

Chad's Oil: Miracle or Mirage?

Following the Money
in Africa's Newest
Petro-State

Executive Summary and Recommendations

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Executive Summary

Chad's Oil: Miracle or Mirage? The Chad-Cameroon Petroleum Development and Pipeline Project, transporting oil from landlocked southern Chad to the Atlantic coast of Cameroon for export, represents the foremost test case of the extent to which oil revenues can be used to alleviate poverty in a challenging developing country context. The most innovative feature of the project is the establishment of a legal framework (Chad's Law 001 and subsequent amendments and decrees) that earmarks money for poverty reduction expenditures and creates an oversight committee to ensure the transparent management of the country's oil wealth. Touting the promise of petrodollars for Chad's poor over public concerns that new revenues would be lost to corruption and mismanagement, the World Bank provided financing that catalyzed the ExxonMobil-led oil development. Given the dismal track record of oil-producing countries around the world and the high stakes in a country as unstable as Chad, this experiment has come into the international limelight. The fate of the \$4-billion plus project is not only of vital importance to the people of Chad, who hope to reap its benefits but risk bearing enormous costs if oil production leads to corruption, conflict and the further concentration of power in the hands of a few. It is also of great interest to other countries facing the challenge of transforming their oil wealth into benefits for their people; to donors attempting to solve the problem of the "resource curse"; and to energy-hungry industrialized countries searching for new and stable sources of oil.

Poverty, Politics and Petrodollars: Chad is a landlocked country with a long history of civil war, continued political instability, a weak judicial system, widespread corruption and an all-encompassing institutional capacity problem. This is an extremely challenging environment in which to attempt to turn oil revenues into benefits for the poor. And the stakes are high—if Chad's oil money is mismanaged, it could mean increased hardships and conflict for the nearly seven million people in Chad living on less than \$1 per day. Since independence in 1960, Chad has known more years of war than of peace, and rising tensions in the region mean that violence is never far off. A coup attempt in May 2004 reminded observers of the fragile political environment, and tensions have increased over the attempt by President Déby's ruling party to change the constitution to allow him to run for a third term in 2006. The Chadian oil experiment depends largely on the political will of the government to respect the rule of law where there is little history of doing so, to develop accountable institutions, and to encourage democracy. In an environment where the government faces internal and external threats, such political will appears to be in short supply.

Chad's Landlocked Treasure: After decades of on-again, off-again exploration and negotiations, in July 2003 Chadian oil began to flow through the 1,050 kilometer pipeline, produced by a consortium comprised of ExxonMobil, ChevronTexaco and Petronas, the Malaysian state oil company. Production from the three active fields in the Doba basin reached its current peak capacity of 225,000 barrels per day in late 2004 and more than 60 tanker shipments have been exported to date. Beyond the 1 billion barrel estimated reserves in these three fields, the presence of the pipeline infrastructure is spurring new oil production and exploration in Chad. ExxonMobil plans to add five new "satellite" fields to its existing production in 2005-2006 and, together with other companies like Canada's EnCana, is exploring other parts of Chad. With these ongoing activities and the government's efforts to attract more investment in the sector, Chad's oil windfall is likely to be much larger than originally predicted.

Oil Revenues – Chad's First Taste of Black Gold: The unprecedented measures put in place to safeguard against misappropriation of oil revenues are now being put to the test. In late 2003, ExxonMobil made its first royalty payment into the government of Chad's escrow account at Citibank in London, and Chad was likely to receive \$140-150 million in oil revenues during 2004 and over \$200 million in 2005. Over their 25-year production span, the first three oil fields in southern Chad may earn the government

more than \$5 billion in oil revenues. Just how much more Chad will receive from other oil fields tapped in the future is yet unknown.

In response to pressure from civil society organizations concerned that the benefits of oil development would not reach the poor, the World Bank conditioned its financing for the pipeline project on the establishment of a revenue management plan. Chad's innovative petroleum revenue management law stipulates that the majority of *direct revenues* from oil production – royalties and dividends – be earmarked and spent on “priority sectors” targeting poverty reduction. In addition, a joint government-civil society petroleum revenue oversight committee (the *Collège*) has been established to play a “watchdog” role, approving projects and monitoring the quality of their implementation.

While some information on Chad's oil revenues is made public, details regarding the calculation of revenues and many key agreements between the oil companies and the government remain secret. Furthermore, legal safeguards contain notable loopholes. For example, all *indirect revenues* – including income taxes on the oil companies – will go directly into general government coffers. These indirect revenues may amount to more than \$3 billion over the next 25 years. In addition, the revenue management law does not cover any revenues from oil produced outside the three original Doba fields. These and other weakness mean that it is difficult for citizens to verify the accuracy of revenue information disclosed and that much oil revenue will fall outside of the jurisdiction of the law and the control of the *Collège*.

On the government side, there is a profound lack of capacity to master the technical aspects of monitoring oil production and determining oil revenues. More than one year into Chad's life as an oil producer, many basic aspects regarding the calculation of oil revenues remain the subject of dispute between the government and the ExxonMobil-led consortium.

“Just Add Oil” – Accountability from Scratch: In a country lacking an effective system of checks and balances, the joint government-civil society revenue oversight committee created by Law 001 is a unique institution, critical to the effort to hold the government accountable for the use of oil money. Experience to date has shown that the *Collège* has made promising strides to establish itself and exert its authority. At the same time it needs increased access to information, an improved ability to investigate expenditures and the cooperation of government to prosecute any wrongdoing identified. The *Collège* lacks an independent and steady source of funding, and without support from Chadian civil society will be unable to effectively carry out oversight in a country as large as Chad. Finally, the government has placed trusted allies – such as President Déby's brother-in-law – on the *Collège* and has interfered with the selection of civil society members. While the *Collège* can influence the budgeting process, reject ill-founded expenditures and investigate the execution of projects it approves, ultimately its ability to ensure that oil revenues are used for poverty reduction depends on the willingness of the judiciary to prosecute cases of misuse, fraud or corruption that the *Collège* may uncover.

Budgeting for the Boom – Spending Chad's Oil Revenues: For a \$4 billion-plus investment, the oil industry enclave in Chad is creating precious few jobs, making the generation of non-oil employment and the careful management and spending of oil revenue paramount. The ultimate success of the Chad experiment will be judged not on barrels of oil produced or revenues generated, but on the successful investment of these revenues in Chad's people through a well-planned and executed budget system.

Chad has little record of effectively budgeting and spending government resources, and has a history of corruption and mismanagement in bidding and procurement procedures. The experience of the 2004 budget – the first containing oil revenues – and plans for 2005 show that there are many obstacles standing between transparent budgeting of oil revenues and spending those monies in a way that reduces poverty.

With increased scrutiny of revenue flows at the macro-level, problems with corruption and mismanagement will likely migrate downstream where they are more hidden from public view. As in other oil rich countries, systems of patronage may develop through the non-transparent awarding of government contracts funded by oil revenues. These tendencies, together with limited government capacity to absorb increased levels of funding, have grave implications for the poverty reduction objectives of a project dependent on the effective use of massive new government revenues. World Bank projects designed to increase capacities in these areas prior to the arrival of first oil have failed to meet their objectives. Despite World Bank promises, the result has been a “two-speed” project whereby the pipeline was completed a year ahead of schedule but the government remains largely unprepared to manage its oil windfall.

Changing Chad – The Role of External Actors: Ensuring that Chad’s oil boom benefits the poor requires not only building government capacity, but altering policies and, ultimately, changing politics. The experience to date reveals both the limits of external actors’ ability to influence these changes and the urgent need for those actors to use what leverage they do have to support adherence to the rule of law and compliance with the revenue management safeguards. In Chad, where citizens have limited influence on their government, external actors – such as the World Bank, IMF, and the U.S. and French governments – can be important sources of pressure for greater transparency and accountability. The rapid accumulation of petrodollars in Chad confronts the World Bank, IMF and other donors with a choice between using their known leverage today and relying on their uncertain leverage in the future.

A “Model Project” Hanging by a Thread: Many obstacles stand in the way of converting Chad’s oil wealth into concrete improvements in the lives of the country’s poor. While some have prematurely hailed the Chad project as a “new model” for harnessing oil revenues to benefit development, the record of Chad’s first year as a petro-state provides many reasons for concern.

Important building blocks for transparent and effective oil revenue management are being developed and need to be nurtured, but limited progress on this front is tempered by worrying trends in the political environment, weaknesses and loopholes in the revenue management system, problems with corruption, transparency deficits and severe government capacity constraints. The oil experiment hangs by a thread.

Chad’s experience shows that transparency is *but one* essential ingredient in a system of oversight, accountability and sanction. Transparent information can be used for both formal and informal enforcement of the law, but the tools to use it have to be in place. Investigative and judicial arms of the government must be independent and capable of prosecuting wrongdoing. Elections must be free and fair and Chadians must have the ability to change their government through the ballot box if they think it has not managed the oil wealth well. Informal enforcement – through monitoring by civil society and publicizing information on the radio and via other media – must be part of a system of accountability. Transparency is only meaningful if information is understood by the government and the public, and if the findings of oversight bodies lead to action.

It is too early to declare the Chad experiment a failure or a success. Whether or not Chad manages to escape the “paradox of plenty” may not be known for years. There are, though, clear lessons that can be drawn from Chad’s experience to date, which can serve as signposts to correct pressing problems in Chad and to guide efforts to assist other developing countries in managing resource wealth. And one of the most fundamental lessons that Chad offers today is the importance of ensuring that minimum conditions of respect for human rights, fiscal transparency, and demonstrated government capacity to implement pro-poor programs are in place prior to promoting investment in the extractive industries.

Recommendations

The following recommendations are based on research conducted over a two-year period, including visits to Chad, interviews with project actors, and ongoing exchanges with Chadian civil society organizations. Many of the recommendations echo calls made by NGOs, Churches, human rights associations, and community organizations in Chad.

Oil Companies

The ExxonMobil-led consortium should:

- Publish all conventions and contracts regarding hydrocarbon exploration and production in Chad. The Consortium should renounce confidentiality clauses in contracts.
- Provide key information regarding the determinants of oil revenue directly to the *Collège* (Petroleum Revenue Oversight and Control Committee), including:
 - volume of crude produced and sold
 - information on the price discount for Doba crude
 - production and transportation costs of crude
 - payment of dividends and royalties
 - debt service payments
 - exchange rate for transactions
 - taxes and customs duties linked to petroleum exploitation.
- Make public annual audits conducted by reputable international firms (e.g., Ernst & Young, KMPG) relating to Consortium activities in Chad.
- Publish maps of planned oil well sites and feeder pipelines in areas of new oil development and make these available to local communities and civil society organizations in Chad.
- Immediately publish oil field-specific and cumulative environmental and social impact assessments. With the development of ExxonMobil's satellite fields and EnCana's ongoing exploration, the impact area of the pipeline project can no longer be considered as confined to the three original Doba fields.

EnCana should:

- Publicly support the application of existing laws regarding the transparency and management of petroleum revenues to any future EnCana oil production in Chad.
- Publish all conventions and contracts regarding hydrocarbon exploration and production in Chad and renounce confidentiality clauses in contracts.
- Publish, in a timely and systematic fashion, information regarding exploration and potential production activities.
- Fund third-party verification of its compliance with social and environmental safeguards during exploration activities in order to comply with the World Bank loan agreement regarding use of the pipeline export facilities.

International Financial Institutions

The World Bank and IMF should:

- Require demonstrated progress on enforcement of laws relating to fiscal management, including sanctions by the government for violations of procurement regulations and prosecution of wrongdoing uncovered through state audits, prior to providing additional project or policy lending or macroeconomic support. In absence of demonstrated enforcement and correction of identified problems, the passage of laws or publication of audits should not be considered satisfactory progress on the improvement of the judicial system or, for example, procurement procedures.
- Ensure that the government's commitment to extend oil revenue management principles to the entire oil sector is made legally binding. The World Bank and IMF should discourage the creation of a second, separate system of oversight for revenues from new oil fields. A parallel oversight framework could provide additional loopholes and muddle efforts to render the sector transparent.
- Require the disclosure of all audits related to oil revenue determination, management and allocation, as well as spending by government ministries. This would include audits of the oil consortium (cost audits), audits of any state oil company created in the future and audits of the management of the Future Generations Fund. The World Bank and IMF also should require publication of any audit supported by their financing or required under the loan agreements and contracts for the Chad-Cameroon project.
- Hold public briefings in N'Djamena and in regional capitals to explain and discuss the findings of regular reviews and evaluations conducted, such as the IMF's Article IV Consultation Reports, World Bank Country Assistance Strategies, or progress reports on the Poverty Reduction Strategy.
- Support the public dissemination of information about the national budget in Chad by helping to offset costs of reproduction, distribution and communication of information to the public, and by maximizing the amount of meaningful information that IFIs make available through their websites and local offices.
- Provide explanations of account balances, debt payments and revenue figures posted on the World Bank's website. While encouraging the government of Chad to disclose such information on its own, the World Bank should publish additional information that it is entitled to disclose, such as oil production figures.
- Support and publish an independent assessment of the spending constraints and absorptive capacity challenges facing the Chadian government, so as to facilitate more even and effective use of funds across priority sectors. (Preference should be given to competent Chadians vs. foreigners for World Bank consultancies.)
- Increase budgetary support to the *Collège* in the short term to reinforce its ability to investigate petroleum-financed expenditures, and to commission third-party assessments of production and revenue reporting.
- Identify and disclose clear benchmarks for progress in the development of Chad's capacity to manage and spend oil revenues. The World Bank and IMF should link those indicators to clear sanctions and remedies aimed at preventing the consequences of misuse of revenues before they occur. They should not ignore "incremental policy slippages" that could develop into fundamental violations of the revenue management system.

- Devote more attention to the development of the non-oil economy in Chad, including the poverty reduction benefits of more labor-intensive sectors.
- Redouble efforts to promote greater fiscal transparency and accountability for the use of all public resources (oil and non-oil revenues)—a particularly urgent need in light of substantial “indirect” oil revenues (taxes and fees) arriving in 2007. The current focus on the transparent management of direct oil revenues should not divert attention from the need for responsible use of all government resources.
- Based on the experience of Chad, ensure that basic minimum governance standards – such as demonstrated respect for human rights, an independent media, a functioning independent judiciary and tested fiscal management and regulatory capacity – exist *prior* to extending support for oil, gas or mineral developments in any country.

International Advisory Group

- Increase efforts to widely disseminate reports and recommendations. The IAG should issue press releases and hold press conferences or public meetings with the publication of each of its reports.
- Conduct advocacy on recommendations between the issuance of semi-annual reports, in fulfillment of its mandate to advise the World Bank Group, governments of Chad and Cameroon, and the oil consortium on the implementation of the pipeline project and related developments. The IAG should request periodic briefings with the Executive Directors of the World Bank Group.
- Include a matrix in each report to track progress on the implementation of specific past IAG recommendations.

Key donors such as the U.S., France and the European Union should:

- Calibrate diplomatic engagement and bilateral support to measurable progress toward increasing political space, democratic governance and respect for human rights and the rule of law. (Head of state or ministerial level visits, without demonstrated progress in these areas, sends the wrong signal regarding reform.)
- Carefully monitor press freedom and provide financial support and backing to independent media outlets, especially radio. The U.S. should continue and expand its support for independent radio stations and special broadcasts that disseminate information regarding the national budget and fiscal transparency.
- Support Chadian civil society efforts to implement a monitoring system to track oil revenue expenditures from the capital to local levels, alerting the *Collège* to problems with project implementation and reinforcing its oversight function.
- Extend technical assistance to the Chadian government to strengthen fiscal management, as well as provide dedicated assistance to the *Collège*, with the goal of training local Chadians to provide the needed technical support on a sustainable basis in the future.

The Chadian government should:

- Extend the revenue management law to cover all oil produced in Chad. The government should make clear what will be done to ensure accountability for oil revenues from future fields and to guarantee against the development of duplicate oversight mechanisms.
- Disclose all contracts and conventions for oil exploration and production in Chad and renounce confidentiality clauses in all future contracts.

- Allow for public debate in the National Assembly on the elements of a new Petroleum Code.
- Refrain from finalizing new oil contracts until the new Petroleum Code is adopted.
- Publish all relevant audits relating to the generation, management and allocation of oil revenues. This would include cost audits of oil companies; audits of budget execution by priority sector ministries; audits of the management of the Future Generations Fund, and other relevant audits.
- Design and implement a continual government training program on oil revenue management including technical expertise to verify production figures and revenue payments from oil companies.
- Commit to greater stability of staff in government ministries, in an effort to retain institutional memory and skills acquired through training programs.
- Refrain from interfering in selection of civil society members of the *Collège*.
- Earmark a minimum percentage of annual oil revenues for the functioning of the *Collège* to ensure the independence and sustainability of its operations.
- Comply with decrees regarding the right of the *Collège* to provide input into the budget process. The government should ensure that the *Collège* participates in the budget committee meetings and receives the draft budget at least 10 days before its adoption by the Council of Ministers.
- Take action on the basis of the findings of audits and *Collège* reports (e.g. regarding misuse of oil bonus money), and implement commitments made to the IMF regarding the creation of a “budget court” and sanctions for violation of procurement laws.
- Institutionalize an inter-ministerial monthly meeting of government officials from the Ministry of Petroleum, Ministry of Finance and the *Collège*, among others, to share information on oil production and revenue generation. These meetings should serve to facilitate communication between actors already engaged in the petroleum sector and do not require the creation of any new structures or offices.
- Ensure adequate funding for the judiciary and respect its independence.

The *Collège* (Petroleum Revenue Oversight and Control Committee) should:

- Dedicate more of its limited resources to investigations of approved projects, to ensure that they are properly executed as planned and actually benefit the poor on the ground. The *Collège* should disseminate the findings of its investigations to both the government *and* the public in a timely fashion.
- Publish and disseminate information on projects to be financed with oil revenues as early as possible, alerting the public to what they can expect in the coming months or year.
- Hold public information sessions in regional towns to alert the population to the *Collège*'s mandate, increase public awareness of how oil revenues are to be used, and explain what mechanisms are in place to check against their misappropriation.
- Act on a presumption in favor of disclosure of any and all information that the *Collège* deems in the public's interest.
- When necessary, use its right to commission third party experts to assess proposed projects or audit production or revenue reporting.

- Hold quarterly “open-house” meetings for Chadian civil society and develop strong working relationships with civil society groups to achieve its mission.
- Develop a regularly updated “matrix” of problems identified and what actions, if any, were taken to address these problems or violations of the law by the government.

Civil Society

Local civil society should:

- Proactively seek out information from the *Collège* and convey this information to key networks in the regions. The *Collège* will be unable to fulfill its oversight role without active collaboration with civil society, from the capital to the village level.
- Organizations in the capital should provide a simplified breakdown of the national budget, showing planned oil expenditures by region and sector, to enable local residents to alert oversight bodies to any discrepancies between planned and actual project implementation.
- Develop a coordinated monitoring and alert system to track the use of oil revenues. Civil society groups should identify existing structures or networks at the regional and local levels that can help disseminate and collect information about project execution to and from the population at large.
- Regularly convey findings to international allies and media outlets as well as to Chadians at large through popular education programs.

International civil society should:

- Support the revenue oversight efforts of Chadian civil society and the nascent “Publish What You Pay/Publish What You Earn” coalition.
- Devote resources to monitoring the status of human rights in Chad, in collaboration with local human rights associations conducting day-to-day surveillance.
- Continue to hold International Financial Institutions, oil companies, and Northern governments to account for their responsibilities vis-à-vis the project and the Chadian people.



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