions, informed by the above four areas of enquiry, are needed with traders, management and audit service providers, and financial regulators on the efficacy of new regulatory or prospective soft policy initiatives. To illustrate the possible scope of prospective soft policy initiatives discussion could expand on, among others, the OECD (2019<sup>[109]</sup>) report, *Due Diligence for Responsible Corporate Lending and Securities Underwriting: Key Considerations for Banks Implementing the OECD Guidelines for Multinational Enterprises*; the role of banker associations (e.g. the Wolfsberg Group, etc.); and the merits of requiring large independent trading corporates to develop capability to apply enhanced assurance safeguards to strategically important transactions – both ex ante before deals are closed and via ex post review to ensure practices are in accordance with benchmarks (much as is done with current anti-bribery and sanctions obligations).

5. **Enhance the role of banks to reduce IFF risk vulnerabilities.** According to Phase 1 results, the withdrawal of large commercial banks appears to have led to more unregulated activities in the physical trade and first trade space, as trading firms themselves are not subject to direct regulation. One question that would be worthy of further enquiry is whether (and if, so how) reintroducing large commercial banks into this space would help improve the coverage and effectiveness of regulation, both through corporate governance practices and by external public authorities. The intention would be to, among other things, reduce the prevalence of oil-backed lending via unregulated entities and/or improve the standards of performance in local and/or regional finance and trading companies. This activity would also contribute to ongoing debates and existing policy dialogue – for example within the Financial Stability Board, FATF, World Bank and IMF – on how to respond to the problem of de-risking and the withdrawal of the large commercial banks from several developing countries considered too high risk. It also would complement the results arising from the work proposed under activities c) and d) above by generating recommendations specifically targeting physical commodity trade.

### 3.2.2 Rethinking ODA relationships with high-vulnerability NOCs

**NOCs are central features of the oil trade nexus but are widely seen as underperforming or corrupt.**

Phase 1 of this programme of work has pointed to the diverse character of NOCs and their dominant role in oil-producing economies due to the sheer volume and value of commercial transactions for which they are responsible. Some NOCs are commercially structured, meaning their structure is similar to that of international oil companies (IOCs). Others sit at the intersection of state commercial activity and the state's power to allocate rents, generating capital assets and investment and enabling delivery of service sector priorities while at the same time playing politically crucial roles in national policy and statebuilding. Because sub-Saharan African NOCs grapple with these contradictory pressures, the tendency has been to regard them as inefficient or poorly managed and to underperform on transparency and accountability norms. This view impacts these NOCs' ability to affordably raise capital for investments from international markets. They also struggle to raise revenue from a range of points across the value chain (where such opportunities exist) and to respond to the variety of development responsibilities that governments and citizens of resource-rich countries typically expect their NOCs to fulfil.

**Opportunities are being missed to assist NOCs to develop broader capabilities and enhance their overall performance.**<sup>55</sup>

For the most part, development actors see NOCs as the key to success in stemming corruption and IFFs in oil and gas producer countries and as prerequisites for public sector reforms that will deliver growth and social inclusion. Yet, this research has shown that opportunities are being missed to include NOCs among the suite of public sector reform initiatives typically sponsored by development assistance agencies, including, for instance, domestic revenue management, public finance and procurement management reforms (Section 2.2). Among the numerous World Bank and bilateral agency projects supporting public finance management or procurement reforms, there are few examples of this programming deliberately including NOCs to enhance their capabilities, for example with respect to selection of buyers or their relationships with mainstream ministries responsible for treasury, revenue and expenditure management. At the same time, WS 1 research cites clear evidence in which ODA engagements – e.g. in Ghana, Mozambique and Uganda (Hickey and Mohan, 2020<sup>[50]</sup>; Westcott, 2020<sup>[49]</sup>) – have combined innovative approaches with favourable conditions of possibility (both local and global) to deliver outcomes that would ordinarily seem to be unlikely. Nevertheless, for the most part, the evidence suggests that there are risks of foregoing opportunities to strengthen NOC capabilities if these entities are viewed only from the perspective of transparency and corruption or if they are sporadically targeted for copy-book reforms or capacity building around a limited set of sector policy or regulation functions.

**Opportunities are being missed in two ways.** The first relates to lost opportunities to help NOCs to develop capabilities to deal with external parties, including overseeing and enforcing IOC compliance with rules and using relationships with multilateral institutions to help soften risks faced by financiers (such as by arranging risk guarantees or equity interests). These capabilities may also refer to enabling IFF risk management by the NOC. This may be through, for instance, public sector procurement, contract management (negotiation, oversight, interdiction), or revenue administration. It may also be through the NOC's engagement with its relevant partner ministries, including treasury and finance, regulatory authorities, or line ministers on whose behalf the NOC may be obliged to deliver or realise value through investments of a service delivery or capital nature.

**Second, ODA could benefit from a greater appreciation of the diversity of both NOCs and the offshore enablers that might limit the impact of domestic and/or individual country action.**

Leaving aside the select few cases in which NOCs may be performing well, on the whole, Phase 1 empirical findings suggest that ODA engagements with NOCs could gain more traction with a greater appreciation of the enormous variance in the character, complexity and capability of a NOC and of the offshore enablers – i.e. the company registrars, banks, auditors' accountants, etc. – that might influence NOC performance or behaviours and limit the impact of development interventions targeting NOC performance.

**The following six policy tasks and activities are proposed as future areas of work through which the OECD and its partners could serve to attenuate IFF risks and improve the development impact of NOCs in sub-Saharan African producer countries:**

1. **Map the existing needs and capacities of producer country NOCs to establish where and how DAC members might engage.** A mapping exercise of the de facto and de jure portfolio of responsibilities and activities of a selection of sub-Saharan African NOCs could yield a better appreciation of the range of functions and activities in which these entities are obliged to engage, including for national development and political purposes. This exercise would also seek to identify where NOCs fall short in ensuring efficiency and integrity in first trade transactions. This exercise could build on the work already started as part of Phase 1 and on the more positive experiences of ODA engagement, such as those identified in Mozambique through the South Africa-Mozambique gas pipeline. Further mapping, undertaken in liaison with NOCs, could assist DAC members to develop a diagnostic instrument that would enable them to identify pockets of capability and thus opportunities to engage in strengthening the capability and performance of NOCs and any other agencies assigned first trade responsibilities. In addition to engaging directly with producer country NOCs, for example, there are opportunities for productive discussion on the way forward through workshops such as that to be hosted jointly by the African Union Commission and the OECD and in fora such as the Chatham House New Petroleum Producers Discussion Group.
2. **Improve NOC trading capabilities.** Greater trading expertise combined with proper price risk management may increase the profitability of NOCs, reduce their reliance on high-risk deals, and improve their ability to manage market fluctuations to their advantage. Informed by the mapping proposed under activity a. above, this activity could be developed in conversations with NOCs, donor institutions (e.g. Oil for Development and the G7 CONNEX Initiative<sup>56</sup>), and relevant organisations such as the commodity exchanges. Relevant functions for development might include NOC capabilities in deal origination, trading and risk management as well as in the ability to review, audit and certify trade deals. One example, though ambitious, could see blended finance targeted to support the creation of a first trade exchange that would enable free and transparent trading activity between NOCs and large traders. Some cash-rich NOCs are developing trading, deal origination<sup>57</sup> and risk management capabilities, raising the question of whether there could be scope for ODA to assist in building origination and risk management capabilities within NOCs through blended finance modalities and, by doing so, assist NOCs to reposition themselves to harness the opportunities of transition towards cleaner and more diversified industrial policies. Other questions present themselves, as well. Is there a possibility to create advisory facilities that would allow NOCs to draw from a common pool of resources and technology and over time develop in-house capabilities for effective trade and investment capabilities, including in cleaner industries? Is there scope for DAC members to support NOC capability to review, audit and certify trade deals such as once provided via the Commonwealth Secretariat?<sup>58</sup> If so, such assistance would be a logical corollary to the NOC mapping activity described above.
3. **Extend existing ODA procurement support to NOCs.** The selection of buyers and allocation of rights to buy oil or gas from NOCs is one of the three high-priority IFF risk areas. Phase 1 analysis found no instances where development partners had directly supported procurement reforms in NOCs despite the fact that in most of these country cases, DAC members are intensively involved in policy and legislative reform and provide hands-on technical support and capacity building to improve public sector procurement.<sup>59</sup> Further, while evaluations of this support often urge donors to take a more strategic, systemic approach (rather than a narrow fiduciary, transactions-based approach), there are few instances of bilateral agencies and international financial institutions having done so. Nor are there many examples of them working strategically and harmonising their engagements, including with coalitions of civil society organisations, chambers of commerce and the media to deploy a range of standard and unconventional assistance modalities.

(See Westcott (2020<sup>[49]</sup>) for discussion of procurement reform examples in Edo State, Nigeria and the Philippines). A preliminary measure could be for DAC members currently engaged with NOCs, such as the United Kingdom Foreign, Commonwealth & Development Office (FCDO), and national public sector procurement reforms (e.g. World Bank, FCDO and the Australian Department of Foreign Affairs and Trade) to identify a sample of countries in which they are currently active; consider ways to extend procurement support to NOCs; and consulting with national authorities to determine their interest. This activity would build on activities a. and b. and make use of the buyer selection protocols produced by the EITI Commodity Trading Working Group and the OECD Development Centre to support state-owned enterprise and national public sector procurement reforms.

4. **Extend existing ODA support to enhance NOC revenue and expenditure management performance.** Some DAC members have accumulated considerable experience in specialised areas of public finance management that are immediately relevant to NOC performance in non-commercial domains, including public investment management, downstream benefit-sharing arrangements, and subnational fiscal transfer arrangements. As with activity c., DAC members with this expertise, together with representatives of DAC-NOC partnerships, could work to identify a set of country contexts in which collateral engagements might be possible, consulting with NOCs and relevant ministries.
5. **Assess the potential for new generation governance interventions to think and engage politically on IFF risk vulnerabilities.** One of the four objectives of this programme of work was to “assemble credible and representative comparative evidence regarding the effectiveness of the current suite of measures to improve the transparency of oil and gas commodity trading”. The lens of political economy analysis has enabled more granular and policy-relevant insights to emerge regarding the key properties of the oil trading ecosystem as well as how the political context affects the impacts of policy, transparency and regulatory instruments. It is premature to generalise about what works and with what approaches in any given context. But there is a solid research tradition and development agency interest in precisely this question. The survey of development agencies’ approaches to extractive industry governance reforms, including for the oil sector, found that a suite of new, ODA-supported interventions have internalised on the importance of political and contextual conjunctures,<sup>60</sup> and are grappling with its implications for programming. The Ghana GOGIG and Nigeria FOSTER programmes are examples of these efforts (Section 2.3), as evidenced in the historical account of EITI in Nigeria, which showed in a granular way the impact of contextual factors that the TAP-Plus report, sponsored by the Brookings Institution had identified (Section 2.1 and Watts (2020<sup>[18]</sup>)). As discussed by Hickey and Mohan (2020<sup>[50]</sup>), the ways in which pockets of effectiveness can emerge to reduce IFF risk vulnerabilities, in the context of new oil producing states including Kenya, Uganda and others, also contribute valuable insights into how institutional reforms can interact with underlying political settlements, cycles of electoral turnover, bureaucratic capacity and so on. The analytic and programmatic interests underlying EITI’s Requirement 4.2 (Section 2.1) similarly aim to make programming more attuned with what will be acceptable to powerful elites, domestic history and politics, a country’s position within global value chains, or other conjunctures (Watts, 2020<sup>[18]</sup>; Engebretsen, 2020<sup>[25]</sup>). Nonetheless, as noted in Section 2.3, much of the evidence about the effectiveness of this new generation of approaches to governance reforms is anecdotal, is not comparative nor systematic, and tends to draw on a small number of relatively well-known success stories. A logical next step that could contribute to the rigor and comparability of these efforts to think and engage politically would be a systematic, country comparative, state of the art study of new generation programming. Such a study could focus on the oil sector and the corruption and/or IFF risks arising at different scales such as global networks and transactions and at national and local levels. Does the new generation of governance interventions, as exemplified in political economy and TAP plus type initiatives, better account for the complexity and transnational diversity inherent in the oil trading ecosystem? Does it effectively

capture the offshore dimensions of IFF risk vulnerabilities? Are these interventions more heterodox in approach, and how are they constrained or enabled by the organisational dynamics of development agencies? Do political economy or TAP-style interventions perform better and produce more durable results than more conventional programming approaches? Subject to interest by DAC members, the DCD Secretariat could further develop this proposal for a broad study in concert with the aid, advocacy and academic agencies and actors already engaged in political economy and TAP style efforts.

6. **Develop policy recommendations for how producer countries and NOCs can best transition to a fossil fuel-free future and avert a race to the bottom on financing.** DAC members are currently considering revising ODA-eligibility criteria to exclude support for new fossil fuel activities.<sup>61</sup> Given the heightened risks of IFFs arising from tightening credit liquidity and the absence of robust NOC investment capacity, it remains to be determined how DAC members can best support countries to mitigate IFF risks in the immediate and long term as they transition from fossil energy dependencies to cleaner energy and industrial policies. What might be the potential unintended effects of such a major policy change on a producer country's exposure to oil-related IFF risks, considering that such a paradigm shift might lead to the withdrawal of traditional avenues of technical assistance, credit risk guarantees or financial support for more adventurous joint venture commercial investments (as exemplified by the Mozambique Gas Pipeline Project)? Exploring these questions could be a further priority of existing DAC policy efforts.

### **3.2.3 Fostering multi-agency engagements: The potential of the IMF FTC Pillar 4**

The Congo country case study and the Biens Mal Acquis scandal illustrated how advocacy and engagements at domestic, regional and global levels can ensure integrity in oil and gas trading activities and potentially converge with complementary modalities deployed by the IMF, bilateral agencies, and advocacy organisations such as Public Eye and Global Witness was (Section 2.3) (Naval, 2020<sub>[73]</sub>). IMF missions, particularly Pillar IV, are now encouraged to raise the FTC, during their regular, Article IV consultations with country authorities.<sup>62</sup> The case study analysis undertaken as part of this programme of work (Naval, 2020<sub>[73]</sub>) suggests that the IMF has gradually moved to address IFF-related issues substantially and proactively. For example, in its review of the integrity of the Congolese NOC, SNPC, the IMF is enabling a “more systematic, effective, and candid engagement with member countries regarding those governance vulnerabilities, including corruption, that are judged to be macroeconomically critical” (IMF, 2018, p. 1<sub>[110]</sub>), by undertaking transaction-level and systems analysis of production sharing agreements, oil sales and revenue management, reporting to parliament. The quality and progress of these IMF-government consultations were supported by investigative and other efforts by a diverse range of development, investigative and advocacy actors at national and international levels. This combination of research, reporting and advocacy activities gave real-time granularity to the information available for the IMF consultations with country authorities, far exceeding what is normally available. This experience suggests that more could be done to leverage these distinct IMF capabilities.

**Two policy tasks and activities are recommended to enhance and broaden the impact of the IMF FTC Pillar IV activities through corollary and largely unconventional ODA practices:**

1. **Stimulate discussion about effective strategies to enhance the impact of the IMF's FTC Pillar 4 activities.** The short, periodic missions during which FTC investigations are carried out do not typically benefit from the kinds of granular data that would be necessary to tackle complicated issues such as IFFs in oil commodity trading. Yet, the IMF's more distinctive engagement in the Congo and elsewhere (Angola and Equatorial Guinea, for example) suggests that the IMF's Article IV missions could have greater impact. Based on these efforts, it is proposed to explore the potential for the IMF to sharpen the focus of its Article IV missions on macro-critical risks resulting from IFF activities, including in this instance in oil commodity trading, on a more regular basis. In doing so, the Fund could work to draw links that correspond with the transnational and reciprocal nature of IFFs, across developed and developing economies, through its Article IV engagement activities.

2. As a corollary of this effort, one idea for strengthening the information base would be to provide ‘just-in-time information and advisory services’ to support IMF country-level dialogue or ODA programming through a facility similar to that of the Public Expenditure and Financial Accountability (PEFA) programme and as a means to inform reform strategies and development priorities. This would apply in much the same way as the PEFA programme provides a framework for assessing and reporting on the strengths and weaknesses of public financial management using standardised metrics, but would be tailored towards identifying and responding to ‘macro-critical IFF risks’. In addition to assessing and reporting on country-level issues within the remit of Pillar 4, such assessments would also seek to capture the relevant IFF control weaknesses that arise from the networks of global enablers (that is, the global network of traders, company registrars, banks, lawyers, accountants and other enablers) that are implicated in the challenges and risks that FTC Pillar 4 aims to address. Other modalities may also be feasible and merit further discussion with prospective partners (e.g. the IMF, extractives sector civil society organisations and engaged bilateral agencies).

### **3.2.4 Assessing the comparative returns and potentials of greater commitments to data transparency**

**Trade transaction transparency is a necessary but insufficient response to the complex challenges of IFF risks in oil commodity trading and has the potential to crowd out corollary actions.** On their face, high profile transparency initiatives like EITI have exceptional convening power and create an impressive policy and advocacy momentum. Yet the evidence assembled by this programme of work, as well as that conducted by EITI and a wider remit of practitioners, shows that the return on extractives transparency initiatives remains highly uneven and often ambiguous. The evidence further suggests that such initiatives have the potential to crowd out equally worthy collateral actions. EITI is well-versed in critiques of the transparency agenda, having commissioned several reviews of EITI impacts over the years. The organisation is also leading discussions at the level of the EITI Board on effective strategies to enhance impacts and has recently committed to an independent evaluation of EITI. Future work is expected to involve evaluation of EITI activities since 2011, covering commodity trades and the wider remit of disclosures and the creation of a monitoring, evaluation and learning framework to enhance EITI impacts and to deepen the corollary effects of its engagements.<sup>63</sup> An important attribute of this work is that it specifically aims to better identify and understand, first, some of the common conditions that make efforts more successful and impactful in one context or sector than in others and, second, the ways in which development actors, governments and the private sector could practically engage to support the disclosure and use of data to enhance outcomes and impacts.

**Two specific actions are proposed to support EITI’s existing activities, both of which would also interact and be complementary to engagement opportunities identified under 3.2.2 2.e:**

1. **Identify feasible ways to strengthen the data disclosure results chain**, including by identifying what kind of information is relevant and necessary for external and internal stakeholders to scrutinise the behaviour of firms. For instance, what kind of transparency is necessary to help internal stakeholders or external financiers hold companies to account on corporate governance standards or to aid oversight efforts by public regulators in home country jurisdictions of trade and finance industry actors?
2. **Identify corollary aspects of IFF risk that are not currently addressed by transparency actions.** Beyond the second wave of transparency and accountability initiatives, there are areas of policy and operational engagement that have potential to reduce IFF risks in oil commodity trading, and to leverage trade transaction transparency for better effect. Some of these potential areas of engagement could include those associated with problems on price manipulation, speculative financial behaviour and the risks associated with futures trading markets, and tax evasion via inter-company behaviour.



# 4 Concluding remarks

At its genesis, this programme of work sought to identify and respond to an increasingly well-documented source of chronic vulnerability in resource-rich fragile economies: IFFs in oil and gas commodity trades. It was a complex, multidisciplinary effort that was multi-scalar in its perspective.

The intrinsic opacity and fluidity of this field caution against drawing definitive conclusions. Yet, the initial results of Phase 1 research also offer good cause for reflection on key questions that frame this programme of work. Specifically, **what works, under what conditions, and through what engagement strategies and approaches?** Although by no means a full account of the insights yielded through this effort, this synthesis paper has shown that transparency and accountability initiatives are both necessary and insufficient as a means of shifting underlying political interests and incentives. Thus, the research completed as part of the Phase 1 of this programme of work demonstrates the significance of considering additional corollary measures – for example, by making criminal police and investigation capabilities from OECD jurisdictions available in producer country settings or enabling such cases to be pursued through the justice pathways of home countries, as exemplified in the *Biens Mal Acquis* case where the cases were heard in France. Also evident is that opportunities may have been missed – both indirect ODA support for NOCs and indirect ODA efforts in public financial management (PFM), procurement or state-owned enterprise reform – to influence or impact on IFF risks and yield greater marginal returns on ODA investments through, for example, the extension of PFM and procurement support to NOCs or the use of tailored blended finance and credit risk guarantees or instruments to assist to build or buttress NOC investment capabilities. Further opportunities that could serve to attenuate IFF risks include countering the retreat of the big banks; assisting traders to gain an appreciable sense of their role as ostensible development finance providers; and reinforcing the role of the IMF through enhanced focused on macro-critical IFF risks in Article IV activities, and the provision of just-in-time advisory IFF services while at the same time ensuring that investigative and advocacy organisations are well placed to both prompt and support these efforts.

Finally, perhaps among the more striking impressions yielded by this programme of work are the pace at which the global commodity trading market is changing and the impact of punctuating market events. The global financial crisis was one such event. Another is the combination of the COVID-19 pandemic, the oil price shock and the significantly escalating demand to decarbonise energy production – much of which occurred in the final months of this research. With institutional and structural dynamics in a near permanent state of flux, it is difficult to keep pace and deliver a coherent response, and it is near impossible to anticipate what may come next. Through the engagement areas presented here, and the insights of a forthcoming policy brief, at minimum this programme of work aims to deliver a series of iterative and adaptable policy responses.

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## Annex A. Methods

### The Programme of Work: Objectives, rationale, purpose and scope

**This programme of work on illicit financial flows (IFFs) in oil and gas commodity trade focused on a key but understudied – and underregulated – sector of the oil and gas global value chain**, namely, first trade oil and gas transactions. These transactions constitute the first trade of a share of domestic oil and/or gas production by a national oil company (NOC) to a commodity trader or other buyer. These shares can derive either from a production share or in-kind payments made to governments by companies undertaking extractive operations or from the NOC's or the government's whole or equity share in oil or gas operations as an operator or partner to international oil companies. Approved by the OECD DAC Anti-Corruption Task Team (ACTT) in December 2018, this multi-year programme of work was officially launched at an Inception Workshop in March 2019 and roundly endorsed by the DAC during a briefing in July 2019.

The programme of work had four objectives:

1. Assemble credible and representative comparative evidence regarding the effectiveness of the current suite of measures to improve the transparency of oil and gas commodity trading. The aim is to discern what works, under what conditions and through what engagement strategies and approaches.
2. Survey and document the mutually supporting networks of actors, interests and incentives in producer countries and offshore jurisdictions that shape and facilitate oil trade IFF risks. The aim is to identify points of intervention with potentially the greatest marginal returns, given the 'political economy' of these networks and jurisdictions.
3. Recommend ways in which IFF risk interventions can be reinforced by official development assistance (ODA) programming, and by actions that may be taken by OECD members offshore, through global convening and regulatory instruments, and within their own home jurisdictions. The aim is to make recommendations targeting both ODA in developing countries and initiatives taken in DAC member home country jurisdictions.
4. Provide a vehicle through which the relevant OECD committees can lead a multi-year programme of work that delivers technical and policy studies, benchmarks, and standards and supports the monitoring of results, including through partnerships with non-DAC member countries and organisations. Accordingly, Phase 1 has initiated linkages with a range of academic, professional, civil society and non-OECD agencies through a flexible modality of workstreams.

### Methods, tasks and organisation of work

The programme of work reflected high-level recognition in DAC forums since 2014 of the "central importance" of linkages between IFFs and development and the particular challenges faced by so-called "high vulnerability countries – that is, countries beset by chronic poverty and inequality, institutional fragility, and episodic conflict that have become increasingly reliant on the proceeds of extractive commodity trade. In this context, and in view of the time and resources available for this first phase, the aim has been to learn from an empirical focus largely, though by no means exclusively, on four quite different African

oil-producing states: Congo, Ghana, Mozambique and Nigeria. There is no suggestion that the challenges faced by these countries are uniform. Indeed, as discussed in the main body of this report, these four countries present quite striking contrasts in the scale, organisation, historical depth, and regulatory and institutional complexity of their national oil and gas sectors. While they are customarily seen as oil-dependent states suffering from the pathologies of the resource curse – state deficits, endemic corruption, the Dutch Disease, fiscal overruns, conflict and political turbulence – the standard resource governance metrics developed by the Natural Resource Governance Institute show very substantial differences in how their oil sectors, including first trades, are organised and are vulnerable to first trade IFFs.

**The programme of work was guided by three leading questions:**

- **How has the problem of IFFs and oil commodity trading been framed and addressed by development actors?** What are the conventional practices ('conventions') that have emerged to tackle these IFF challenges, and how have these been applied to improve transparency, disclosure and accountability around the three IFF risks associated with the oil sales process?
- **How has the understanding and response of development actors to corruption and IFF risks in the oil trade sector evolved over time?** The ways in which oil and gas IFFs have been thought about and engaged with have generally been consistent over time and place, despite great diversity in the country contexts. At the same time ODA ideas, approaches and instruments have also changed from conventional practices to those that are more politically and tailored to context, in response to four broad trends: The first is the uneven track record of implementation and results. The second is the changing nature of IFF risks, whether as a result of changes in the actors (e.g. traders, financiers, national state-owned enterprises, etc.), the emergence of different financing and intermediation instruments (e.g. joint ventures, local banks, special purpose vehicles), or as a reflection of geopolitical shifts (e.g. the rise of Chinese investment and private debt financing in sub-Saharan African producer states). Third are the dynamics in the internal institutional cultures and logics of the actors (e.g. of organisations such as EITI, the Norwegian Agency for Development Cooperation and the World Bank and of the advocacy communities) that intend to mitigate IFF risks. And fourth are the changing policy priorities and professional approaches that, at any one particular time, characterise a policy domain such as extractives industry governance or development assistance in general.
- **In terms of ODA engagements, what has worked, why and with what approaches, and how could ODA be rendered more effective?** What are the specific conditions, produced by geography, history, political economy, pre-existing ideas and institutional capabilities, shape the outcomes of transparency-risk mitigation engagements? All the reports produced as background to this paper (Annex C) demonstrate the importance of political economy analysis as a lens to understand how and why particular modes of intervention arise when they do; the crucial importance of the conjuncture (marked, for example, by regime change, geopolitical clashes, a price collapse, the cascading effects of COVID-19) in determining how interventions are received; and the impacts they have, both intended and unintended, on the nature of the oil and gas trading ecosystem and the three IFF risks of particular interest here.

**Responding to these questions has involved three elements:** research and consultation with like-minded agencies and actors; preparation, quality assurance and adoption of deliverables; and dissemination of findings and recommendations. As anticipated, the first element has been the focus of Phase 1 activities. Section 3 of this report includes proposals for consultation and engagement by the OECD-DAC and partner OECD policy commitments and institutions as part of Phase 2 of this programme of work. Prior to review of the end of the Phase 1 Report by the ACTT Plenary, all written materials remain in confidence and reports prepared by each workstream are treated as internal working documents.

**Activities have been organised under three workstreams.** These workstreams are logically interrelated and do not bear any order or priority. Each workstream was assigned to a dedicated team that has been regularly guided by the Secretariat and cross-referenced through review workshops. Following are key features of these workstreams.

**Workstream 1 (WS 1). Oil and gas trade transaction transparency: Trader-national oil company transparency and potential synergies with ODA policy and practice.** This workstream is focused on efforts made, principally over the last 20 years, to improve the transparency of transactions between oil traders and NOCs and through this, the accountability and integrity of these transactions. Transparency efforts aim to deter malfeasance by, and collusion among, parties to the transaction, thus lowering the three kinds of IFF risks (see Section 2.1) to which producer developing countries are vulnerable. The workstream aimed to identify approaches to transparency that appear to yield the best results and to examine what could be done to more deliberately draw on ODA experiences in other relevant sectors and areas of reform. Three areas of high-profile ODA programming have been reviewed: public procurement, revenue management and the reform of state-owned enterprises. Of the three workstreams of the programme of work, this is the most immediately related to DAC members' aid policies and operations.

The written products of WS 1 consist of a main report and five working papers that in different ways address the overarching question of what works, under what conditions, and through what engagement strategies and approaches. Addressing such questions requires comparative case studies, and the reports draw on country cases from Congo, Ghana, Kenya, Mozambique, Nigeria, Tanzania and Uganda as well as from different donor experiences and projects. All reports rely on extensive reviews of primary and secondary literature, and some have undertaken semi-structured interviews with key informants to gather additional information and triangulate findings. Semi-structured interviews do not follow a formalised list of questions but are instead more open-ended, allowing for a discussion with the interviewee rather than a straightforward question-and-answer format. This has the advantage of uncovering new questions and issues that might have been forgone had a standardised questionnaire been used. People interviewed to inform WS 1 include representatives of DAC donor agencies, civil society and international financial institutions.

The authors and titles of the WS 1 report and the five working papers of this workstream and the manner they are referenced in this Phase 1 report are as follows:

Watts, M. (2020), "Workstream 1 Report: Trader-National Oil Company Transparency and Potential Synergies with ODA Policy and Practice", *OECD IFFs and Oil Trading Programme Workstream Report, No. 1*. Unpublished.

Gillies, A., A. Malden and J. Williams (2020), "Illicit financial flows and oil and gas commodity trading transparency", *OECD IFFs and Oil Trading Programme Working Paper, No. 1*. Unpublished.

Engebretsen, R. (2020), "Genesis and performance of EITI Requirement 4.2", *OECD IFFs and Oil Trading Programme Working Paper, No. 2*. Unpublished.

Naval, C. (2020), "Transnational investigative and advocacy work and fiscal transparency initiatives as vehicles in anti-corruption engagements in oil-producing countries: The Biens Mal Acquis case and IMF-FTC engagements in the Republic of the Congo", *OECD IFFs and Oil Trading Programme Working Paper, No. 3*. Unpublished.

Westcott, C. (2020), "Oil and gas trade transaction transparency and potential synergies with ODA policy and practice", *OECD IFFs and Oil Trading Programme Working Paper, No. 4*. Unpublished.

Hickey, S. and G. Mohan (2020), "Jumping straight to Norway? Assessing the impact of best-practice reforms on oil governance in Africa's new producers", *OECD IFFs and Oil Trading Programme Working Paper, No. 5*. Unpublished.

**Workstream 2 (WS 2). Mapping networks of corporate arbitrage in oil and gas trading: Opportunities for identifying risks in energy traders’ financial conduct using due diligence information.** This workstream placed NOCs, traders and financiers on a larger canvas – that is, as part of a global trading ecosystem. IFFs are relational: They depend upon and are enabled by a global financial infrastructure that includes banking and clearing systems, and company networks (subsidiaries, affiliates, holding companies, joint ventures) that span both onshore markets and offshore financial centres and trading hubs where national jurisdictional authority appears in different forms and to varying degrees. Thus, the aim of workstream 2 has been to better understand those corporate trading networks and identify any prospective IFF risks or vulnerabilities these might create.

To examine the corporate trading networks in question and their potential weaknesses, the WS 2 team used the Orbis database and an especially developed algorithm. Orbis contains information about approximately 300 million companies across the world, and the algorithm developed by the WS 2 team is able to draw on this wealth of information to map and visualise complex corporate structures that would otherwise be difficult to grasp. The first step was to map ownership links between all the known entities belonging to a firm. WS 2 then supplemented the equity data with shareholding and accounting data, resulting in a group profile of the scope of complex ownership structures in the sector and the intensity of their use. The mapping also helped indicate where there are potential weaknesses in the system. Once the mapping was completed, WS 2 engaged in consultations with specialist forensic accountants, lawyers and business experts, including from KPMG and the civil society organisation Open Oil. In addition, the WS 2 team established contact with and presented its preliminary findings to the OECD Centre for Tax and Administration and the Directorate for Financial and Enterprise Affairs. These initial consultations helped to verify the accuracy of the maps, provided useful pointers as to the underlying rationale for the visible corporate structures and helped identify avenues for future engagements.

The authors and title of the WS 2 research report and the manner it is referenced in this Phase 1 Report are as follows:

Nesvetailova, A., Palan, R., Petersen, H., and Phillips, R., (2021). “Workstream 2 Report: IFFs and Commodity Trading – Mapping Networks of Corporate Arbitrage in Oil and Gas Trading.” London: City, University of London. Available at:

[https://researchcentres.city.ac.uk/\\_data/assets/pdf\\_file/0005/583565/IFFs-AND-COMMODITY-TRADING-final-oct-2020-.pdf](https://researchcentres.city.ac.uk/_data/assets/pdf_file/0005/583565/IFFs-AND-COMMODITY-TRADING-final-oct-2020-.pdf)

**Workstream 3 (WS 3). Understanding the relationship between traders and bankers in oil and gas transactions.** This workstream explored the hypothesis that IFF risks can be traced to, and/or are fostered by, the relationships between commodity traders and the parties involved in trading and instruments used to finance these trades. The role of enablers such as financiers remains largely understudied in the IFF literature, and thus this workstream provided new information needed to develop IFF policy responses. For instance, the work aimed to critically examine the proposition that by altering (by regulation or other means) the behaviour of trade financiers and financing instruments (banks and other sources of finance such as crude-for-product swaps or prepayment arrangements), it may be possible to impact directly on the IFF risks that arise at the interface of traders and NOCs.

The ACTT tasked KPMG with documenting the perspective of industry actors, including by drawing on the consulting firm’s own experience and gathering insights from relevant individuals across the commodity trading industry with experience dealing with NOCs for the procurement of crude or oil products. The WS 3 team focused its research on Switzerland and the United Kingdom due to these countries’ positions as major trading hubs, with the intention to expand the work to other predominant trading hubs in the future. Key informant interviews informed the WS 3 Report and targeted representatives at various levels in the trading and financial industries whose roles relate directly to trading with NOCs, including compliance, management, finance and control, structuring, and business development. Five interviews were conducted

with large commodity trading firms, three with financial institutions, and two with regulators and business associations. International oil companies and mid- and small-sized traders did not respond to the interview requests and thus were not represented in the interview sample, something that obviously impacts on the ability of the report to draw any conclusions about these parts of the industry. Interviews were conducted in a semi-structured manner.

The authors and title of the WS 3 research report and working paper and the manner they are referenced in this Phase 1 report are as follows:

Culbert, P., Dawson, N., and Isaieva, O., (2020), "Workstream 3 Report: IFFs and Oil Commodity Trading – The Nexus Between Traders and Bankers in First Trade Oil and Gas Transactions", *OECD IFFs and Oil Trading Programme Workstream Report, No. 3*. Unpublished.

Engebretsen, R (2020) "Country case studies". *OECD IFFs and Oil Trading Programme Working Paper, No. 6*. Unpublished.

## Annex B. Phase 1 written products

Table A B.1. Phase 1 written products

Workstream	Report titles and authors
1	<p>“Workstream 1 Report: Trader-National Oil Company Transparency and Potential Synergies with ODA Policy and Practice”, <i>OECD IFFs and Oil Trading Programme Workstream Report, No. 1</i>. Unpublished. Michael Watts</p> <p><u>Contributory working papers</u></p>
	<p>a. “Illicit financial flows and oil and gas commodity trading transparency”, <i>OECD IFFs and Oil Trading Programme Working Paper, No. 1</i>. Unpublished. Alexandra Gillies, Alex Malden and Joseph Williams</p>
	<p>b. “Genesis and performance of EITI Requirement 4.2”, <i>OECD IFFs and Oil Trading Programme Working Paper, No. 2</i>. Unpublished. Rebecca Engebretsen</p>
	<p>c. “Transnational investigative and advocacy work and fiscal transparency initiatives as vehicles in anti-corruption engagements in oil-producing countries: The <i>Biens mal acquis</i> case and IMF-FTC engagements in the Republic of the Congo”, <i>OECD IFFs and Oil Trading Programme Working Paper, No. 3</i>. Unpublished. Claire Naval</p>
	<p>d. “Oil and gas trade transaction transparency and potential synergies with ODA policy and practice”, <i>OECD IFFs and Oil Trading Programme Working Paper, No. 4</i>. Unpublished. Clay Wescott</p>
	<p>e. “Jumping straight to Norway? Assessing the impact of best-practice reforms on oil governance in Africa’s new producers”, <i>OECD IFFs and Oil Trading Programme Working Paper, No. 5</i>. Unpublished. Sam Hickey and Giles Mohan</p>
2	<p>“Workstream 2 Report: IFFs and Commodity Trading – Mapping Networks of Corporate Arbitrage in Oil and Gas Trading.” London: City, University of London. (Available at: <a href="https://researchcentres.city.ac.uk/__data/assets/pdf_file/0005/583565/IFFs-AND-COMMODITY-TRADING-final-oct-2020-.pdf">https://researchcentres.city.ac.uk/__data/assets/pdf_file/0005/583565/IFFs-AND-COMMODITY-TRADING-final-oct-2020-.pdf</a>) Anastasia Nesvetailova, Ronen Palan, Hannah Petersen and Richard Phillips</p>
3	<p>“Workstream 3 Report: IFFs and Oil Commodity Trading – The Nexus Between Traders and Bankers in First Trade Oil and Gas Transactions”, <i>OECD IFFs and Oil Trading Programme Workstream Report, No. 3</i>. Unpublished. Phil Culbert, Neal Dawson and Olena Isaieva</p> <p><u>Contributory working paper</u></p>
	<p>a. “Country case studies”. <i>OECD IFFs and Oil Trading Programme Working Paper, No. 6</i>. Unpublished. Rebecca Engebretsen</p>

## Annex C. Workstream executive summaries

### Workstream 1: Executive summary

Workstream 1 (WS 1) focuses on illicit financial flow (IFF) risks arising from the relationship between commodity trading firms and national oil companies (NOCs). These include risks relating to the selection of buyers and allocation of buyers' rights; the negotiation of terms of sale; and the collection and transfer of revenues into national spending systems. Of particular interest is the first trade, i.e. the sale of physical commodities made by governments or state-owned companies to buying companies, including commodity trading companies. Until recently, this nexus has been relatively unexplored in the resource governance discourse despite the scale of these transactions and their associated corruption risks.

Through a political economy-informed framework, the WS 1 aims to provide a frank assessment of efforts to date, underscore areas and approaches that appear to offer the best prospects for impacting IFF risks, and recommend practical actions for immediate uptake as well as other measures requiring further investigation.

WS 1 has two components. Component 1 examines existing transaction and due process transparency initiatives that centre on the trader-NOC nexus and the IFF risks associated with first trade oil and gas. Component 2 draws on the wealth of experience gained via DAC members' official development assistance (ODA) engagements with oil and gas-dependent developing countries, including through what are termed indirect interventions in the field of public procurement, revenue management and the reform of state-owned enterprises. The rationale here is that ODA experiences across these non-oil sectors have much light to shed and offer comparable learning experiences for interventions specifically focused on IFFs in the oil and gas sector.

The five working papers produced through the two WS 1 components address, in different ways, the overarching questions of what works, under what conditions, and through what engagement strategies and approaches. The themes of the working papers are as follows:

- an overview of transaction transparency with respect to IFF risks and the oil trading system
- a study of new transparency efforts with a dedicated NOC-trader nexus, the Extractive Industries Transparency Initiative Requirement 4.2.
- the role of investigative journalism and advocacy in assisting other regulatory interventions such as the International Monetary Fund (IMF) Fiscal Transparency Code Article IV programmes (using the country case of the Republic of the Congo, the Biens Mal Acquis case and IMF financial transparency reforms)
- a comparative study of five new African oil states (Ghana, Kenya, Mozambique, Tanzania and Uganda)
- an assessment of ODA-supported measures in respect of reforms in public sector procurement, tax and revenue administration, and state-owned enterprises (SOEs) as sources of collateral learning for the oil and gas sector.



## Key findings

Part I of the WS 1 report draws out three lessons learned, that is – three issue areas that stand out in relation to the approach, how the approach has changed over time, what has worked, and under what conditions. Each lesson learned represents important arenas of ODA and regulatory engagement:

- the limits of transparency and disclosure
- NOCs as an arena of reform
- constraints in managerial approaches to IFF reforms.

Each of these lessons learned also represents different though interrelated, approaches to dealing with the oil trade-related IFF risks, or what are referred to as logics of engagement. In exploring these logics of engagements – their strengths, limits and opportunities – WS 1 demonstrates how each highlights aspects of the larger ecosystem of the NOC-trader nexus in related but different ways. Until relatively recently, the trader-NOC nexus was largely unexplored by transparency interventions despite the scale of these transactions and their associated corruption risks. There are very few hard requirements related to transaction disclosure by buying companies or for beneficial ownership disclosure of buyers, and the contracts governing these transactions are typically not required to be in the public domain.

Part II covers larger conceptual and analytical frames of reference including what is called political embeddedness and the oil trading ecosystem. The former emphasises the importance of political economy analysis as a lens to understand the operations of NOC-trader relations, i.e. how engagements are shaped by the time and place and especially the political conditions in which they arise and in which they are put to work. The challenge is to understand why particular instruments, such as transparency and SOE reform packages, exhibit specific trajectories of implementation and efficacy.

It is clear from WS 1 findings that space and time matter for engagements. In some cases, there are pockets of effectiveness even in economies afflicted by the so-called resource curse. In others, engagements are superficial or do not take hold (so-called isomorphic mimicry). WS 1 points to the importance of conjuncture (a moment of crisis or conflict) to explain the success or otherwise of particular instruments. These could be elite incentives, the character of the political settlement, or whether or not IFF engagements are institutionally embedded and if so, how and with what durable effects.

WS 1 also found current interventions face twin challenges. The first is crafting an approach – a combination of perceived problems and solutions that optimise available modalities and resources and the possibilities of pacing and sequencing, with acceptable scope and scale – that is both fit for purpose and fit for context. The second is what the World Bank's *World Development Report 2017: Governance and the Law* labelled the “implementation gap”: dealing with the persistent difference between what is intended, the approach, for example, and may have been pledged and what is actually implemented, adopted or complied with. The gap reflects the capacity of actors to commit, their willingness to co-operate and co-ordinate, the structural barriers that frame the conditions of possibility, and the ways power is manifested. Given the oil trade ecosystem and what WS 2 calls its “exceptional” character, the challenges thrown up by the implementation gap appear particularly pronounced for ODA engagements seeking to engage with IFFs in oil and gas trading.

Finally, multi-scalar processes and multiple regulatory jurisdictions that interlock and interpenetrate in complex ways underscore the need to think beyond the nation and to reflect on what these imply for IFF engagements. Adopting plural, complementary and multi-jurisdictional efforts that are capable of seizing hold of and exploiting opportunities as they emerge – often unexpectedly and without prior warning – is a useful principal to add to the arsenal of mitigation measures and incentives for ODA support. The new, so-called second generation prescriptions that claim to do development differently and think politically will only fulfil their promise if they focus on local and national contexts exclusively and consider the political economy of the global oil assemblage in which these efforts are embedded. Well-formulated policy instruments that arrive from afar and alight in frontier zones will always be tightly constrained and their

outcomes open to question. ODA can no more manage outcomes than it can determine in any way the conditions of possibility of its own operations. Its reach is always limited.

## Workstream 2: Executive summary

The aim of Workstream 2 (WS 2) is to help unpack the oil trade ecosystem and the networks of corporate arbitrage in the trading of these commodities by investigating the nature of the inner structure of a corporate network, the geographical and topographical location of corporate entities, and the organisation of equity ownership of a select number of energy trading groups. The purpose of the analysis is to help identify potential IFF risks as they manifest in the form of vulnerabilities in the system of governance relating to the reporting of financial activities within the group or to societal stakeholders. Specifically, WS 2 was tasked to:

- map the complex corporate ecology (comprised of assemblages of companies, or corporate units, through which managers operate across multiple jurisdictions, mainly by deploying various legal and accounting instruments and practices)
- interpret, as far as possible, the functions and purposes that these instruments and techniques serve
- interpret, based on these activities, how different elements of this ecosystem produce (or may be benchmarked) to known IFF vulnerabilities
- indicate whether further work is needed to both better understand the global political economy of corporate arbitrage and to flesh out and triage the intended, inadvertent and perverse impacts of potential remedial actions.

Using the global company database, Orbis, WS 2 draws on a set of powerful analytical methods that help analyse the organisation of the modern firm. The techniques allowed the authors to track corporate patterns and analyse potential weaknesses in the system of governance that may affect stakeholders' monitoring ability. WS 2 profiled a group of target firms operating in the energy trading sector: six independent firms including Trafigura and Glencore; nine integrated energy firms including BP and Total; six national oil companies (NOCs) including the Nigerian National Petroleum Corporation, Sonangol (Angola), and two mid-sized players, Sahara and OandO. Following data collection and analysis of a set group of energy traders, the results were shared and, where possible, confirmed through expert interviews conducted by Workstream 3. The purpose was to establish broader patterns of corporate organisation and identify financial signatures, where possible.

### **Key findings**

The commodity trading sector as a whole is highly opaque compared to other economic areas. This opacity is generated through diverse means. There are many categories of energy traders. Within the framework of this programme of work, WS 2 differentiates between traders as independent business units (independents) such as Glencore, Trafigura and the like, and those that exist as cogs in a larger corporate undertaking, or integrated' energy companies such as BP, Royal Dutch Shell and the like. Key findings include the following:

- The independents are heavy users of offshore financial centres (OFCs) for their holding companies, regional holdings and special purpose vehicles. As part of the WS 2 benchmarking exercise, the team analysed the equity structure of the top 100 global industrial firms in the world in terms of revenues in 2018. The analysis found that among these top 100, an average of 18% of group subsidiaries were owned via an OFC-based intermediated holding companies. For the large integrated firms in the sample, the share was 29.6%. In the case of the independent trading companies, the percentage of group subsidiaries owned via an OFC-based intermediated holding

companies was dramatically higher at 96.7%. In contrast, NOCs appear to be relatively moderate users of OFC jurisdictions. Disproportionate deployment of corporate entities registered in such jurisdictions contributes to a greater degree of opacity in the accounts of these groups as a whole. Intensive use of such jurisdictions, particularly by the independent sector, combined with the complexity of corporate holdings through OFC jurisdictions, weaken the system of governance within the group or towards societal stakeholders.

- An issue of concern shared by both integrated and independent companies in this sector is a tendency towards centralising and pooling value among divergent entities within the group. Wholly owned energy trading subsidiaries embedded inside a large corporate group appear to operate both as highly centralised energy trading hubs and as centralised hubs for a broad range of intra-group treasury management roles. Pooling of origination activities takes place in relatively few legal entities within the group and combining trading specific functions with other internal corporate financing and treasury functions appears to be the norm.
- The accounts of the highly centralised energy trading hubs embedded in the corporate ecosystem within both independent and integrated companies exhibit a common pattern of a fixed operating margin cost structure, whereby roughly all of the income entering the company exits the company as an operating cost in a relatively fixed, highly correlated manner, regardless of income volatility. This implies that the traders' accounts are managed by the group.
- NOCs appear to be comparatively simple organisations, often consisting of a small number of legal persons who own assets and partake in contracts in markets. Lack of data availability for this segment is a major concern. Some NOCs do not publish consolidated accounts. As a result, the ability of national stakeholders to ensure integrity and responsible business conduct is extremely limited. Lacking strong internal accountability, NOCs are thought to have limited ability to raise capital directly from the international markets and must rely instead on the independent or integrated energy trader for loans, which raises IFF risks as elaborated in Culbert, Dawson and Isaieva (2020<sub>[15]</sub>).
- In their corporate mapping, WS 2 identified a class of dormant corporate entities. A dormant entity is a proxy for companies: one only sees its balance sheet, but not the corresponding income statement. Dormant companies hold funds or cash but have no operational functions. They are subject to limited auditing. WS 2 identified at least one case in which a dormant company may potentially be used as a so-called slash fund, hence increasing the IFF risk involved.

### Workstream 3: Executive summary

Workstream 3 (WS 3) delved into the relationship between traders and bankers in oil and gas transactions, exploring the hypothesis that IFFs risks can be traced to and/or are fostered by the relationships among commodity traders, the parties involved in the trade of physical oil, and the instruments used to finance these trades such as oil-backed loans, commodity swaps and oil derivative trades. The role of enablers, including trade financiers, remains largely understudied in the IFF literature despite the crucial role enablers play in financing all types of trade, including some that pose high IFF risks, and despite high-profile IFF cases in the past that implicated the trade–finance relationship.

More specifically, WS 3 focused on the first trade between the sub-Saharan African national oil companies (NOCs) and commodity traders. Oil sector transactions are perceived as highly susceptible to IFFs due to the complexity of the oil production, refining, transportation and supply business; the number of participants; and the multitude of financing arrangements along the value chain. Focusing on the first trades of equity oil provides an opportunity to gather insights into oil-backed lending, commodity swaps, government subsidy, and the role that contracting intermediaries play in the process.

In sum, the objective of the WS 3 was to:

- explore the modalities through which traders and bankers intersect
- analyse the current obligations, and conduct, of bankers and/or trade financiers regarding IFF protocols – de jure and in de facto practice – and drawing on the case studies of the United Kingdom and Switzerland
- contribute to developing IFF policy responses by identifying potential opportunities for intensified and new mechanisms for positive engagement by bankers in IFF mitigation efforts through their relationships with traders. For instance, the work aimed to critically examine the proposition that by altering (by regulation or other means) the behaviour of trade financiers and financing instruments (banks and other sources of finance such as swaps), it may be possible to impact directly on the IFF risks that arise at the interface of traders and NOCs.

The OECD engaged KPMG AG to document, as far as possible, the contours and practices of trading from the perspective of industry actors, in particular, traders and financing institutions. The WS 3 team drew on KPMG's experience and gathered insights from relevant individuals familiar with the NOC trading nexus. This included banks based in Switzerland and the United Kingdom, as well as commodity traders and trade financiers familiar with NOCs for the procurement of crude or oil products. The WS 3 team conducted interviews with people at various levels in the organisations whose roles relate directly to trading with NOCs, including individuals from compliance, management, finance, business origination and development. Additionally, the WS 3 team relied on informal discussions with market participants and reviews of previously published literature.

The OECD selected Switzerland and the United Kingdom, two major commodity trading hubs, as a convenient and supportive starting point, although the intention is to expand the work to other predominant trading hubs as the programme develops.

### ***Key findings***

- Independent traders deploy bank-provided trade finance, both from OECD jurisdictions and increasingly from non-OECD jurisdictions, to fund their trading activities.
- The combination of regulatory requirements introduced in the wake of the 2008 global financial crisis, lower margins and stakeholder scrutiny has led to a widespread retreat of banks from physical commodity trading.
- Traders on occasion are acting as financial institutions, a practice that seems to have become increasingly common since 2008. Traders can fulfil the role of banks through several mechanisms: pre-payments or oil-backed lending; swaps and processing agreements; providing open accounts to clients; and offering other long-term financing instruments to counterparties. Such services can be highly lucrative, given the increasingly high costs of capital faced by many sub-Saharan African NOCs.
- There has been an increase in joint venture (JV) arrangements between local banks and traders, a trend sometimes referred to as localisation or nationalisation of trading. Smaller banks operating in the country or region of oil and gas sales may have lower risk thresholds and lesser compliance management capabilities than the global operators. Similarly, the legal framework these regional banks operate within may be less onerous, and regulators supervising them may lack the experience and overall visibility that more established regulators can bring to bear.
- JVs between a trader and a NOC provides a vehicle for the trader to get access to local markets and build a business network. JVs also play a vital role in enabling investments into a country's infrastructure such as storage, transportation and services related to supply chain operation. At the same time, the standard compliance processes of the global trader may or may not apply to the JV activities, such as the process on avoiding conflict of interest, thus significantly increasing IFF risks.

- Many transactions relating to first trade will not involve a financial instrument that is subject to money laundering legislation. There is even less scrutiny in the context of activity by NOCs and traders that settle activity on open account terms (i.e. through invoicing and making payments without the involvement of more complex financial instruments such as letters of credit).
- In general, trading that results in the physical delivery of a product falls outside the scope of OECD home jurisdictions regulation, as is the case with Switzerland and the United Kingdom. There is no regulation that requires banks to check the due diligence of a third party, i.e. the client of the client. Across both Switzerland and the United Kingdom, the regulation pertaining to money laundering remains limited in its reach with respect to the operations of traders and NOCs with a presence in these jurisdictions.
- Financial instruments such as oil-backed loans and syndicated loans will usually, due to their size, have a high degree of scrutiny involving the lawyers of all parties. The effectiveness of regulation in identifying and mitigating IFF risks is driven in part by the maturity of understanding of the regulated firms and also by the ability of regulators to identify failures by regulated firms to adhere to regulation and regulators' ability to compel compliance. Financial Action Task Force Mutual Evaluations of both Switzerland and the United Kingdom conclude that while firms display a strong fundamental understanding of the risks that they face in respect of IFF control frameworks, the application of these controls has at times been found to be inconsistent.

# Notes

<sup>1</sup> Large-scale – so-called “grand” – corruption involving high-level public officials is widely associated with the award of mineral and oil and gas rights, procurement of goods and services, commodity trading, revenue management through natural resource funds, and public spending.

<sup>2</sup> The High Level Panel on Illicit Financial Flows from Africa estimated that African countries were losing USD 50 billion annually due to illicit flows and that, between 2000 and 2015, net illicit outflows between Africa and the rest of the world averaged USD 73 billion annually. See UNECA (2018<sub>[121]</sub>) at <https://repository.uneca.org/bitstream/handle/10855/24382/b11893503.pdf?sequence=1&isAllowed=y>. Illicit flows involving foreign businesses occur primarily through tax evasion via debt restructuring and transfer pricing.

<sup>3</sup> Capital flight is defined as the outflows of financial resources from a country in a given period that are not recorded in official government statistics. See Ndikumana and Boyce (2018<sub>[130]</sub>) at <https://www.peri.umass.edu/publication/item/1083-capital-flight-from-africa-updated-methodology-and-new-estimates>. The terms capital flight and IFFs are sometimes used interchangeably, but they are distinctly different concepts. Depending on the definition used, capital flight can be illicit, but this is not always the case. See also UNCTAD (2020<sub>[124]</sub>) at [https://unctad.org/meetings/en/SessionalDocuments/cimem2d49\\_en.pdf](https://unctad.org/meetings/en/SessionalDocuments/cimem2d49_en.pdf).

<sup>4</sup> Trade misinvoicing, the manipulation of invoices as a means of shifting funds abroad (and also called trade mispricing), is a key channel for moving illicit value across borders.

<sup>5</sup> For further discussion, see <https://www.mckinsey.com/industries/oil-and-gas/our-insights/oil-and-gas-after-covid-19-the-day-of-reckoning-or-a-new-age-of-opportunity> and <https://www.naturalgasintel.com/national-oil-companies-slash-capex-budgets-in-unprecedented-crisis/>.

<sup>6</sup> Some of the largest investment banks, later known as Wall Street Refiners, established specialised departments for trading in the oil market. By 2003, most of the biggest United States hedge funds were engaged in commodity markets, with their involvement tripling between 2004 and 2007. See Gkanoutas-Leventis (2017<sub>[14]</sub>).

<sup>7</sup> Culbert, Dawson and Isaieva (2020<sub>[15]</sub>) examines the five major categories of actors in the first trade of oil in sub-Saharan Africa and their roles and trends, especially since the 2008 global financial crisis. See also Watts (2020<sub>[18]</sub>).

<sup>8</sup> The exception in the top five trading houses being Glencore (revenues of USD 219 billion in 2018 158 000 employees), which is also a major extractive company in the mining sector and owns limited upstream assets in the oil sector.

<sup>9</sup> The African NOCs are not uniform. GNPC (Ghana) and ENH (Mozambique) are still in formation and limited in their capacities; Nigerian National Petroleum Corporation is a massive bureaucratic, regulatory and commercial entity with many moving parts; and Sonangol (Angola) in many respects resembles in its organisational form a South Korean chaebol. Congo’s Société Nationale des Pétroles du Congo (SNPC) seems like a worst case. See Soares de Oliveira (2015<sub>[118]</sub>) and Victor, Hults and Thurber (2011, pp. 2-12<sub>[123]</sub>).

<sup>10</sup> This change was initiated with the introduction of the Basel III (November 2010) and Basel IV (2016-17) regulatory frameworks, which imposed higher capital requirements on risk-weighted assets including commodities and limited the ability of banks to provide short-term balance-sheet loans such as trade finance facilities. Many top banks consequently exited commodity trading after 2013. Among these were Barclays and Deutsche Bank which closed their commodity trading divisions; JPMorgan, which sold its trading operation to the large, Swiss-based international trader, Mercuria Group; and Morgan Stanley, which made a deal with Castleton Commodities International LLC. Prior to this shift, these large banking institutions held commodities trading as a substantial part of their business operations.

<sup>11</sup> Over the first eight months of 2020, to September, big commodity traders including Glencore, Gunvor, Mercuria, Trafigura and Vitol profited from volatile commodity prices. While returns to big oil producers tumbled, traders bet on price swings, storage deals and other opportunities created by market volatility. See <https://www.ft.com/content/6eee360e-dd70-4fe9-b47b-96b20a509a60>.

<sup>12</sup> Sustainable Development Goal 16.4 calls on the international development community to redouble its efforts to fight organised crime and illicit financial flows. See [https://www.un.org/ga/search/view\\_doc.asp?symbol=A/RES/70/1&Lang=E](https://www.un.org/ga/search/view_doc.asp?symbol=A/RES/70/1&Lang=E).

<sup>13</sup> DAC members provided USD 17.71 million in official development assistance (ODA) to oil and gas projects in 2018 and USD 34 million to these in 2019. In terms of total numbers, for 2018 this represents 0.015% of total ODA from bilateral DAC members and 0.02 percent for 2017. Data are from the OECD Credit Reporting System at <https://stats.oecd.org/Index.aspx?DataSetCode=crs1#>.

<sup>14</sup> Strikingly, in two recent synopses of risk mitigation and governance management in the oil and gas and extractive sectors published by the World Bank, the role of traders and the oil trading system is almost wholly neglected. These are *Balancing Petroleum Policy: Toward Value, Sustainability, and Security*, (Hurdeman and Rozhkova, 2019<sup>[26]</sup>) at <https://openknowledge.worldbank.org/handle/10986/31594> and *License to Drill : A Manual on Integrity Due Diligence for Licensing in Extractive Sectors*. International Development in Practice, (Votava, Hauch and Clementucci, 2018<sup>[127]</sup>), at <https://openknowledge.worldbank.org/handle/10986/29809>.

<sup>15</sup> The ACTT brings together DAC members to support policy makers, donors and developing countries to better fight corruption. It also promotes efforts to strengthen the coherence of donor approaches supporting developing countries in implementing the UN Convention Against Corruption. For more information, see <http://www.oecd.org/dac/accountable-effective-institutions/What%20is%20the%20ACTT.pdf>.

<sup>16</sup> Nonetheless, paper trading warrants a brief explanation. In paper trading, traders take a paper position in the market, through futures, swaps or options and based on an underlier that is a commodity. This means that unlike the trader in a physical trade, the paper trader does not take physical control of the commodities. Paper trade is engaged in for speculative purposes and for managing the risks associated with commodities trading through hedging (also called the futures trade). While commodity traders do engage in paper trading, both for hedging and speculative purposes, it is smaller than their physical trade activity. This financialisation of oil and the rise of paper trades have made oil prices more volatile and largely independent of physical trades and market fundamentals. See Watts (2020<sup>[18]</sup>) and KPMG (2015<sup>[120]</sup>).

<sup>17</sup> A current example of these comprehensive reviews is the Leveraging Transparency to Reduce Corruption project (also known as the Transparency, Accountability and Participation' Project), launched in 2017 by the Brookings Institution supported by Results for Development (and the Natural Resource Governance Institute. Eisen et al. (2020<sup>[32]</sup>) is the most recent for the project, at [https://www.brookings.edu/wp-content/uploads/2020/06/LTRC\\_Corruption\\_vfinal\\_x2screenreader4.pdf](https://www.brookings.edu/wp-content/uploads/2020/06/LTRC_Corruption_vfinal_x2screenreader4.pdf).

<sup>18</sup> According to Brockmyer (2016<sup>[31]</sup>) open washing is to “project a public image of transparency and accountability, while maintaining questionable practices in these areas”, and it, “implies that government sponsors of [multi-stakeholder initiatives] membership are not sincere in their desire for reform”. See [https://eiti.org/files/documents/brockmyer\\_2016\\_global\\_standards\\_in\\_national\\_contexts.pdf](https://eiti.org/files/documents/brockmyer_2016_global_standards_in_national_contexts.pdf).

<sup>19</sup> Most recently, Rustad, Le Billon and Lujala (2017<sup>[34]</sup>) examined the objectives and successes of EITI. They note that in many ways, the EITI has succeeded in terms of reaching its institutional goals and some of its operational goals, in particular when it comes to producing annual reports. The EITI has engaged the civil society groups through several measures, particularly through the Multi-

Stakeholder Group, but seems to have failed to empower the public to hold governments and companies to account. However, the authors also caution that evaluations of EITI may not have thus far used the right criteria to measure success..

<sup>20</sup> The concept of multi-scalar governance and institutions, as applied to extractives industry governance and the Nigeria case, is discussed in Porter and Watts (2016<sub>[117]</sub>) at <https://pubdocs.worldbank.org/en/741251485539885445/WDR17-BP-Multi-Scalar-Governance-and-Institutions.pdf>.

<sup>21</sup> More paradoxical was the business success of Sonangol, Angola's national oil company. According to Soares de Oliveira (2007<sub>[119]</sub>), during the 1990s until the early 2000s, it was “an island of competence thriving in tandem with the implosion of most other Angolan state institutions”. See <https://doi.org/10.1017/S0022278X07002893>.

<sup>22</sup> A recent evaluation of Asian Development Bank support found that 61% of loans and grants supporting SOEs are rated as successful or higher, compared to about 75% of all loans and grants rated as such. A World Bank portfolio review broadly concurs (Westcott, 2020<sub>[49]</sub>).

<sup>23</sup> No history has been written how the Norwegian approach came to be thought of as a “model”. Hickey and Mohan (2020<sub>[50]</sub>), refer to a triad of reforms that began in Norway in the early 1970s: a dedicated ministry responsible for developing and overseeing sector policy and national objectives; a regulatory body, empowered to create regulatory policy and collect revenues; and a state-owned oil company operating commercially.

<sup>24</sup> Norway's Oil for Development programme, launched by the Norwegian government in 2005, addresses resource, financial and environmental dimensions of natural resource governance through institutional twinning and capacity building. Despite accounting for only 1% of Norway's ODA, it is considered a flagship programme because it addresses strategic policy at sector and organisational levels and has consistently been in high demand.

<sup>25</sup> The Uganda story is more fully elaborated by Hickey and Izama (2019<sub>[129]</sub>) at <https://ssrn.com/abstract=3523026>. Abdulai and Mohan (2019<sub>[111]</sub>) apply the same framework to Ghana and the performance of Ghana Ministry of Finance. See <https://www.effective-states.org/working-paper-119/?cn-reloaded=1>.

<sup>26</sup> Thurber, Hults and Heller (2011<sub>[51]</sub>) looked at the Norway model in ten larger oil producers. See <https://doi.org/10.1016/j.enpol.2011.05.027>.

<sup>27</sup> For every generalisation there will be exceptions. Hickey and Mohan (2020<sub>[50]</sub>) note that the African Development Bank's engagements with NOCs has been appreciably more open and less doctrinaire. NOC corporate governance has always been central to TAP initiatives: The very establishment of the EITI Standard that requires the disclosure of information along the extractive industry value chain shows how central the question of NOC corporate governance was to the transparency work (as opposed, for example, to that of IOCs, the oil service companies or indeed other parts of the state apparatus in oil-dependent economies).

<sup>28</sup> As perhaps is to be expected, programmatic support is more likely to succeed in countries with relatively strong governance and control of corruption (Westcott, 2020<sub>[49]</sub>). World Bank support to SOEs, even in some low capacity, high corruption contexts, has proven successful when there is simple, selective and flexible project design as well as prior analytic work, strong supervision, strong client commitment and collaboration with external actors and donors.

<sup>29</sup> On these general approaches, see Unsworth (2010<sub>[122]</sub>) at <http://www2.ids.ac.uk/gdr/cfs/pdfs/AnUpside-downViewofGovernance.pdf> and Booth and Unsworth (2014<sub>[72]</sub>) at <https://cdn.odi.org/media/documents/9204.pdf>. On these approaches in second generation oil sector projects in Ghana and Nigeria, see Bhalla, Waddell and Ough (2016<sub>[112]</sub>) at <https://cdn.odi.org/media/documents/10357.pdf>; Buckley, McCulloch and Travis (2017<sub>[114]</sub>) at <https://doi.org/10.35188/UNU-WIDER/2017/257-1>; and Porter and Watts (2017<sub>[43]</sub>) at <https://doi.org/10.1080/00220388.2016.1160062>. On these approaches at the level of ODA country programming, see Bain, Porter and Watts (2015<sub>[68]</sub>) at <https://openknowledge.worldbank.org/handle/10986/22379> and Bain, Booth and Wild (2016<sub>[69]</sub>) at <https://cdn.odi.org/media/documents/10867.pdf>.

<sup>30</sup> Heller, Mahdavi and Schreuder (2014<sub>[115]</sub>) discuss the example of Indonesia's Pertamina, where unbundling was explicitly rejected but the NOC went on to perform well on both regulatory and commercial fronts. See <https://resourcegovernance.org/analysis-tools/publications/reforming-national-oil-companies-nine-recommendations>. Hickey and Mohan case study of Ghana (2020<sub>[50]</sub>)



suggests that powerful NOCs that receive high levels of government investment and political support (with embedded autonomous-type relationships among politicians and bureaucrats) can help generate important financial support for oil sector development and wider infrastructure and social investments. Most ODA interventions and the wider epistemic community on oil governance overlook this possibility due to a mixture of neoliberal bias and reasonable and/or evidenced-based concerns about many NOCs.

<sup>31</sup> By way of illustration, the World Bank has on numerous occasions supported the modernisation of public procurement systems at federal and state level in Nigeria, often together with the United Kingdom Foreign, Commonwealth & Development Office. But there have not been similar engagements with the Nigerian National Petroleum Corporation.

<sup>32</sup> An exception is Mozambique, where a World Bank public expenditure review found that debt financing of the government's stake in extractive industry projects was creating additional fiscal risks. This led to the establishment, with World Bank and IMF support, of a new fiscal risk unit in the country's Ministry of Economics and Finance that reported directly to the minister regarding the fiscal risk implications of government guarantees, public enterprises and public-private partnerships (Westcott, 2020<sub>(49)</sub>).

<sup>33</sup> By "insiders", the authors are referring to individuals who are themselves closely involved in either the design or implementation of the programme themselves or in the ongoing conversations around thinking and working politically.

<sup>34</sup> In March 2007, a report published by the French civil society organisation, Comité Catholique contre la Faim et pour le Développement (CCFD), entitled, "Biens mal acquis profitent trop souvent: La fortune des dictateurs et les complaisances occidentales" that enumerated 23 instances of kleptocracy – some resolved, some under investigation and a number on which no action had yet been taken but where suspicions of corruption were strong. CCFD estimated, quite conservatively, 23 national leaders and their families had diverted between USD 100-180 billion of assets, often to Western countries in recent decades. The release of the report launched the Biens Mal Acquis (ill-gotten gains) affair and related investigations, which contributed to shed light on the role of source and destination countries with regard to proceeds of corruption (Naval, 2020<sub>(73)</sub>).

<sup>35</sup> In the build-up to the Luanda Leaks, Isabel dos Santos was reported to have moved her residence and business to Dubai and its more accommodating financial services, as was common for African oligarchs. In addition to threats and disinformation campaigns against the leaders of organisations that filed complaints, incidents in Libreville, Gabon and Brazzaville, Congo illustrated the backlash against activists and critics. For more detail, see Shaxson (2020<sub>(126)</sub>) at <https://www.taxjustice.net/2020/01/20/luanda-leaks-the-effects-on-the-ground-in-africa/>; (Soares de Oliveira (2020<sub>(100)</sub>) at <https://www.ft.com/content/806e7d95-7921-43fb-8bbf-8100ae295fd1>; and especially Chapter 8 of *The Finance Curse: How Global Finance is Making Us All Poorer* (Shaxson, 2018<sub>(116)</sub>).

<sup>36</sup> The Topical Trust Fund on Managing Natural Resource Wealth seeks to help countries build capacity to manage their natural resource wealth effectively. The fund supports natural resource-rich, low-income and lower middle-income countries to derive the maximum benefit from their oil, gas and mineral resources. By providing technical assistance to support the building of economic policy and administrative capacities, it aims to boost economic development and alleviate poverty.

<sup>37</sup> Properties in this context are features of the ecosystem that are created through the interaction of its different elements and actors. Some properties, because they are created by design, may be anticipated; others may be unexpected or unintended. For example, liquidity is a fundamental property of the oil trading ecosystem and one that changed as an unintended consequence of banking regulations introduced after the global financial crisis.

<sup>38</sup> Hickey and Mohan (2020<sub>(50)</sub>) highlights the role of ideas, i.e. ideology, in how policies are crafted and/or responded to. Above and beyond political settlements, what mattered were hegemonic ideas such as resource nationalism, "the market", etc.

<sup>39</sup> Volatility, understood as the difference between highest and lowest value during the same month, increased on average in the 1990s from a volatility index of between one and two per barrel to over ten barrels in the period since 2000.

<sup>40</sup> Over 2008-10, paper trades exceeded physical trades in value by an order of 20-30 times and became both an investment index and a commodity class. This opened up opportunities for speculative behaviour..

<sup>41</sup> The first oil traders established their domicile in Switzerland after the 1970s oil crisis (e.g. Vitol), and others followed in the post-Cold War period (e.g. Trafigura, Litasco and Gunvor).

<sup>42</sup> Trading hubs are locations that attract traders through such factors as favourable regulation and tax rates, strong capital markets, a tradition of trade and shipping, and broad talent pools. The main trading hubs have historically developed in London, New York, Chicago, Houston, Calgary, Tokyo, Hong Kong, Geneva, Zug and Singapore. In recent decades, Switzerland, the United Arab Emirates and Dubai, and Singapore have gained in popularity due to favourable tax and pro-trade regulatory environments. London and the United Kingdom today account for 25% of crude trading and Switzerland for 35%. High-profile accounting scandals and defaults of trading companies could seriously hamper further growth of the Singapore hub.

<sup>43</sup> For more information, see <http://www.fatf-gafi.org/media/fatf/documents/4th-Round-Ratings.pdf>.

<sup>44</sup> See, for example, Leitner, Peck and Sheppard (2006, pp. 310-311<sup>[125]</sup>): “[f]rontiers are liminal zones of struggle between different groups for power and influence – each seeking to expand their influence by shaping these zones on their own terms. In this view, the frontier is a fuzzy geographic space where outcomes are uncertain”.

<sup>45</sup> Roll (2014<sup>[101]</sup>) and others suggest that pockets of effectiveness are characterised by organisational strength; organisational culture and proactivity (e.g. being mission-driven, making efforts to enhance this, and in recruitment practices and performance orientation); and operational autonomy (an organisation’s legal mandate, leadership and relations to political decision makers) and the extent to which each entity enjoyed political protection and/or support.

<sup>46</sup> In an April 2020 opinion piece in the Financial Times, White argues that financial regulators began to question the lack of scrutiny of commodity trading, but that this debate petered out. See <https://www.ft.com/content/2f01cf55-d4b7-491e-bda8-5167731b5ce5>.

<sup>47</sup> There is even less scrutiny in the context of activity by NOCs and traders that settle activity on open account terms (i.e. through invoicing and making payments without the involvement of more complex financial instruments such as letters of credit), as the financial institution processing the payment has very limited visibility. This challenge is further compounded by the likelihood of high payment volumes with a mix of regulated and unregulated activities.

<sup>48</sup> See, for instance, <https://www.publiceye.ch/fr/thematiques/negoce-de-matieres-premieres/rapport-contradictoire-sur-les-matieres-premieres-aucune-mesure-malgre-la-necessite-dagir>.

<sup>49</sup> This programme of work is by no means the first to acknowledge not only the severely limited returns possible from the predominant marketplace approaches to improving governance in the extractives sector but also, perhaps, the broad frustration with such approaches. As noted, these assign large aspirational roles to oil industry corporates; rely heavily on the probity of corporate good governance codes and compliance systems; and tend to gloss over dramatic asymmetries in power by placing undue faith in voluntary engagements in multi-stakeholder groups, the disciplining of NOCs, and regular round-tableing and cajoling corporate players to be more forthcoming. The range of collateral and complementary engagements needed to augment conventional transparency, accountability and participation approaches are examined in Brockmyer and Fox (2015<sup>[128]</sup>) at <https://eiti.org/files/documents/assessing-the-evidence-msis.pdf> and in Eisen et al. (2020<sup>[32]</sup>) at [https://www.brookings.edu/wp-content/uploads/2020/06/LTRC\\_Corruption\\_vfinal\\_x2screenreader4.pdf](https://www.brookings.edu/wp-content/uploads/2020/06/LTRC_Corruption_vfinal_x2screenreader4.pdf).

<sup>50</sup> A growing volume and share of sub-Saharan African government debt are owed to commercial creditors (25%), compared to multilateral (38%), Paris Club bilateral (7%) and non-Paris Club bilateral (30%) lenders See Calderon and Zeufack (2020, p. 5<sup>[10]</sup>) at <http://hdl.handle.net/10986/33293>. This condition is enhanced in oil producer states.

<sup>51</sup> Proposed areas of engagement were discussed during an Anti-Corruption Task Team Plenary and follow-up meeting, on 2 June and 6 July, respectively, and are the subject of ongoing bilateral exchanges.

<sup>52</sup> Examples of such initiatives could include internal corporate governance programmes by traders; guidelines or conditions from the financial institutions that finance the business of traders such as indirect regulation; and OECD Due Diligence Guidelines.

<sup>53</sup> A politically exposed person refers to an individual who holds a prominent public position or role in a government body or international organisation.

<sup>54</sup> While the important roles played by management advisory and audit and/or accounts firms in corporate governance were acknowledged in the Concept Note, these were not included in Phase 1 activities. Nonetheless the expectations gap between what the public expects of audit firms and what they deliver does appear to be growing. On this, see Brooks (2019<sup>[113]</sup>) and Shaxson (2018,

pp. 232-234<sub>(116)</sub>). The authors are not aware of any systematic evaluations by scholars or regulators of their roles in the oil and/or gas trade ecosystem.

<sup>55</sup> Such assistance could link to ongoing work at Chatham House, described at <https://www.chathamhouse.org/2016/03/cost-emerging-national-oil-company>, and to work by consulting firms like Westwood See <https://www.westwoodenergy.com/event/noc-assembly-2019>.

<sup>56</sup> The G7 CONNEX was established by the G7 at its summit in Brussels in 2014. The Initiative supports governments of developing countries and economies in transition to negotiate complex commercial contracts in the extractive sector.

<sup>57</sup> Deal origination is the process by which firms identify investment opportunities, including on the buy side and sell sides of their operations.

<sup>58</sup> By way of example only, the logical extension of this would be DAC support for the creation of a "First Trade" exchange that would enable free and transparent trading activity between NOC's and large traders. Trading, origination and risk management capability within participating NOCs would need to be developed, but these would improve transparency, strengthen the ability of the NOC to manage the short-term market and its positions to best advantage, and reduce some of the asymmetry between the NOC and large international traders. These could be further extended to include the sales of future rights allocations, thus providing the basis for the certification of trade deals.

<sup>59</sup> It should be noted that DAC members have funded the development of the OECD Development Centre Guidance to Support State-Owned Enterprises in selecting buyers of publicly owned oil, gas and minerals <https://doi.org/10.1787/25183702>.

<sup>60</sup> As noted in The Case for Thinking and Working Politically: The Implications of 'Doing Development Differently', "Evidence tells us that domestic political factors are usually much more important in determining developmental impact than the scale of aid funding or the technical quality of programming. ... Too many times over the past few decades, we have seen projects fail because they demand changes that are not politically feasible" See (TWP, 2015<sub>(131)</sub>) at <https://twpccommunity.org/wp-content/uploads/2018/02/the-case-for-thinking-and-working-politically.pdf>.

<sup>61</sup> Also under discussion is a transition phase during which DAC could institute a carbon-neutral ODA trajectory and ODA providers could catalyse support for fossil fuel-related activities through blended finance and other hybrid instruments in ways that are progressively carbon neutral and that generate the technology or know-how needed to support and sustain a clean transition.

<sup>62</sup> Provisions of Pillar IV on resource revenue management overlap with all three IFF risk areas, including open contracting procedures for license allocation; the identification of beneficial owners of companies holding licenses; reporting on payments to governments at the project level as an established international norm; transparency in commodity trading and recognition that disclosing payments by traders is well within reach of countries and companies; the publication of environmental and social impact assessments and accompanying management plans and reports; and other existing standards and requirements around state-owned natural resource companies initiatives .

<sup>63</sup> Both of these initiatives are under provisional consideration by the EITI Board.